Special Article

With the signing of major trade agreements (the North American Free Trade Agreement and the GATT Uruguay Round), Mexico and Canada have increased their processed food and beverage imports from the U.S. along with other items. It is likely that these trends will continue, even though 1995 exports to Mexico were down due to the peso devaluation. Further negotiations on trade agreements with other Western Hemisphere countries, notably Chile, Costa Rica, and the MERCOSUR countries (Brazil, Argentina, Uruguay and Paraguay), could also increase U.S. exports to Latin America.

The U.S. is among the world leaders in exports and imports of processed foods. The appeal of U.S. brand names and the influence of U.S. multinational firms abroad help promote its exports in international markets. And with a large population base of high-income consumers, the U.S. is a natural magnet for food imports, bringing a variety of choices to U.S. consumers. *[Fred Ruppel (202) 219-0883; fruppel@econ.ag.gov]* AO

Part Two: Foreign Affiliates of U.S. Food Firms

Foreign trade tells only part of the story in international commerce in the food processing industry. In fact, U.S. food processing firms reach overseas markets mainly through product sales of their foreign affiliates. Only 2 percent of affiliate sales in 1995 were shipped to the U.S. Third countries purchased 19 percent, while the balance of sales were made in the host country.

The U.S. is among the largest investors in foreign food processing industries. U.S. investments doubled from $15 billion to $31 billion in just 5 years (1991-95), increasing steadily each year. U.S. investments in food manufacturing abroad are not concentrated in any particular products, but are spread across the board. Nearly 70 percent of U.S. food industry investments are in Western Europe, Canada, and Mexico. Within Europe, the U.K., Germany, Netherlands, and France are the major recipients of U.S. foreign direct investment (FDI). While U.S. investment is growing rapidly in some areas of Latin America and Asia, the investments are starting at a lower base.

Most investments have been in countries with relatively high consumer incomes and with similar tastes, but there have been many reasons for the recent growth in FDI. It is not always economically feasible to export bulky products to countries that are a long distance from the U.S., particularly when those countries produce about the same farm products that the U.S. does.

So firms do the next best thing and set up processing plants. A plant may sell its product in just one country, or it may export from that plant to other countries in the region. The products made in such plants include a range of items, such as mayonnaise, salad dressings, cookies and biscuits, and soft drinks.

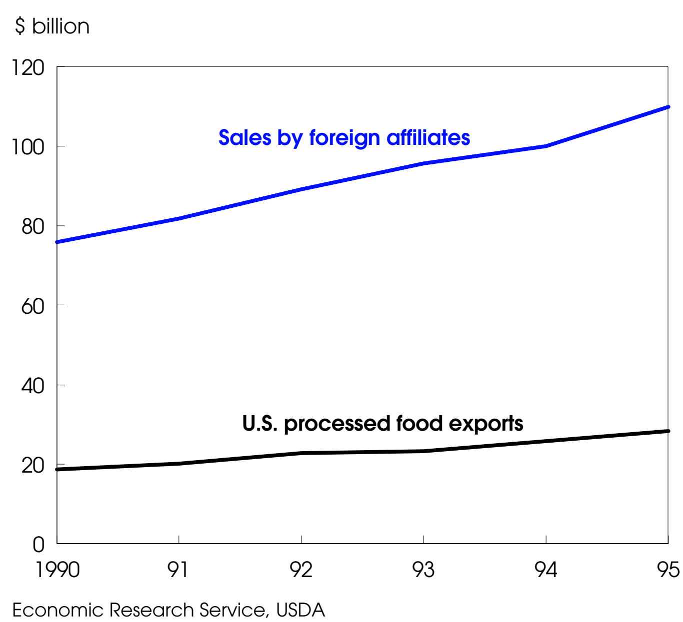
The European Union (EU), with its affluent consumers and high tariffs, has been a magnet for FDI. Tariffs for many processed products are high enough so that it is more profitable to have processing plants within the EU than to export.

Free trade agreements such as NAFTA have also led to increased investment as well as trade, with U.S. exports and investment to Mexico doubling in the last 5 years. While both declined in 1995 due to the peso devaluation, they are on the upswing in 1996. MERCOSUR (Brazil, Argentina, Uruguay, and Paraguay) has spurred new growth in U.S. investment in the region. MERCOSUR's Common External Tariff (CET), initiated in 1995, applies to imports by member countries. While CET's are not as high as the tariffs they replaced, the common tariffs have motivated U.S. firms to invest directly in these countries. MERCOSUR is now viewed as a potentially integrated regional market with common trade rules and an improved degree of economic stability.

FDI has also been aided by liberalized investment rules abroad. The Uruguay Round of GATT (and subsequently WTO) has influenced FDI growth. While tariffs are being reduced by the Uruguay Round, investment rules are also being liberalized within the GATT/WTO. In addition, individual countries have been liberalizing their investment rules.

