U.S. Foreign Direct Investment in the Western Hemisphere Processed Food Industry. By Christine Bolling, Market and Trade Economics Division, Steve Neff, and Charles Handy, Food and Rural Economics Division, Economic Research Service, U.S. Department of Agriculture. Agricultural Economic Report No. 760.

Abstract

Foreign direct investment (FDI) has become the leading means for U.S. processed food companies to participate in international markets. Affiliates of U.S.-owned food processing companies had $30 billion in sales throughout the Western Hemisphere in 1995, nearly 4 times the level of processed food exports. This report puts U.S. foreign direct investment and trade in processed foods to the region into global perspective, and finds evidence that, in the aggregate for the 1990's, trade and FDI are complementary—not competitive—means of accessing international food markets. Incomes have grown sufficiently in most countries to support growth in affiliate sales and U.S. exports, indicating a strong demand for a wide variety of processed foods.

Keywords: U.S. food processing industry, Western Hemisphere, foreign trade, foreign direct investment

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Note: Use of company names in this report is for identification only and does not constitute endorsement by the U.S. Department of Agriculture.

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Summary

Exports alone are insufficient to measure the U.S. presence in international markets. The value of sales from affiliated companies in foreign countries typically dwarfs the value of exports alone. While the United States exported about $8 billion worth of processed food to other Western Hemisphere nations in 1995, U.S. affiliates throughout the Western Hemisphere recorded sales of $30 billion, nearly four times as great.

Those business affiliations come about through what is called foreign direct investment (FDI), typically defined as an investment of 10 percent or more in a foreign enterprise. The 10-percent threshold is assumed to give the investor a controlling interest in the enterprise. Most companies are majority-owned.

U.S. food processing companies had invested more than $11 billion in food processing affiliates in other Western Hemisphere nations as of 1995, nearly double the 1990 level. Those investments represented a third of total U.S. investments in foreign food companies.

Growth of U.S. investment in foreign countries is related to a number of factors:

- Rules regarding foreign investment were liberalized in a number of countries over the last several years,
- Population growth has created more demand for food products in general,
- Income growth has created more demand for processed foods, along with a desire for a wider variety of foods in the diet as well as more healthful diets,
- Individual countries' economies have become more stable than they were in the past and more friendly to both domestic entrepreneurs and foreign investments, and
- Regional trade agreements, like NAFTA (involving Canada, the United States, and Mexico) and MERCOSUR (involving Argentina, Brazil, Chile, Paraguay, and Uruguay), have encouraged investors.

Foreign direct investment for the most part has complemented U.S. exports rather than competed with them, chiefly because of the types of foods available in Western Hemisphere countries. Some products are too expensive to ship, and thus lend themselves primarily to domestic consumption: dairy products, wheat and corn flour, breakfast cereals, pet foods, livestock feeds, cookies and crackers, pasta, chocolate products, soft drinks, vegetable oils, and mayonnaise. Some prepared fruits and vegetables are produced in countries that are large fruit and vegetable producers, close to the raw product; these investments may be a source of U.S. imports: orange juice, frozen vegetables, and canned tomatoes, for example.

FDI seems to have beneficial effects on the economy of the host country, perhaps because it contributes to the country's food production infrastructure. Processed foods can often be produced in the host country for less then the delivered cost of direct exports, while at the same time creating jobs, raising the gross domestic product, and producing products that can themselves be exported to earn foreign currency. Canada, Mexico, Brazil, and Argentina account for $9.9 billion (90 percent) of the $11 billion total of U.S. food companies' foreign direct investment in the Western Hemisphere.

Canada is one of the top markets for U.S. processed food, and income growth has been strong to promote consumer demand. Sales of U.S. affiliates of food processing companies in Canada account for about three times the level of direct U.S. exports to Canada. U.S. investments in Canada's food industry more than doubled between 1985 and 1995. Sales from U.S. affiliates in Canada are concentrated in flour milling, soft drinks, and brewing, while major sales in exports are in meat products and frozen and canned foods.

U.S. investments in **Mexico**'s food industry rose from $0.4 billion in 1985 to $2.9 billion in 1995. Sales of U.S. affiliates of food processing companies in Mexico account for about three times the level of direct U.S. exports to Mexico. A debt-equity conversion program in the mid-1980's and a reduction in inflation, along with prospects for joining NAFTA, encouraged foreign investment. Sales from U.S. affiliates in Mexico are spread throughout the food industry, with direct U.S. exports to Mexico concentrated in meatpacking, poultry, animal fats, soybean oil, wet corn milling, and dry/condensed milk.

