Chapter 6

U.S. Foreign Direct Investment in the Western Hemisphere

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Foreign direct investment (FDI) plays an ever-increasing role in defining the U.S. presence in the Western Hemisphere processed food industry. An especially large burst of U.S. FDI in the hemisphere occurred during the 1990s, following Mexico's investment code reforms in 1989, the implementation of MERCOSUR (Common Market of the South) in 1991, and NAFTA (North America Free Trade Agreement) in 1994. Given this experience, will the FTAA likely affect the rate of U.S. FDI growth in the hemisphere?

There is no clear-cut answer to this issue, since many factors affect companies' decisions to establish affiliates in other countries. This paper provides some perspectives on the FTAA and U.S. FDI. It describes trends in U.S. FDI in the processed food industries in the hemisphere since the early 1990's. It discusses motivations for FDI, including recent changes in FDI protections in the Western Hemisphere, due in part to regional trade agreements. Finally, it offers conclusions on the potential effects of the FTAA on the motivations for U.S. firms to increase FDI in the hemisphere.

U.S. FDI in the Western Hemisphere

The stock of U.S. foreign direct investment in the Western Hemisphere food processing industry reached $13 billion by 2001, more than doubling since 1990 (fig. 6-1). These investments generated sales that were also double the level of 1990 (fig. 6-2). The importance to the U.S. of FDI in the FTAA is underscored by the fact that the $45 billion of sales from foreign affiliates of U.S. firms in the hemisphere has eclipsed U.S. processed food export earnings to the hemisphere ($12.5 billion in 2000).

Mexico, Canada, Brazil, and Argentina are the largest host countries for U.S. FDI in the Western Hemisphere processed food industry. Mexico and Canada are the second and third most important worldwide destinations for U.S. FDI in the food processing industry after the United Kingdom. U.S. investments cover a wide array of processed food products, but investments in beverages—both soft drinks and malt beverages—oilseed processing, and highly processed foods are the largest.

Some U.S. companies, such as Kellogg, General Mills, and Corn Products International have been in these markets for decades.[1] Others such as Tyson Foods, Perdue, and Smithfield, ventured into the hemisphere market during the past decade. Cargill, ADM and Bunge increased their presence in the Latin American oilseed complex in the 1990s. Corn Products International is one of the largest food processing companies in the United States and is now perhaps the largest presence of the U.S. processing firms operating in the hemisphere. Latin America accounted for a fifth of the company's earnings, and in the early 1990s, the company's consumer food sales and earnings compounded at 11 percent and 17 percent, respectively.

Within NAFTA, market integration has been deepening, as evidenced by rapidly expanding two-way trade and the greater north-south orientation of U.S.-Canada and U.S.-Mexico industries.

[1] See appendices for a list of U.S. and other firms engaged in FDI in Argentina and Brazil.

Some of the increased NAFTA trade in intermediate and processed products is linked to growth in FDI. Large firms are now better able to divide production lines between member countries, so that a product mix can be produced on either side of the border with considerable duty-free import/export activity in intermediate goods.

In contrast to Canada and Mexico, FDI has provided the primary means for U.S. companies to participate in the Argentina and Brazil markets, with limited trade in intermediate or processed food products. From the U.S. perspective, Argentina and Brazil have been limited and even declining markets for U.S. processed food exports since the 1990s. Sales from U.S. FDI affiliates in the Argentine and Brazilian processed food industry are $3 billion and $6 billion respectively, far greater than the level of U.S. exports of processed foods to those countries (figs. 6-3 and 6-4). U.S. FDI sales are also larger than exports in Venezuela, Colombia, Peru, Chile, Honduras, Costa Rica, and the Dominican Republic, indicating that it is less costly to set up affiliates to serve those markets than to attempt to export from the United States.

