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July 2, 1993

The Honorable Donald W. Riegle
The Honorable Kent Conrad
The Honorable Thomas A. Daschle
The Honorable Carl M. Levin
The Honorable Howard M. Metzenbaum
The Honorable Ernest F. Hollings
The Honorable Harris Wofford
United States Senate

This letter responds to your request that we provide information on the Mexican government's involvement in the Amerimex Maquiladora Fund (AMF) and the extent of this fund's and other funds' efforts to buy U.S. companies and move them to Mexico.

More specifically, you asked us to discuss (1) the Mexican government's involvement in U.S. investment funds, including AMF, that acquire an interest in U.S. companies; (2) the activities of AMF; (3) an additional U.S. investment fund that acquired an interest in U.S. companies that were prospects for moving to Mexico; and (4) other investors that have acquired an interest in U.S. companies that were prospects for moving to Mexico.

APPROACH

We obtained information for this letter from a number of U.S. and Mexican sources. To determine the Mexican government's involvement in funds, including AMF, that purchase shares of U.S. companies, we conducted an extensive literature search. In addition, we interviewed appropriate officials from the U.S. Departments of State, Commerce, and the Treasury, the U.S. Trade Representative, the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), and the Mexican embassy in Washington, D.C. In Mexico, we obtained information from appropriate representatives of the Mexican Secretariat for Trade and Industrial Development (SECOFI), the Foreign Trade Bank of Mexico (Bancomext), and Nacional Financiera, S.N.C.

(NAFINSA). To determine the activities of AMF, we reviewed the AMF brochure and limited partnership certification and incorporation papers and interviewed officials from AMF in New York City and Merida, Mexico. To identify other investment funds whose purpose was to purchase shares of U.S. companies that were prospects for moving to Mexico, we conducted a literature search of U.S. investment funds that had conducted activities related to Mexico and interviewed officials from the funds identified and the acquired companies. To locate other individuals that acquired an interest in U.S. companies that conducted activities in Mexico, we followed up on leads from interviews with investment fund officials that we identified.

BACKGROUND

According to AMF representatives and the AMF brochure, AMF is a $20-million U.S. investment fund that was established to "acquire controlling interest in small- to mid-sized U.S. manufacturing companies with a view to moving all or a portion of the manufacturing operations of each company to Mexico as maquiladoras."[1] The Chairman and Chief Executive Officer (CEO) of the New York-based Warwick Group, and the Chairman of the Mexican-based Operadora Amerimex Fund, started AMF in January 1992 and provide management and administrative services and investment advice to the fund.[2]

NAFINSA joined AMF as a limited partner and investor at the invitation of the general partner of AMF. NAFINSA is Mexico's development bank for corporate modernization. NAFINSA's principal objectives include (1) promoting economic development and modernization of Mexico's

[1]According to the AMF brochure, the term "maquiladora" refers to a mass production or assembly plant in Mexico. Mexican plants operating under the maquiladora program can import, duty free, capital equipment and components for processing or assembly on the condition that the production is primarily destined for export.

[2]The Chairman of Operadora Amerimex said he served as the Treasurer for the Mexican state of Yucatan from 1991 through 1992 and as the Secretary of Economic Development for the Mexican State of Yucatan from 1984 through 1988.

manufacturing plants, (2) assisting in the development of Mexican capital markets, and (3) attracting foreign investment to assist in Mexico's economic development. NAFINSA's main function is to assist in providing credit and financial services and support for small- and medium-sized companies in Mexico.

On February 16, 1993, U.S. Representative Richard Gephardt wrote to Mexican President Carlos Salinas de Gortari to protest the involvement of NAFINSA, in AMF, the investment fund that was set up for the purpose of acquiring controlling interest in U.S. companies to move them to Mexico. In the letter, Mr. Gephardt urged President Salinas to reevaluate the Mexican government's participation in AMF and to assure him and other supporters of free trade that "predatory efforts such as this will not continue".

On February 17, 1993, the embassy of Mexico published a press release stating that NAFINSA was in the process of terminating its participation in AMF.