FDI is not one-sided, but U.S. investments abroad have exceeded inward foreign direct investment in the U.S. food processing industry. Foreign direct investment in the U.S. food industry was $25 billion in 1995, compared with $23 billion in 1990. The large increase in FDI in the U.S. occurred in 1989, when the UK's Grand Metropolitan purchased Pillsbury. Japan's entry into the U.S. food industry occurred in the late 1980's. Cur-

Processed Food Sales by U.S. Affiliates Exceed Exports



rently, the UK, the Netherlands, and Germany are the largest investors in the U.S. food industry, followed by Japan and Canada.

The most significant impact of this investment in the U.S. has been the creation or saving of jobs in the food industry, foreign trade, and food sales. Sales by these U.S. affiliates of foreign companies are about $50 billion (about 12 percent of total sales of the U.S. food industry), and most of the goods stay in the U.S. U.S. affiliates of foreign firms employ about 200,000 people for a payroll of over $5 billion.

The Economic Effects Of Foreign Direct Investment

A major question is whether the rapid growth in sales from U.S. affiliates abroad comes at the expense of U.S. exports.

Sales from U.S.-owned foreign affiliates exceed total processed food exports fourfold, and have increased from $75 billion in 1990 to over $110 billion in 1995. U.S. exports and sales from U.S. affiliates abroad are both growing because of the strong foreign demand for processed foods.

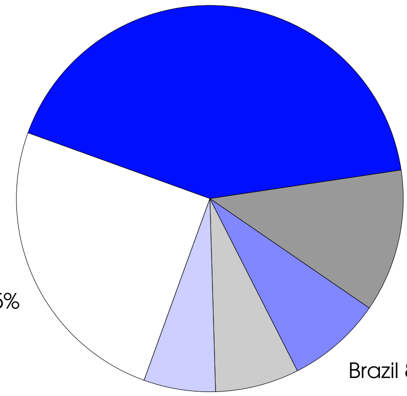
At one end of the spectrum, sales by U.S.-owned foreign affiliates exceed U.S. processed food exports over tenfold in Argentina, Brazil, Thailand, and the Philippines. Characteristics common to these countries are a large agricultural base, high tariffs, and distance from the U.S. that makes exports of many food products economically infeasible. However, the locations of these countries are ideal for exporting to regional markets.

Canada and Mexico are typical of countries in the intermediate range, where U.S. affiliate sales are three- to four times larger than U.S. exports. Characteristics of these countries are proximity to the U.S. and major trade agreements. Japan and Korea are at the other end of the spectrum, where U.S. processed food exports far exceed sales from affiliates.

The propensity for individual firms to serve foreign markets through foreign affiliates does not necessarily result in a reduction of their own exports of processed food. ERS firm-level data for 32 U.S. multinational food processing firms shows that sales from their foreign affiliates grew 9 percent per year, from $37 billion in 1988 to $64 billion in 1994. In addition, sales from foreign affiliates as a percent of these firms' total sales grew from 27 percent to 31 percent. During the same period, exports from the U.S. plants of the 32 firms grew 20 percent per year—from $2.7 billion in 1988 to $8.4 billion in 1994.

Thus, a descriptive examination of firm-level data suggests some strong positive associations between trade and foreign direct investment. However, it does not establish a causal relationship and, therefore, it cannot answer the question of whether foreign direct investment by food processors leads to an increase or decrease in the export of processed food products.

EU Is a Magnet for Investment By U.S. Food Processing Firms



Economic Research Service, USDA

The number of U.S. food processing firms that have at least 50 percent of their food processing abroad has increased in the 1990's. CPC International had 95 of its 123 plants (77 percent) outside the U.S. in 1993. Philip Morris/Kraft Foods had the largest absolute number of foreign plants—119 of a total 251 plants. However, the U.S. is not alone in food processing FDI. Nestle (Switzerland) and Unilever (U.K. and Netherlands) are examples of European companies that also have extensive food processing facilities abroad.

The economic consequences of FDI go beyond international trade. U.S. firms have received a sizable net income and have reinvested profits from their endeavors. Because of increased economic growth in the foreign country, the U.S. finds that it has new markets—for intermediate products for industry abroad, and for processed foods to meet increased foreign demand. The dividend to other countries is the compensation for the labor employed in their countries, and the benefits to the local economy from the incomes of these workers when they buy goods and services. In addition, host countries also gain the transfer of technology through FDI.

The intertwining of trade and foreign investment demonstrates the complexity of the food industry in the 1990's. The simultaneous inward and outward movement of food products and investment capital demonstrate the global nature of the U.S. food industry.

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