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U.S. Firms Invest in Mexico's Processed Food Industry

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The 1994 North America Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico was established to enhance trade. The successful increase in trade was accompanied by an even more important sharp increase in foreign direct investment (FDI) between the partners, especially between the United States and Mexico.

U.S. exports of processed foods to Mexico, mostly processed meats, poultry, animal fats, and vegetable oil, increased from \$1.1 billion in 1990 to \$2.8 billion in 1998. U.S. processed food imports from Mexico grew from \$1 billion to \$2.5 billion in the same years, and were mostly malt beverages, prepared fresh and frozen fish, and distilled spirits (table 1).

At the same time, foreign direct investment (FDI) between the United States, Canada, and Mexico increased sharply, paving the way for a regional food system. FDI, or

substantial ownership investments in foreign businesses, allows the investing firm to exercise control over the use of those assets (unlike foreign portfolio investment, which is passive and does not seek control over decisionmaking).

The \$6.5 billion in sales generated by U.S. food processing affiliates in Mexico overshadowed U.S. exports of processed food products to Mexico by more than a 2-to-1 ratio in 1998, making FDI more responsible than direct exports for the increasing presence of U.S. food processing firms in Mexico (fig. 1). U.S. FDI in Mexico's \$47 billion processed food industry increased from \$210 million in 1987 to \$5 billion in 1997 (fig. 2).

Mexico is now the third largest host country for U.S. FDI after the United Kingdom and Canada. Nearly three-fourths of the U.S. FDI in Mexico's food processing sector is in firms producing a wide variety of highly processed foods including snack foods, edible vegetable oils, mayonnaise and salad dressing, meat and poultry, concentrates and flavorings, confectionery products, and pasta and related products. About one-tenth of the U.S. FDI is in flour mills or bakery product companies; about 15 percent is in breweries and soft drink bottlers. Less than 5 percent is in fruit and vegetable processors.

Investor-Friendly Laws Increase FDI

This increase in FDI continues a trend that began prior to the enactment of NAFTA, when the Mexican Government changed many FDI rules in the late 1980's. In 1988, Mexico reformed its most important FDI law to allow foreign investors to own a larger than 49-percent share of investment properties. NAFTA strengthened the rights of foreign investors to get back their initial investment and profits by granting equal treatment under the law for foreign and domestic investors and by prohibiting new laws that could change the status of existing foreign investments.

Through an exchange with Mexico's Department of Agriculture and other government agencies under the Mexico Emerging Markets Exchange Program, administered by USDA's Foreign Agriculture Service, researchers at USDA's Economic Research Service gained new insight into U.S. investment in Mexico's food processing and agribusiness. About \$1.6 billion of the \$4 billion of FDI inflows into Mexico's food and beverage industries that occurred during 1994 to 1998 came from the United States. Canada, the United Kingdom, the Netherlands, and France also made significant direct investment in Mexico's food indus-

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Table 1

Processed Food Trade Between the United States and Mexico Is a Two-Way Street

U.S. exports to Mexico		U.S. imports from Mexico	
Processed food industry	1998 sales	Processed food industry	1998 sales
<i>Million dollars</i>		<i>Million dollars</i>	
Meat processing	798	Malt beverages	551
Vegetable oils	314	Prepared fresh and frozen fish	437
Poultry slaughter	242	Distilled and blended spirits	150
Animal and marine fats	192	Canned fruits and vegetables	126
Wet corn milling	153	Salad dressings	93
Dry and condensed milk	132	Bottled and canned soft drinks	83

Source: USDA/ERS Processed Food Trade data set.

try (fig. 3). The largest foreign direct investments to Mexico are in companies that produce beer, soft drinks, and snack foods (table 2).

U.S. FDI continued to flow into Mexico's processed food industry in 1998; the largest investments were by Coca-Cola in Mexico's beverage industry. The U.S. firm Corn Products Incorporated expanded its interest in a joint venture with Arancia-CPC, Mexico's largest corn product processor, which makes corn oil, starches, and inverted sugars that are used in a variety of processed foods and industrial products. Mission Produce, a U.S. produce company, is opening its second avocado processing plant in Mexico. The U.S. meat company Smithfield Foods is negotiating to buy Grupo Alpro, Mexico's largest pork processing company. Many U.S. food companies, such as Campbell Soup, General Mills, Ralston Purina, and PepsiCo, have had plants in Mexico for decades.

