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Canada-U.S. Bilateral Direct Investment and Trade:

Food and Beverage Manufacturing Industry

by

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Problem

With the emergence of increased trade liberalization, international location of investments in food and beverage processing and levels of trade may change. There is concern that the Canada-U.S. Free Trade Agreement (FTA), in particular, may result in U.S. multinational enterprises (MNEs) rationalizing operations in Canada and to some extent substituting their production in Canada with exports from the United States. The magnitude of U.S. affiliates' contribution to Canadian food and beverage sales, some 25 percent, and the strong foothold their products have in the marketplace serve to emphasize the important role U.S. multinationals play in the Canadian industry.

On the other hand, Canadian firms may realize new opportunities for exports and foreign direct investment (FDI) in the United States, Mexico and worldwide with the policy reforms embodied in the FTA, the North American Free Trade Agreement (NAFTA) and the General Agreements on Tariffs and Trade (GATT). In addition, FDI and trade are affected by a vast assortment of other factors, such as exchange rates, input costs, tax policies, and strategic behavior, to name just a few.

Objective

The overall objective of this research project is to assess the effects of trade liberalization and other factors on bilateral direct investment and trade and the structure of the food and beverage manufacturing industries in Canada and the United States. The study is divided into three stages:

Stage 1: Describe changes in FDI and trade and the factors influencing them using secondary, industry-level data.

Stage 2: Describe the structural changes taking place in the food industries in Canada and the United States and how they relate to FDI and trade using secondary, industry-level data.

Stage 3: Provide a more complete analysis of changes in FDI, trade and structure of the industry by obtaining primary data from large North American firms.

Methodology

Stage 1 involves a descriptive analysis of changes in levels and composition of Canadian and American FDI and trade using data obtained primarily from the Bureau of Economic Analysis, the USDA, the United Nations and Statistics Canada. Theoretical literature is surveyed to

understand the determination of FDI and other modes of international involvement. Previous studies pertaining to the impacts of the CUSTA and the role of multinationals in Canada are also surveyed. For Stage 2, census data and other data sources are used to determine the importance of foreign ownership in the domestic markets of Canada and the United States as well as the importance of export markets to the domestic industries.

Finally, Stage 3 involves personal interviews with firms operating in Canada and the United States. A brief, yet general, questionnaire is being prepared with the aim to better understand corporate decision-makers' motivations for accessing foreign markets and their reasons for choosing one mode (such as FDI) over another (such as trade). The strategic planning of North American MNEs regarding bilateral investments in the Canadian and U.S. food industries will also be discussed in the interview process in light of the new trading and investment rules under the FTA.

Findings

Stage 1 has been largely completed while Stages 2 and 3 are still in progress. The following is a summary of pertinent findings discovered thus far concerning most recent statistics on Canada-U.S. bilateral direct investment and trade.

Importance:

The Canadian and U.S. economies are highly integrated in terms of FDI and trade in food and beverage products; however Canada is significantly more dependent on the United States in terms of inflows and outflows of both FDI and trade. The United States is becoming relatively more involved with other nations in terms of FDI and trade.

- The United States is Canada's most important source of FDI (60% of total inflows) as well as the most important holder of Canadian direct investment abroad (52% of total outflows).

- The United Kingdom's share of worldwide FDI in Canada (33%) and share of Canadian

direct investment abroad (23%) is large and second to that of the United States. The United States's long term share of FDI in Canada is declining, while FDI from the United Kingdom is increasing.

- The United Kingdom and Canada are the United States's most important sources of FDI (about 38% and 27% respectively) as well as the most important holders of U.S. direct investment abroad (18% and 15% respectively). Both countries, however, have been losing share of U.S. direct investment abroad in the last decade, while the share of other nations, namely the Netherlands, Australia, Germany, Spain and Mexico, has been increasing.

- Both Canadian and U.S. FDI inflows and outflows are dominated by industrialized countries. Latin America (in particular Brazil and Mexico) receives about 10 percent of U.S. direct investment abroad. Canadian direct investment in Latin America is at most about 2 percent of total outflows.

- Canadian food and beverage direct investment abroad is strikingly dominated by beverage products (almost exclusively alcoholic): 68 percent of FDI outflows to the United States and 95 percent to the United Kingdom involve beverages. The miscellaneous food products group (US SIC 206,207,209), which includes sugar and confectionery products, snack products, coffee and tea, vegetable and animal oils, pasta and fish products, appears to account for a large portion (possibly 60%) of the non-beverage share of Canadian direct investment in the United States

- U.S. direct investment abroad by industry is significantly more diversified than Canada's. The most important industries for U.S. direct investment in Canada (and worldwide) are miscellaneous food products with 27 percent of U.S. outflows, grain milled products (including breakfast cereals) with 25 percent, and beverage products (mostly soft drink) with 17 percent. Fruit and vegetable, and dairy products account for much of the remainder.

