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EFFECT OF ENHANCED TRADE ON INVESTMENT: SURVEY EVIDENCE

EXECUTIVE SUMMARY

- The magnitude and destination of direct investment flows into and out of Canada depends ultimately on decisions by individual firms. This paper analyzes four recent surveys which investigated the main determinants of investment in Canada by US firms and of investment in the United States by Canadian firms. Analysis was focused on two questions: one, what is the relative importance of trade barriers on investment decisions?; two, what is the likely impact of their removal on investment flows?
- Surveys conducted by the Conference Board of Canada and DEA on the determinants of investment in Canada found that the great majority of firms surveyed did not consider trade barriers as a governing factor on future investment decisions.
- In addition, the DEA survey found that two-thirds of the US firms included believed a continuation of the status quo or some rationalization, to be the most likely outcome of a trade liberalization agreement. Only one fifth believed removal of trade barriers would have a profound impact on their Canadian operations.
- Surveys conducted by the C.D. Howe Institute and the International Business Council of Canada on the determinant of recent Canadian investment in the United States, found that trade barriers were a governing factor for a substantial and growing minority of firms.
- For the majority of Canadian firms which chose the United States in order to serve that market more efficiently or to diversify product lines or operations, the foreign investment appears to have had a neutral to mildly positive impact in the Canadian economy, in terms of net exports gained on jobs created. In the growing minority of cases where ease and security of access were significantly involved, however, there seems to be a net loss to the Canadian economy.
- Hence, removal of trade barriers under a comprehensive trade agreement appears to have a neutral effect on US investment in Canada and a mildly negative impact on Canadian investment in the United States. Bilateral investment flows are thus expected, in the short to medium term, to shift more in Canada's favour. The overall impact will be slight since the factors found as most influential in investment decisions are highly insensitive to the elimination of trade barriers.
- As far as the fate of American subsidiaries in Canada is concerned, trade liberalization is likely to result in no change or further rationalization in the large majority of cases. It must be remembered, however, that substantial rationalization in the operations of subsidiaries has already taken place under the Kennedy and Tokyo Rounds.