THE MEXICAN GOVERNMENT'S INVOLVEMENT IN FUNDS THAT ACQUIRED AN INTEREST IN U.S. COMPANIES

Our review and a spokesman for SECOFI indicated that NAFINSA is the only Mexican federal government entity that has invested in funds that acquired an interest in U.S. companies. This fact was confirmed by officials from Bancomext and the U.S. Treasury Attaché in Mexico City, Mexico. NAFINSA invested in two funds that have acquired an interest in U.S. companies: it made a direct investment in AMF and an indirect investment in the U.S.-based Ventana Equity Expansion Partnership IV, L.P.. NAFINSA has also invested in the U.S.-based Ventana North America Environmental Fund, which primarily intends to invest in Mexican companies and on occasion may make investments in other countries.

<u>NAFINSA's Involvement in AMF</u>

In 1992, the general partner of AMF invited NAFINSA to invest in the fund as a limited partner.[3] NAFINSA invested $3.75 million in AMF. In consideration of this investment, NAFINSA also received $15,000 in shares in Amerimex Partners, L.P., the general partner of AMF. These shares represented approximately 10 percent of the total capital of that partnership. NAFINSA also received $5,000 in shares in Amerimex Management, L.P., which is providing management services to AMF. These shares represented 50 percent of the total capital of the management partnership. According to NAFINSA officials, NAFINSA was not involved in any capacity in the management of AMF.

A spokesman for NAFINSA explained that NAFINSA's involvement with AMF was seen as part of its effort to support small- and medium-sized business development in Mexico, a role similar to that of the U.S. Small Business Administration. AMF was created to encourage the development of maquiladora plants in the state of Yucatan, Mexico, creating jobs and economic development in that area. A NAFINSA brochure says that NAFINSA provides small- and medium-sized investors with temporary and minority share capital to establish new companies and to support companies already in business; normally, NAFINSA's participation does not exceed 25 percent of the equity and does not extend beyond 7 years.

According to NAFINSA and AMF representatives and the U.S. Treasury Attaché in Mexico City, NAFINSA is no longer affiliated with AMF. A NAFINSA representative said that in January 1993, NAFINSA initiated the process to divest itself of its investment in AMF. By February 18, 1993, NAFINSA secured a letter of intent from a private Mexican investment group to purchase its shares in AMF. This sale was

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[3]In a limited partnership, a general partner is the person, firm, or group representing limited partners in the management of partnership assets. A limited partner is an individual who purchases units in a partnership, in the hope of economic gain or tax benefits, and is not active in the management of the partnership. General partners have unlimited liability, while limited partners may be liable only to the extent of their committed investment basis.

concluded on April 5, 1993. This transaction allowed NAFINSA to divest itself completely of its investments in AMF and its shares in the two limited partnerships associated with AMF. Currently, NAFINSA is not associated in any way with AMF or any of its associated partnerships or companies, according to officials of both AMF and NAFINSA.

NAFINSA's Involvement in the Ventana Equity Expansion Partnership IV, L.P.

In April 1990, a subsidiary of NAFINSA, Alta Tecnología de Componentes Electrónicos, S.A. (ATCE), invested as a limited partner in the U.S.-based Ventana Equity Expansion Partnership Fund IV, L.P. ATCE invested $3 million out of the $12.5 million in total capital obtained for this fund's final offering in April 1990. NAFINSA has a controlling interest in ATCE, and NAFINSA officials sit on ATCE's board of trustees. However, according to a NAFINSA representative, ATCE "functions entirely as a private sector company." Only ATCE's board of trustees makes decisions regarding investments in investment funds such as the Ventana Equity Expansion Partnership Fund IV, L.P.

Ventana Equity Expansion Partnership Fund of Irvine, California, was formed to invest in joint ventures and establish strategic alliances in Mexico. According to Ventana and Banamex[4] representatives, Ventana Equity Expansion Partnership purchased minority shares in two U.S. companies that have since become active in Mexico. In 1989, the fund purchased less than 10 percent of the shares of a San Diego-based electronics company. According to a Ventana representative, just before Ventana's investment, the electronics company planned to expand its production into a new electronics area and was considering establishing a plant in the Far East. After Ventana's investment, the company set up a plant in Mexicali, Mexico. It employs 40 workers in Mexicali and 50 workers in San Diego, California. The investment in Mexico has not resulted in a reduction in the number of the company's workers in the United States,

[4]Banamex is a major private Mexican bank that also invested in Ventana Equity Expansion Partnership.