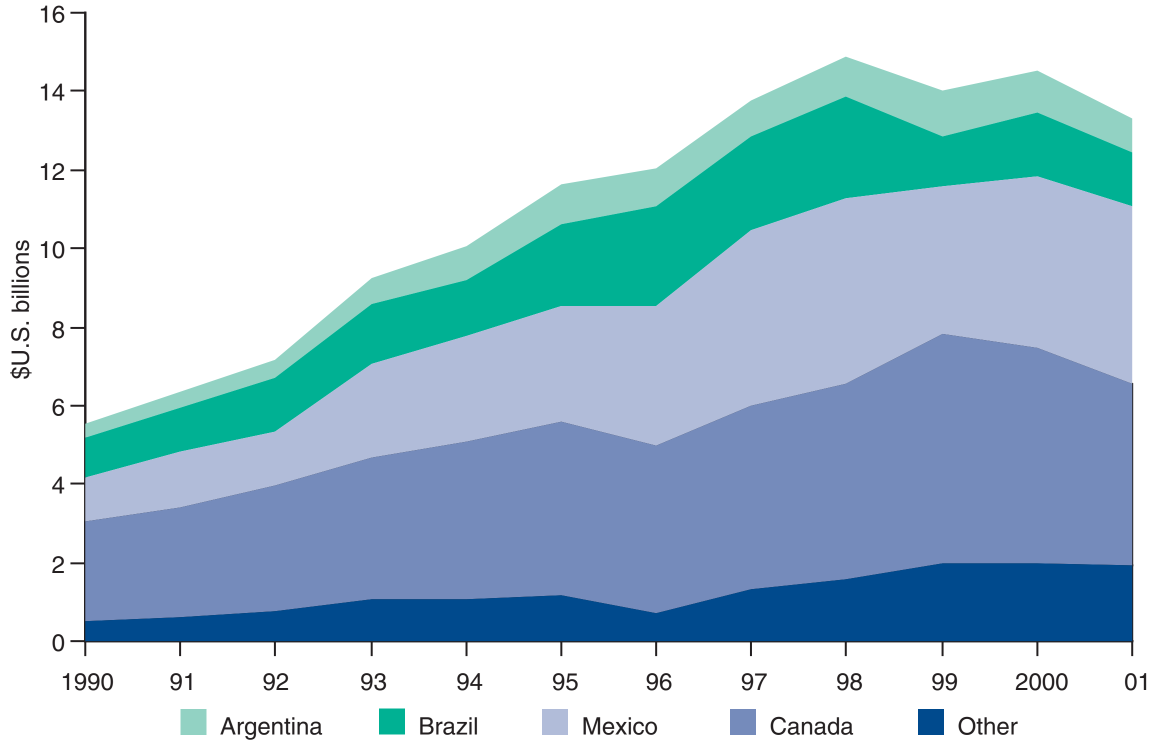
Because Brazil and Argentina produce many of the same commodities as the United States and have lower input costs, it is more economical for U.S. firms in those countries to produce processed products by FDI from local inputs. Also, most of the products from U.S.-owned firms in Argentina and Brazil are destined for their domestic markets. Even in export-oriented Argentina, nearly three-fourths (and in Brazil, nearly two-thirds) of the sales from U.S. FDI are for domestic use. Nevertheless, some U.S. FDI is export-oriented. U.S.-owned firms in Argentina and Brazil supply products to the U.S. market such as apple juice and frozen concentrated orange juice, processed meats, processed nuts, chocolate, coffee, and sugar products.

Some processed food trade between the U.S., and Brazil and Argentina is due to trade among affiliates. U.S. imports of processed foods from Argentine affiliates of U.S.-based multinationals were valued at $60 million in 1998 (table 6-1). The value of U.S. imports from affiliates in Brazil is undisclosed, but is thought to be much larger. U.S. exports to food processing affiliate plants in Argentina and Brazil amounted to only $72 million and $21 million respectively in 1998. U.S. exports to Argentine affiliates, at 60 percent of the total, comprised a significant share of the total processed food exports.