U.S. investments in **Brazil**'s food industry tripled between 1985 and 1995. Sales of U.S. affiliates in Brazil were about 11 times the level of exports. Liberalization of Brazil's investment laws, the recent stabilization of Brazil's economy, and Brazil's membership in the regional trade pact MERCOSUR created new interest in Brazilian investments. Sales from U.S. affiliates in Brazil are from cookies, biscuits, orange juice, soft drinks, canned and frozen fruits and vegetables, oilseeds and products, breakfast cereals, and beer. Sales from direct exports are concentrated in tallow and meat products, milled rice, hops, cheese, and nonfat dry milk.

Argentina has the highest per capita income in South America, with 30 percent of that spent on food. U.S. investment in Argentina's food industry quadrupled between 1985 and 1995, encouraged by a government debt-equity program that helped to stabilize the economy and rein in inflation, special incentives to foreign investors, and Argentina's membership in MERCOSUR. Sales of U.S. affiliates in Argentina were about 25 times the value of direct exports. Sales from U.S. affiliates in Argentina are chiefly in processed beef products, oilseed products, soft drinks, grain products, animal feeds, pet foods, ice cream, cream cheese, cookies, and crackers. U.S. export sales are concentrated in processed fruits and vegetables and beverages.

Definition of Terms

Foreign direct investment (FDI) is "the act of purchasing an asset and at the same time acquiring control of it." FDI includes investment by a company, group, or individual in new facilities, existing enterprises, a share of existing enterprises, or land or natural resources, located within another country. FDI is motivated by the desire to control or use the acquired assets, which is in contrast to passive control, embodied in portfolio investment. (Södersten and Reed, 1994, p. 501)

For statistical purposes, the U.S. Department of Commerce (Commerce Department) considers FDI as an investment of 10 percent or more in a foreign enterprise. An investment of this amount usually represents an attempt by the investor to gain some degree of influence or control over the decisionmaking of an enterprise. The Commerce Department reports FDI in terms of the stock of investment and the sales of the U.S.-owned affiliates resulting from FDI.

Portfolio investment is considered to be motivated by the potential return on investment and not by the desire to influence the management of the enterprise. Statistically, the Commerce Department classifies ownership of less than 10 percent as portfolio investment. **Greenfield** indicates the establishment of a new enterprise. Only 20 percent of foreign direct investment in the food industry is greenfield investment. **Mergers and acquisitions** are investments in already established businesses.

The processed food industry is defined here as the products listed in the U.S. Department of Commerce Standard Industrial Classification (SIC) Code 20 as "Food and Kindred Products." The SIC is the statistical classification underlying all establishment-based U.S. economic statistics that are classified by type of industry (OMB, 1987). It assigns establishments to industry groups based on their principal economic activity. Under the SIC system, establishments or plants that produce similar products, use similar processes, or provide similar services are assigned the same two-digit code number.

The 49 industries in the processed foods sector are known as "Food and Kindred Products" and fall into group SIC-20. SIC-20 includes establishments that manufacture or process foods and beverages for human consumption, as well as certain related products, such as chewing gum, fats and oils, and animal feeds. Products in SIC-20 must be value-added products, which do not always correspond to the more problematic "high-value products" designation. Fresh fruits and unshelled nuts are examples of high-value products that have undergone no processing and, hence, are excluded from SIC-20. Conversely, some "low-value" products are included in SIC-20, such as animal feeds and manufactured ice, because some processing had to take place to get the product to the customer.

Many processed food products serve as inputs into other manufactured foods and other goods, particularly those in the dairy products, grain mill products, and fats and oils categories. All of these items are included in SIC-20, whether the final destination is use as an intermediate product or consumption as a final good. In addition, many products are sold at a number of value-added levels. For example, beef sold "on the hoof" is listed as a raw commodity. However, as beef moves further downstream toward the consumer, it is always listed in the processed food category, whether it is sold as carcass beef (slaughter), as boxed beef (initial packaging), or as final cut (shrink-wrapped in the grocery display case).

Product mandate occurs when a conglomerate or multinational company decides that a specific product will be produced in a particular plant, and not in other similar plants, leading to specialization in production lines.