as a deliberate act of policy or inadvertently[11]. An interest in jumping a high tariff, for instance, can induce foreign direct investment in the local market. Other import barriers, such as quantitative limits on imports in a particular sector, could also induce FDI in the form of expanded production in the local market[12]. Regional (or in some cases global) trade agreements and economic integration may also influence FDI decisions by firms.[13] Larger market size, resulting from regional trade agreements, provide opportunities for investors to take advantage of economies of scale and, therefore, encourage investment flows.[14] Rules of Origin, which distinguish between products produced by countries party to the regional agreement and those that are not, also may induce third country investment.[15]

The second set of links is the impact of FDI on trade.[16] FDI policies by affecting investment decisions, influence the size, direction and composition of trade[17] and subsequently its contribution to growth and development[18]. FDI can have sweeping and dynamic effects on the host country as it stimulates capital formation, competition, innovation, productivity[19] and savings. All these factors can impact on a country's import and export activities. Several

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[11]McCulloch in Froot (1993).

[12]Bhagwati (1985); Bloningen & Feenstra (1996).

[13]The possibility not only of increased intra-regional investment, but also of increased third country investment were powerful incentives for Canada to take part in developing and agreeing to the investment provisions of the FTA and NAFTA.

[14]Rugman (1990). It has been observed that in regional trade areas, e.g., in the European Union, investment flows between the member and non-member third countries have increased substantially: UNCTAD (1993); WTO (1995).

[15]Hindley (1990); Kruegar (1995). Normally, members of free trade agreements maintain their own external tariff schedules. This creates the need for "rules of origin" to determine if inputs originating in a non-member country and imported into the free trade zone by a member country for further processing would receive free trade treatment when the final product is exported to another member country. Rules of origin can have a protectionist effect and lead a member investor to source inputs inside the free trade area. This would encourage non-member countries to invest within the free trade area. Similarly, the Hub and Spoke system may influence investment choices, with investors preferring to invest in the "hub" than the "spoke". Baldwin (1993) WTO (1995).

[16]Only the impact of FDI on host country's exports and imports is discussed in the paper because of the focus on inward FDI stocks and flows.

[17]McCulloch in Froot (1993); OECD (1993); Fujimora (1994).

[18]UNCTAD (1997).

[19]Caves (1974).