The United States is not the only foreign investor in the hemisphere, but it accounts for a significant share of the region's FDI. It is estimated that the United States has approximately 40 percent of the total FDI in Brazil's processed food industry. In Argentina's processed food industry, it is estimated that U.S. firms account for 25 percent of the total foreign direct investment. Likewise, about 60 percent of the total FDI in Mexico's processed food industry and more than half of the total FDI in Canada's processed food industry are from the United States. Major non-U.S. investors include industry giants Nestlé (Switzerland) and Unilever (U.K.-Netherlands), the two largest food processing companies worldwide in terms of sales. Danone (France) and Parmalat (Italy) are relative newcomers in the Western Hemisphere market.

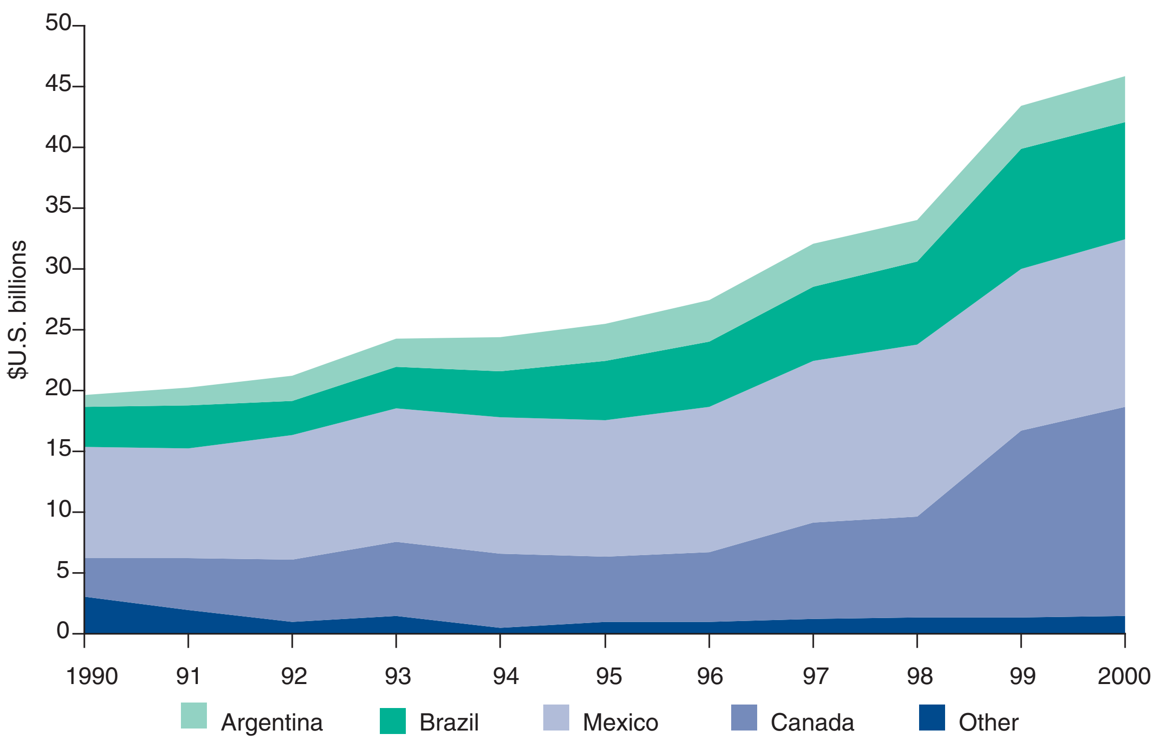
Domestic or multinational firms tend to dominate individual sectors. For example, in Brazil, Kellogg's manufactures most breakfast cereals, while Coca-Cola and Pepsi dominate the soft drink market. Nestle and Parmalat dominate the dairy industry, along with Brazilian dairy cooperatives. Unilever's affiliate Gessy Lever is Brazil's leader of canned vegetables and tomato-based products. Brazilian firms dominate meat processing, most processed fruits, orange juice and beer.