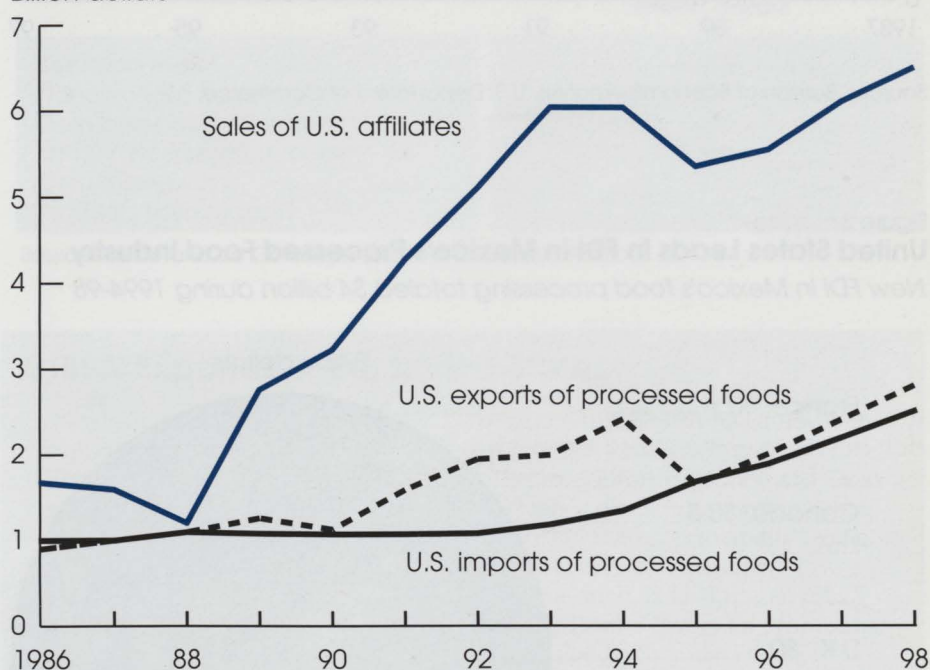
Economic Growth Also Increased FDI

U.S. food processing affiliates in Mexico export an average of only 2.5 percent of their sales to the United States. Because most of the processed foods produced in Mexico stay in Mexico, Mexican economic growth has been the principal

Figure 1

Sales of U.S. Affiliates in Mexico More Than Double the Value of U.S. Exports of Processed Food to Mexico

Billion dollars



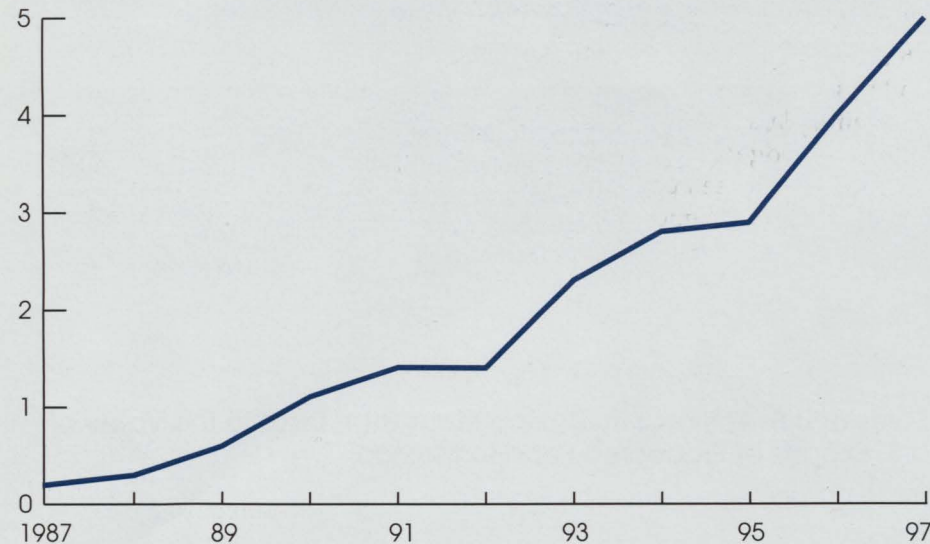
Source: USDA/ERS Processed Food Trade data set and Bureau of Economic Analysis, U.S. Department of Commerce data.

macroeconomic prerequisite for FDI. Except for a downturn in 1995 and slow growth at the close of 1998, the Mexican economy generally experienced healthy economic growth since 1990. Even with 1995's setback, Mexico's economy, as measured by its gross domestic product (GDP), has grown an average of 3.5

percent a year between 1990 and 1998. This economic growth led to a 9-percent raise in inflation-adjusted per capita income in Mexico from \$3,100 in 1990 to \$3,389 per year in 1998. (Based on relative retail prices in the United States and Mexico, this \$3,389 has buying power in