nor are there plans to do so, according to officials from Ventana and NAFINSA.[5]

Ventana and Banamex representatives told us that in 1990 Ventana Equity Expansion Partnership purchased 1 to 2 percent of the shares of an Irvine-based health company that makes intravenous solutions. This company is not moving its operations to Mexico, but it is looking at ways to sell its products in Mexico. It will consider setting up a plant in Mexico, if this act would help in entering the Mexican market. At present, it employs 2,000 workers in the United States and none in Mexico.[6]

NAFINSA's Involvement in the Ventana North America Environmental Fund

In January 1992, Ventana created and launched the North America Environmental Fund. The purpose of this fund is to promote the development of Mexico's environmental industry and to help improve the environment along the U.S.-Mexico border. According to NAFINSA officials, Ventana invited NAFINSA to participate as a limited partner in the fund.

The North America Environmental Fund is seeking a total of $50 million in capital subscriptions from investors. In January 1993, Ventana completed the fund's initial offering with $20 million committed from a group of multinational investors, including NAFINSA. NAFINSA invested $1.6 million in the fund, according to Ventana and NAFINSA officials.[7]

A Ventana representative reported that the $20 million from its initial offering will be used to invest (1) in expanding

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[5]We were not able to independently verify this information because the Ventana representative was not willing to release the identity of this company.

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[7]However, according to a NAFINSA official, in January 1993, the Ventana North America Environmental Fund's initial offering totaled $6.4 million.

environmental companies in Mexico; (2) in joint ventures between established U.S. environmental companies and Mexican companies; and (3) directly in companies located in the countries of the fund's investors (e.g., Belgium, Japan, Mexico, Spain, and the United States), providing them with the capital to expand operations into Mexico. The Ventana representative said Ventana will invest between 10 percent and 40 percent in Mexican joint ventures and a smaller percentage in U.S. companies. Ventana is seeking to invest in well-run, profitable U.S. companies with proven performance and production capability to conduct technology transfers and maybe to expand operations into Mexico with subsidiaries.

The Ventana representative explained that these investments will promote U.S. exports and are not intended to involve relocations. As of June 1993, the fund had not made any investments.

THE ACTIVITIES OF THE AMERIMEX MAQUILADORA FUND

According to AMF representatives, AMF purchased majority shares in two U.S. companies and plans to continue investing in U.S. companies. AMF has obtained $20 million in capital and is seeking additional investors to increase its capital to $50 million. Currently, AMF has used $8 million of the $20 million in the fund for its investments in two U.S. companies.

According to AMF representatives, in May 1992, AMF purchased 80 percent of the shares of a U.S. garment company. This company contracted out for the production of and marketed women's dresses. All its contracts were then with U.S. manufacturers. Soon after AMF's investment, the company shifted approximately 40 percent of its contracted work from U.S. manufacturers to Mexican, Guatemalan, and Colombian manufacturers.

Currently, this company generally produces 70 percent of its dresses in-house and contracts out for 30 percent of its dresses to subcontractors in Mexico, Colombia, and Guatemala. In mid-May 1993, the company purchased a U.S. producer of women's dresses, Springfield Industries, which is now its main domestic production source. This is the first time this company has owned its own production facilities. It employs 150 U.S. workers. Springfield Industries subcontracts out 30 percent of its production to U.S. manufacturers during the peak season from December through April and May.

All of this company's offshore work (that is in Mexico, Colombia, and Guatemala) is imported to the United States under subheading 9802 of the Harmonized Tariff System.[8] The company's products use U.S. textiles, and as a consequence, 60 percent of the final products are U.S. made, according to the president of the acquired company. This official also said that the company could not have survived against Far East imports if it had not subcontracted out to offshore producers its more complicated labor-intensive garments. He added that the company would have considered subcontracting in the Far East, where wage rates are even lower, but instead moved some of its subcontracted work to Mexico because of the AMF investment and the 9802 tariff structure.[9]

According to AMF officials, in early 1993, AMF purchased 75 percent of another U.S. garment company that produces half of its products in-house and contracts out the other half. This company employs 600 U.S. workers in three plants in North Carolina and South Carolina. When AMF was considering purchasing the company, the company had experienced 2 years

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[8]Under tariff heading 9802 of the U.S. Harmonized Tariff Schedule, processed or manufactured products are allowed to enter the United States with a duty on only the value added in the foreign country if the goods contain U.S.-made components.