Figure 6-1
U.S. foreign direct investment in the Western Hemisphere processed food industry



Source: Economic Research Service, USDA.

Figure 6-2
Sales from U.S. FDI in the Western Hemisphere processed food industry



Source: Based on data from Bureau of Economic Analysis, U.S. Department of Commerce.

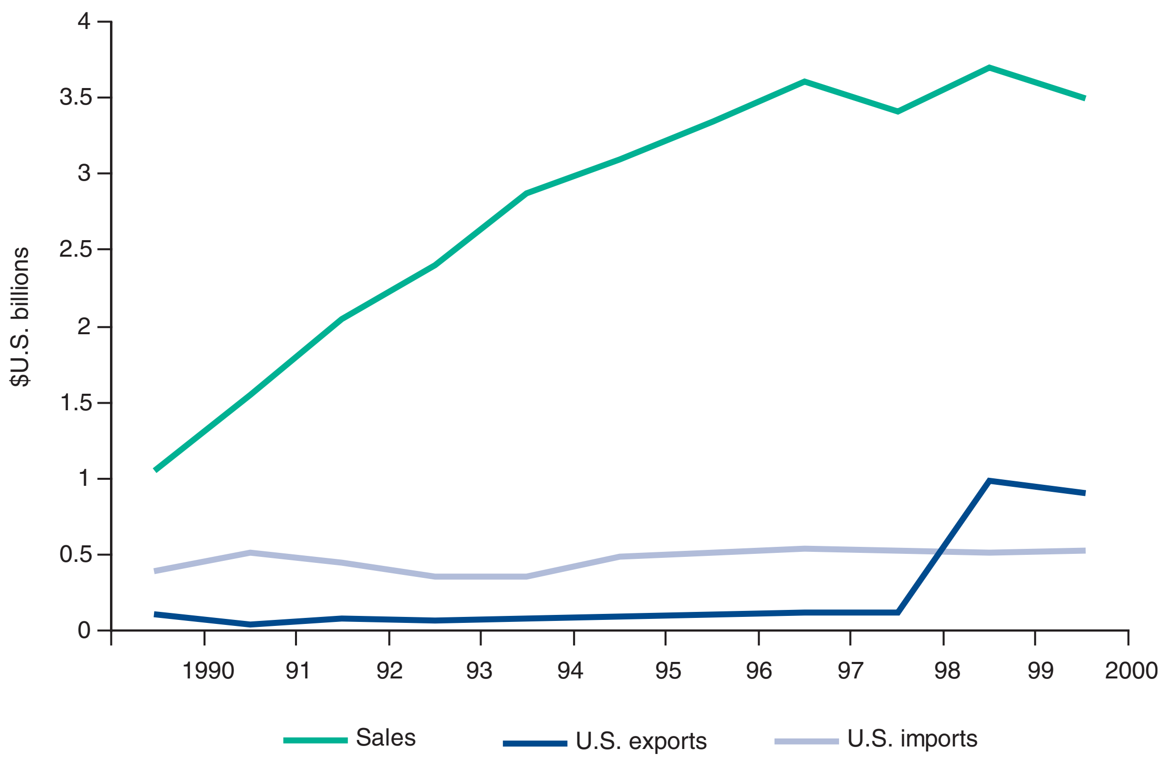
Motivations for FDI

Motivations for FDI come from internal factors, such as prospective economic growth rates, and external factors, such as trade and FDI policies. At the heart of increased FDI in the hemisphere has been investor sensitivity to macroeconomic conditions relating to economic stability and growth in key countries such as Mexico, Canada, Argentina, and Brazil, the largest host countries for U.S. FDI in the hemisphere. Sizeable population increases, and the fundamental changes that are occurring in eating habits, such as increased use of prepared foods and away-from-home consumption, are other factors driving FDI in food industries. Also, firms are recognizing the new market opportunities that are emerging for creating global supply chain systems that have the potential to operate efficiently across borders.