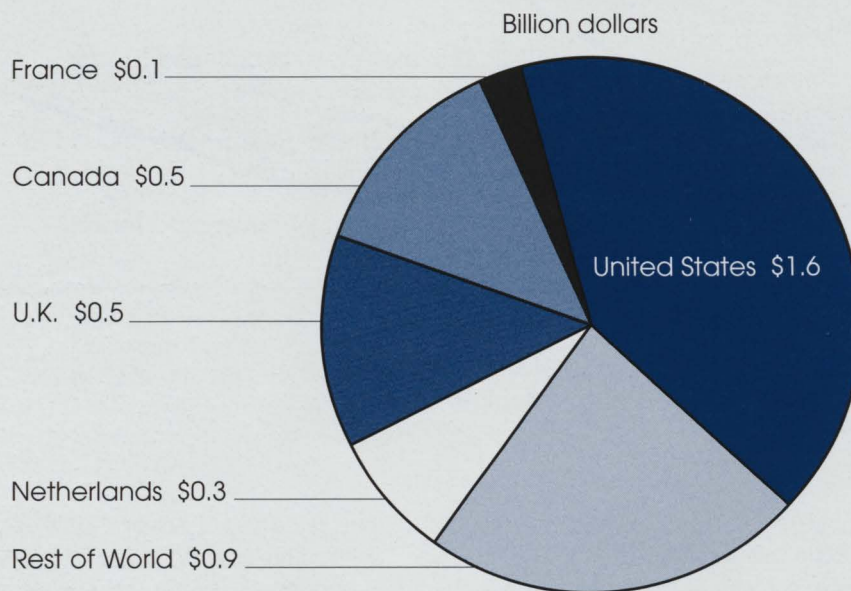
Figure 2
U.S. FDI in Mexico's Processed Food Industry Grew 25-fold Between 1987 and 1997

Billion dollars



Source: Bureau of Economic Analysis, U.S. Department of Commerce.

Figure 3
United States Leads in FDI in Mexico's Processed Food Industry
New FDI in Mexico's food processing totaled \$4 billion during 1994-98



Source: Secretaria de Comercio y Foment Industrial, Mexico.

Mexico equal to \$7,700 in the United States.) Mexico's GDP is forecast to grow 2 to 3 percent in 1999, and should grow faster than that predicted for the U.S. and Canadian economies during the coming decade.

Higher incomes have increased food demand by Mexican consumers and sales for Mexican food processing companies. Overall sales in Mexico's food and beverage industry grew from \$37 billion in 1990 to \$47 billion in 1997, a 26-percent increase. Higher sales in the Mexican food processing industry encouraged increased investment, including investment by foreign firms.

NAFTA helped Mexico's economy to grow, leading to increased investor confidence in Mexico. A synergy between investment and trade developed as U.S. firms located food processing plants by comparative advantage based on shifting production and marketing costs. As long as the Mexican business environment was stable, U.S. firms could do business in a country with low labor costs relative to the United States and a depreciating currency relative to the U.S. dollar. The strengthening of the dollar vis-à-vis the peso during the 1990's made purchase of Mexican companies less expensive to U.S. investors.

Some U.S. products, such as vegetable oil, dried milk, and flavorings, are exported to U.S. affiliates in Mexico for further processing into mayonnaise, salad dressings, bakery products, and beverages. Most U.S. beef and poultry exports are sold directly to wholesalers and retailers (such as Wal-Mart's Mexican affiliates in the case of beef) and some is further processed. The devaluation of the Mexican peso lowers labor and related costs in terms of dollars, so that the cost of the finished food product made in Mexico is often less

than if the finished product had been exported from the United States, again making FDI attractive for expanding markets.

Smaller U.S. Investment in Mexico's Farm Sector

U.S. companies have also invested in Mexico's farmland, poultry farms, and other production agriculture, but not to the same extent as in the processed food sector. Mexico has limited irrigated land attractive to U.S. companies wanting to invest in higher value production agriculture, such as vegetables. U.S. companies account for 78 percent of the total FDI in Mexico's production agriculture, which amounted to \$45 million from 1994 to 1997.

Nearly three-fourths of the U.S. investments in Mexico's agricultural sector center on fruits, vegetables, and flowers. Minor interests are in livestock and poultry production. FDI has often been combined with contract farming, where U.S. processors and distributors contract with Mexican growers to deliver products to packing or processing facilities. In the vegetable industry, U.S. firms often invest in Mexican packing sheds rather than in farmland. Mexico's poultry industry has both contract farming and FDI by U.S. firms.