- The United States is Canada's most important source of food and beverage (SIC 20) imports

(57% of total inflows) as well as Canada's most important destination for exports (56% of total outflows).

- Canada is the United States's most important source of food and beverage (SIC 20) imports (17%), though U.S. imports from Australia, Thailand and Mexico are also significant. U.S. exports to Japan (26%) far exceed those to Canada (15%), which ranks second, and Mexico (8%), which ranks third.

Net balance:

Canada is a slight net importer of FDI from the U.S. food industry and a large net exporter of FDI to the U.S. beverage industry. Canada has a net surplus trade position with the United States in food and beverage products. The value of food and beverage sales of U.S. affiliates in Canada exceeds the value of U.S. food and beverage exports to Canada more than two-fold, while the value of Canadian exports to the United States is about two-thirds the value of Canadian affiliates' sales in the United States.

- FDI in the United States from Canadian food and beverage multinationals during the late 1980s (about \$6 billion) exceeded that of U.S. direct investment in the Canadian food and beverage industry (about \$2 billion). On an industry basis however, Canada is a slight net importer of FDI from the U.S. food industry and a substantial net exporter of FDI into the U.S. beverage industry.

- In 1989, U.S.-owned affiliates' sales of food and beverage products in Canada (\$8.1 billion) exceeded those of Canadian-owned affiliates in the United States (\$5.6 billion), and similarly the number of employees of U.S. affiliates in Canada (40 thousand) exceeded that of Canadian affiliates in the United States (30 thousand).

- U.S. affiliates' sales and employment worldwide exceed the total of all foreign affiliates' sales and employment in the United States, whereas the total FDI of all foreign affiliates in the United States exceeds U.S. direct investment abroad. While this is the case, total assets (FDI or parent investment, plus investment from all

other sources) of U.S. affiliates exceeds those of all foreign affiliates in the United States. Unfortunately, we cannot confirm this for U.S. affiliates in Canada versus Canadian affiliates in the United States due to confidentiality of data.

- Little historical data are available for employment of Canadian affiliates in the United States, however it is apparent that it was increasing quickly in the late 1980s. Employment of U.S. affiliates in the Canadian food and beverage industry fell from about 44 thousand to 33 thousand between 1982 and 1987, then rose to about 40 thousand in 1989. The employment of U.S. affiliates in the food and beverage industry worldwide fell by 7 percent between 1982 and 1988, then rose by 15 percent between 1988 and 1989.

- Canada is a net exporter of food and beverage products (SIC 20) to the United States as well as to its trading partners worldwide. In 1991, Canadian exports to the United States were valued at \$3.5 billion whereas Canadian imports from the United States were valued at \$3.1 billion. The United States has recently become net exporter of food and beverage products to its worldwide trading partners.

Growth:

During the 1980s, U.S. direct investment in the Canadian food and beverage industry grew slower than U.S. direct investment in the Canadian economy as a whole and slower than U.S. direct investment in a number of other countries' food and beverage industries. On the other hand, Canadian direct investment in the U.S. food and beverage industry grew very quickly during the 1980s. Trade data for this period has not been analyzed.

- U.S. direct investment in the Canadian food and beverage industry grew modestly during the 1980s (on average about 7% per annum), somewhat slower than U.S. direct investment in the Canadian economy as a whole. U.S. direct investment in the Canadian and United Kingdom food and beverage industries is growing slowly relative to U.S. investment in a number of other countries, namely the Netherlands, Germany,

Spain, Australia, Mexico, Argentina, the Philippines and South Korea.

- Canadian direct investment in the U.S. food industry grew very rapidly during the 1980s (doubling on an average annual basis), significantly faster than Canadian investment in the U.S. economy as a whole.

Post FTA:

Both U.S. direct investment in the Canadian food and beverage industry and U.S. food and beverage exports to Canada have increased since the initiation of the FTA in 1989. On the other hand, Canadian direct investment in the U.S. food industry has been stagnant and Canadian exports have been growing significantly slower than U.S. exports to Canada. In 1988, Canada's net trade balance with the United States was \$1.2 billion and by 1991 it had fallen to \$470 million.

The lowering of tariffs and nontariff barriers under the FTA may be stimulating U.S. exports to Canada more than Canadian exports to the United States, though the tariff rates for each country's industries have not been significantly different. This is an area that clearly requires further investigation. The appreciation of the Canadian dollar relative to the U.S. dollar has most likely contributed to this trade balance deterioration.

Some substitution of U.S. multinational production in Canada with imports from the United States has taken place, but overall, U.S. direct investment in the Canadian food and beverage industry has continued to grow modestly, by about 10 percent yearly between 1989 and 1991.