Unilateral trade reforms and free trade agreements have played roles in increasing opportunities for FDI. Market integration provides the opportunity for companies to operate with even larger economies of scale in regional rather than national markets. Falling trade barriers permit companies to reconfigure trade patterns that are more efficient and find new opportunities such as accessing seasonal supplies that reduce inventory and storage costs.

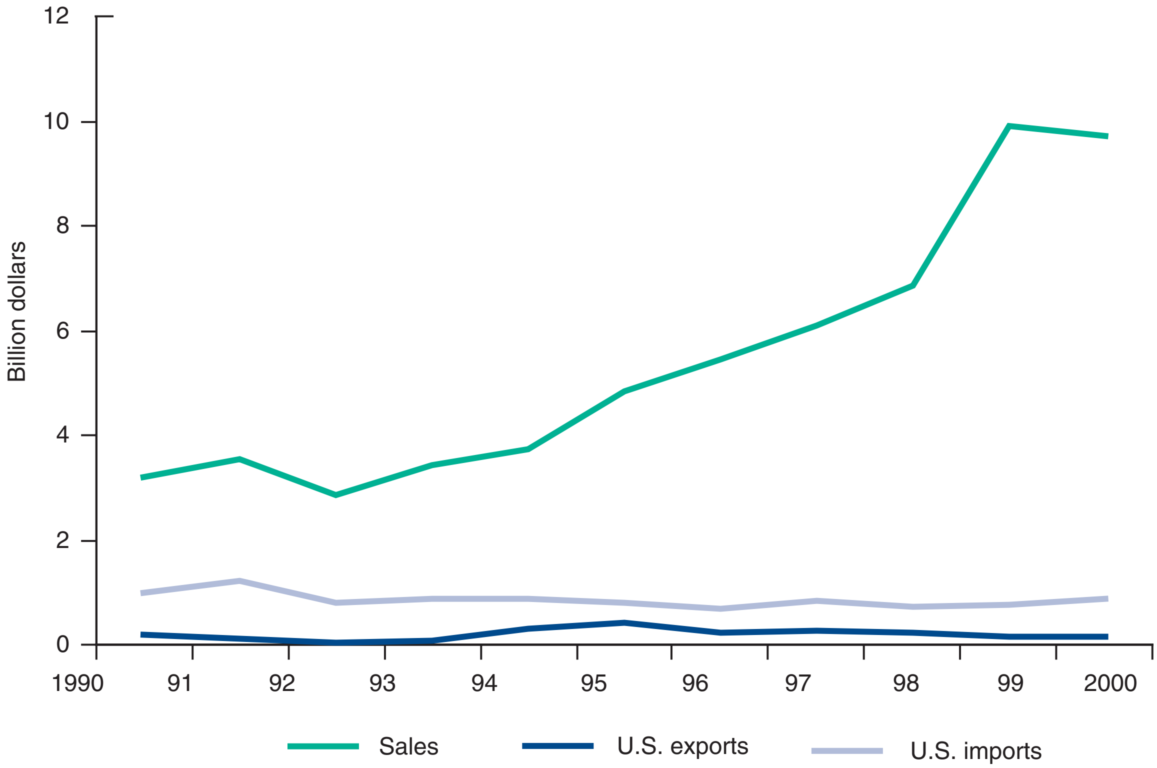
Liberalization of FDI rules have also helped to stimulate FDI in the hemisphere. Mexico adopted a major unilateral reform of its longstanding restrictive foreign investment regime in May 1989. The Regulations of the Law to Promote Mexican Investment and to Regulate Foreign Investment were issued, which provided greater certainty by establishing rules for classified activities. These laws were extended in a new Foreign Investment Law in 1993 that allowed investment in more sectors of the economy. Important rules enacted under NAFTA regime include the rights of foreign investors to have the same process of recourse to dispute settlement