United States Also Hosts Mexican FDI

Mexican firms have also increased their investments in U.S. processed food companies. Sales from Mexican affiliates in the United States amounted to \$664 million in 1996 compared with nearly zero in 1990. The two largest Mexican companies with interests in U.S. food processing, the bread baking company GIBSA (see box) and Gruma, a flour, tortilla, and bread maker began exporting products for the U.S. His-

panic market. Minsa, a Mexican corn milling company with six plants in Mexico, now has two corn milling operations in Texas and Iowa. Mexico's DESC acquired Authentic Mexican Food Incorporated, a processor of Mexican-style food based in Texas.

Owning plants in the United States as a hedge against currency fluctuations has been particularly important for companies like GIBSA

that import most of their inputs, such as U.S. wheat and vegetable oil, for their Mexican plants. The Mexican peso crisis in 1995 increased GIBSA's costs for imports. Even GIBSA's earnings in Mexico were cut in terms of dollars by the peso devaluation. Using the dollars earned in its U.S. plants, GIBSA could pay for imports for its plants in Mexico. GIBSA and Gruma represent the modern Mexican food

Table 2

Mexican Beer and Malt Industries Are Leaders in New Foreign Direct Investment Since 1994

Processed food industry	1994-98 investments
	Million dollars
Beer and malt	1,115
Nonalcoholic beverages	719
Corn chips and other snacks	426
Other miscellaneous foods	363
Corn milling	271
Products from sugar	104

Source: Secretaria de Comercio y Fomento Industrial, Mexico.

GIBSA Expands in the United States

Mexican companies, such as Grupo Industrial Bimbo S.A. (GIBSA), have targeted their sales to certain segments of the U.S. market, especially Hispanics. GIBSA, a leader in Mexico's breadmaking industry, has more than 60 plants in Latin America, Mexico, and the United States, with 57,000 employees and worldwide sales of more than \$2.3 billion. In addition to making bread, GIBSA produces other baked goods, wheat and corn flour, snack foods, confections, and frozen fruits and vegetables. GIBSA also produces inputs that are used in the baking industry, such as machinery and plastics.

GIBSA initially exported products from its Mexican plants to the United States, especially to cities with a large concentration of people of Mexican

origin. Now, GIBSA has a number of plants that produce bread and tortillas in California, Texas, and Ohio and has a distribution system that covers 16 States, principally in the South and Pacific regions.

Firms such as La Tapatia, C&C Bakery, Pacific Pride, La Fronteriza, Fabila Foods, Suandy Foods, National Foods, Proalsa Trading, and Bimar Foods are among GIBSA's subsidiaries in the United States. One of GIBSA's principal acquisitions during 1998 was Mrs. Baird's, a leader in the bread-baking industry in the Southwestern United States with sales of more than \$300 million. In March 1999, GIBSA further expanded in the United States by acquiring the Four-S Baking Company in Los Angeles with sales of about \$40 million.

processing industry, which also includes industrial giants Cerveceria Modelo, FEMSA Cervesa, and Compañia Nestlé, all of which have sales in excess of \$1 billion.

FDI Enhances Choices, Employment, and Trade

Two-way FDI and trade are further integrating the U.S. and Mexican economies, with capital being provided by U.S. and, to a lesser extent, Mexican firms. Eventually this integration could mean more efficiency in providing food to consumers, as the NAFTA partners become a regional food market. Increased fruit and vegetable trade between Mexico and the United States has extended the season for particular fruits and vegetables. Consumers in both countries have more choices in foods and beverages. U.S. affiliates, for example, lead in the production of deboned chicken and chicken parts in Mexico, while Mexican affiliates have added tortillas, salsa, and other Mexican-style foods to U.S. supermarket shelves.

FDI often encourages more uniformity in food quality in response to purchasers' requirements. For example, Wal-Mart's affiliates in Mexico require a particular grade of beef cut to Wal-Mart's specifications. Uniform supply and quality speed

further development of the supermarket and foodservice industries that demand these services.

FDI has increased employment in Mexico by U.S. affiliates and increased investment earnings from U.S. investments abroad. Nearly 84,000 persons earning \$772 million were employed by U.S. affiliates in the food industry in Mexico in 1996, compared with 50,000 persons earning \$174 million in 1986. U.S. affiliates' net income in Mexico's food processing industry was \$288 million in 1996, bringing in a source of reinvested capital for further growth in Mexico's food industry. Mexican-owned food processing affiliates in the United States also have grown and by the end of 1996 employed 5,500 persons.

FDI also increases two-way trade. U.S. exports have increased recently partly because many U.S. affiliates in Mexico import products from the United States for further processing in Mexico. Partially processed products from the dairy, poultry, corn milling, and vegetable oil industries are among the United States' largest food exports to Mexico. Instead of replacing trade, FDI has often successfully fostered trade between Mexico and the United States.

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