[9]Wage rates in Mexico are considerably higher than in certain countries in the Far East. For example, according to data provided by the Department of Labor's Bureau of Labor Statistics, the hourly compensation rate for production workers in Mexico during the late 1980s was approximately 136 percent higher than in the Philippines, 238 percent higher than in Pakistan, and 321 percent higher than in China. According to the Bureau of Labor Statistics, in 1988 Mexican hourly compensation rates were estimated to be US $1.25; in 1992 they were calculated to be US $2.35.

of financial losses and was discussing moving operations to the Caribbean or the Far East. The company is now maintaining its 600 employee operations in the Carolinas and is shifting its contracted work from U.S. to Mexican manufacturers.[10]

Many Companies Meet Some of AMF's Investment Criteria

According to the AMF brochure, the fund generally seeks to invest in U.S.-based companies that have the following characteristics: (1) low- to mid-technology manufacturing operations; (2) annual sales in the range of $10 million to $100 million; (3) moderate to good growth; (4) excellent management and sales teams willing to stay with the company after acquisition; (5) proven products that have been on the market for at least 3 years, preferably with a brand name; and (6) a labor component of 20 percent to 30 percent of the cost of the goods sold.

The number of U.S. companies that qualify for the AMF annual sales criteria can be roughly estimated using Internal Revenue Service (IRS) data. Our analysis of IRS data indicated that at least 14,266 companies meet AMF's investment criteria in the area of annual sales.

Although IRS data did not indicate the exact number of companies with annual sales between $10 million and $100 million, they provided information on the number of companies with sales between $10 million and $50 million and those exceeding $50 million. According to IRS data on corporate income tax returns for 1989, 14,266 corporate income tax returns were submitted for manufacturing companies with annual sales ranging between $10 million and $50 million, and 4,535 returns were submitted for manufacturing companies with annual sales exceeding $50 million. These figures are understated because some corporations did not indicate the number of subsidiaries included on their income tax returns.

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[10]We were not able to independently verify this information because AMF was not willing to release the identity of this company.

No standard industrial classification (SIC) data are available on the number of U.S. companies that would meet AMF's investment criteria for the percentage of labor in the costs of goods sold.[11] According to the SIC Manual for 1987, SIC data are classified by establishment, not by company. The SIC Manual defines an establishment as an economic unit, generally at a single physical location, where business is conducted or where services or industrial operations are performed. An establishment is not necessarily identical with a company, which may consist of one or more establishments.

AN ADDITIONAL INVESTMENT FUND ACQUIRED AN INTEREST IN U.S. COMPANIES THAT WERE PROSPECTS FOR MOVING TO MEXICO

Our review identified only one other U.S. investment fund whose purpose was to acquire an interest in U.S. companies that were prospects for moving to Mexico. Inter American Holdings (IAH) acquired an interest in two U.S. companies, a textile company and a furniture company, according to IAH representatives. There is no Mexican government investment in IAH, according to an IAH representative.

In 1990, IAH purchased approximately 51 percent of the shares of Countess York, a textile operation that buys fabric to make sheets and comforters. Countess York considered moving but never moved its operations to Mexico. IAH representatives explained that Countess York had discussed moving its operations to Mexico as a way to stay in business during a time when its sales had dropped significantly. Countess York employed approximately 190 to 200 workers in Los Angeles County. According to IAH representatives, this company was having management problems and was never able to move to Mexico. In 1991, IAH sold Countess York to Hollander, a U.S. company. Countess York, under the name of Hollander, still conducts manufacturing operations in Los Angeles and has no operations in Mexico, according to a Hollander representative.

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[11]The standard industrial classification is the statistical classification standard underlying all establishment-based federal economic statistics classified by industry.

IAH representatives reported that in late 1988, IAH bought 7.5 percent of the interest in Eric Morgan, Inc., using capital of IAH and private investors, none of whom were Mexican. Eric Morgan, Inc., a manufacturer of wood cabinets for stereos and televisions, was a 5-year-old company when IAH purchased it.

