

Other factors will also influence the level of exports to the EU from countries outside EU, notably:

- ◆ the level of exchange rate volatility for external currencies versus the single currency;
- ◆ the configuration within the EU of those Member States participating in EMU, versus those Member States that do not qualify or that decide to remain outside of EMU;
- ◆ competitiveness effects from the elimination of currency conversion costs for those exporters that are already in the EU, putting exporters in countries outside the EU at disadvantage;
- ◆ the possible one-time discrete jump in exchange rates when the European Council decides on the fixed conversion rates between participating EU currencies; and
- ◆ the effects of a restructuring of financial markets in the EU, which should increase liquidity and increase competition in the European financial services sector, thereby reducing transaction costs.

For Canada, the following specific issues need to be monitored and addressed where needed:

- ◆ the position of the UK with respect to EMU is of importance for Canada-EU trade;
- ◆ the amount of euro invoicing that occurs in the longer term in other parts of the world, such as Asia, will be of strategic importance;
- ◆ arresting the long-term decline of exports to the EU, as a proportion of total Canadian exports;
- ◆ the method used by the European Council to derive conversion factors for intra-EU currency conversion;
- ◆ ensuring that financial institutions can provide trade finance of up to 20 percent of Canadian imports denominated in euros; and
- ◆ that Canadian exporters are aware of the provisions that are being made for contract conversion and introduction of currency conversion rates in the EU.

Foreign Direct Investment

As far as FDI is concerned, there is little theoretical or empirical evidence to enable an informed prediction as to the net effects on FDI flows both into and out of the EU. In addition to some of the effects noted above, EMU could have the following effects on inward and outward EU FDI:

- ◆ a greater incentive to concentrate FDI on the "core" EU Member States that participate in EMU;
- ◆ an increase in inward FDI flows relating to the financial services sector as this sector becomes more concentrated in certain locations; and
- ◆ a long term increase in outward FDI flow from the EU as increased EU growth spurs more external market-oriented FDI.

Specifically for Canada, FDI in Europe is of significant importance, and is related to MNE investment in subsidiaries, and the financial services sector, largely centred on London, UK. The possible effects on Canada-EU FDI flows are as follows:

- ◆ "agglomeration" effects which result in economies of scale, hence attracting FDI from external sources;
- ◆ "liquidity" effects in the financial services industry, which in turn may induce FDI inflows so as to take advantage of restructured and more competitive pan-EU financial markets;
- ◆ FDI diversion effects from Canada as third parties decide to concentrate new investments on the EU; and
- ◆ in the longer term, an increase in FDI outflows to Canada, to take advantage of Canada's strategic position in trading specific goods and services within NAFTA.