Figure 6-3
Sales by U.S.-owned affiliates in Argentina vs. U.S. trade in food products



Source: Based on data from Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 6-4
Sales by U.S.-owned affiliates in Brazil vs. U.S. trade in food products



Source: Based on data from Bureau of Economic Analysis, U.S. Department of Commerce

as national investors do, with some exceptions. Expropriations can only proceed by public utility cause and through compensation at the commercial valuation. In addition, Canadian, Mexican, and U.S. investors have the right to third party arbitration in investment-related disputes for nationals, governments, or state enterprises of the three countries.

Argentina and Brazil have FDI rules in place through bilateral agreements and through MERCOSUR. Through the 1990s, the Argentine government signed bilateral agreements with 14 Western Hemisphere countries and Canada that included provisions for investment. The Argentine Government signed the Reciprocal Encouragement and Protection of Investment Agreement with the United States in 1991. Brazil signed bilateral agreements with Chile and Venezuela that included investment provisions.

The Colonia Protocol for the Promotion and Protection of Investments in MERCOSUR adopted in January 1994 is the principal regulation for governing foreign direct investment between MERCOSUR member countries, with provisions on investment treatment, transfers, expropriation, and settlement of disputes. The Buenos Aires Protocol for the Promotion and Protection of Investments, which applies to nonmember countries, was approved in August 1994. There are exceptions to investment protection, which include fishing (Argentina), and leasing of rural property (Brazil). Settlement of disputes between contracting parties is under the dispute settlement proceedings established under the Protocol of Brasilia (1991) or the mechanism established in the framework of the Treaty of Asuncion (Article 8 of Protocol of Colonia). For nonmember countries, settlement is through arbitration according to Article 2 of the Buenos Aires Protocol.

Table 6-1—U.S. trade with foreign affiliates in NAFTA and MERCOSUR countries in processed foods, 1998

Country	U.S. exports to affiliates in:	U.S. exports to:	U.S. imports from affiliates in:	U.S. imports from:
	Million dollars			
Canada	894 (17%)	5,249	2,182 (32%)	6,881
Mexico	461 (16%)	2,843	525 (22%)	2,360
Argentina	72 (61%)	118	60 (11%)	531
Brazil	21 (9%)	234	NA (NA)	762

NA = Not available for reasons of disclosure. The figure may be as high as $400 million. Percent is percent of total exports and imports to country.

Source: U.S. Department of Commerce, Bureau of Economic Analysis. U.S. Foreign Direct Investment Abroad: Operations of Foreign Affiliates of U.S. Companies, Preliminary 1998 Estimates.

Conclusion

If rules that are conducive to foreign direct investment are adopted, the FTAA could affect the rate of growth of FDI in the hemisphere. Increased FDI will contribute to the achievement of an increasingly integrated food supply system that serves the hemisphere efficiently.

Strategic corporate considerations will be at the heart of decisions on increased foreign direct investment. Countries chosen for additional FDI will most likely have some comparative advantage in agricultural products and other major inputs. While Brazil, Argentina, Canada, and Mexico are most likely to remain as the core countries, U.S. FDI will probably increase in other countries as well if the FTAA succeeds in extending protection of U.S. FDI to all countries in the region.

Given that many firm-specific factors affect individual firms' FDI decisions, it is difficult to bracket the potential growth in FDI in the hemisphere. Nevertheless, growth in FDI is expected to be positively influenced by free trade agreements for any given set of foreign direct investment motivations. Favorable business climate and favorable investment laws, a stable economy and government, and the potential for economic growth are positive precursors for both FDI and trade agreements. One difficulty in measuring the effect of free trade agreements is that trade agreements are typically trailing indicators of an improved business environment in a host country.

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