

instruments, such as performance requirements, become increasingly unenforceable and irrelevant, the more global MNEs become.

4.2.2 Trade

It has been shown that FDI has a considerable and direct effect on trade.⁶⁵ However, little theoretical or empirical work has been undertaken that examines these effects and linkages. Theory has largely ignored the role of MNEs in trade and there is a lack of detailed, comparable and reliable data on direct investment flows and trade flows, particularly on intra-firm trade. Nonetheless, some trade policy suggestions do emerge from what little is known.

The evidence presented above indicates that trade and FDI are complementary. Although this relationship is somewhat soft, it can be stated with some conviction that FDI at least does not act as a substitute for trade. Although most trade still takes place between unrelated parties, intra-firm trade is an important part of the Canadian economic reality. Canadian affiliates of U.S.-owned MNEs show a relatively good performance in generating exports and foreign-owned manufacturing firms have relatively higher export propensities than domestic firms. To the extent that trade and FDI are complementary, open policies on FDI should encourage trade.

Free trade policies (such as the FTA and NAFTA) have been shown to affect affiliate firm behaviour.⁶⁶ Free trade provides an impetus for Canadian affiliates of foreign-owned MNEs to streamline production, become more competitive and seek out a niche that will justify their existence. Otherwise, they may become redundant within the new global strategy of the MNEs. If free trade agreements can increase global competitiveness of Canadian affiliates, domestic firms operating in the industry will also be forced to rationalize their behaviour. This will have a positive long-run effect on productivity and Canadian international competitiveness.

On the other hand, the threat of trade liberalization causing foreign parents to increase exports at the expense of host-country production appears to be minimal.

⁶⁵OECD, *The Impact of Foreign Investment on Domestic Economies of OECD Countries*, p. 61.

⁶⁶Respondents to the Conference Board of Canada Survey Report No. 88-92, *op. cit.*, stated that government policies had little direct effect on their behaviour, but then cited free trade agreements as an important factor pushing them to continually rationalize their production activities. This could indicate that the respondents to the survey, and perhaps the business community in general, may not consider certain international policies (such as free trade agreements) to be in the same category as domestic government policies.