From December 1988 to January 1989, Eric Morgan moved all of its operations to Mexico. According to an IAH representative, Eric Morgan moved to Mexico because (1) its Los Angeles operation was in a building condemned due to earthquake damage, and it was planning to move out of Los Angeles because it could not get a new factory permit; and (2) the company was marginally profitable and needed the advantage of Mexico's low-cost labor to stay in business. Eric Morgan had employed 250 workers in the Los Angeles area, approximately 85 percent of whom were Mexican immigrants. Eric Morgan scaled down the number of its workers to 200 Mexican employees when it moved its operations to Mexico.

Eric Morgan ran into difficulties launching its Mexican manufacturing operations and eventually was taken over by the Resolution Trust Corporation (RTC). U.S.-based Bush Industries bought all Eric Morgan's assets and none of its liabilities from RTC in September 1990, according to a Bush Industries representative.

From September 1990 through January 1992, Bush Industries maintained manufacturing operations at Eric Morgan's establishment in Mexico, which involved a contracted plant and workers. In June 1992, Bush Industries bought its own plant and hired its own workers in Mexico. The company in Mexico is called Bush Industries of Mexico and employs approximately 150 Mexican workers.

According to an IAH representative, IAH is no longer investing in U.S. companies to move them to Mexico, but it does provide consulting services to help U.S. companies set up operations in Mexico. IAH has provided this service to 17 companies.

For example, IAH provided this type of service to Louisiana Pacific Corporation, a northern California-based lumber company. According to IAH and Louisiana Pacific representatives, from mid-1989 through the end of 1990, IAH provided Louisiana Pacific Corporation with consulting services to help with the expansion of its operations into Mexico. The purpose of Louisiana Pacific's Mexican operations is to barge redwood lumber from northern California to Mexico to be air dried, planed, and shipped to southern California. Louisiana Pacific and IAH representatives reported that Louisiana Pacific expanded some of its operations to Mexico because it was losing market share in southern California due to problems with California's railroads. Louisiana Pacific did not set up a plant in southern California because of difficulties getting construction permits and paying the high cost of land. None of Louisiana Pacific's technology or plant equipment were moved from the United States to Mexico, and none of its U.S. plants were closed as a result of this move, according to IAH and Louisiana Pacific representatives.

OTHER INVESTORS ACQUIRED AN INTEREST IN U.S. COMPANIES THAT WERE PROSPECTS FOR MOVING TO MEXICO

The Chairman of the Mexican-based Operadora Amerimex, who is also a manager and administrator of AMF, said that he, as an individual, along with other private U.S. and Mexican investors, invested in three U.S. companies that have since moved all or part of their operations to Mexico.

In 1986, Operadora Amerimex's Chairman, as an individual investor, and a Mexican and a U.S. partner purchased a controlling interest (67 percent of its shares) in Caps, Henry, and Springer Dental Lab, a small U.S. producer of dental crowns and bridges. Before this purchase, the company had manufactured all of its products in Houston, Texas. It had four U.S. employees-the three partners, and a secretary. In March 1987, Caps, Henry, and Springer began marketing Mexican-made crowns along with its U.S.-made crowns in the United States. At that time, the company employed 14 technicians in Yucatan, Mexico. The Chairman of Operadora Amerimex sold his shares to the other Mexican partner in 1991.

A representative of Caps, Henry, and Springer said that today, Caps, Henry, and Springer has nine employees in the United States who perform the more highly skilled technical, managerial, and sales functions. In Mexico, it has 50 workers, who produce crowns and bridges for the U.S. and Mexican market. About one-third of its production is sold in Mexico. Its production has increased tenfold since 1987. All equipment used in the manufacturing process is made in the United States. All materials (porcelain, dental stone, dental metal, etc.) are also of U.S. origin.

Other Purchases

According to the Chairman of Operadora Amerimex, in 1988 he and a group of U.S. and Mexican investors pooled their resources and purchased 20 percent of the shares of Fenwick, a California-based producer of fishing rods. After purchasing these shares, the Chairman of Operadora Amerimex persuaded the company to lease a plot and build a plant in Mexico. However, before Fenwick began its Mexican operation, all of its shares were bought by another U.S. company, Berkley, Inc.

According to a Berkley, Inc., representative, from 1988 to 1993, Berkley, Inc., manufactured fishing rods in the Mexican facility set up by Fenwick. At its peak, Berkley, Inc., employed 750 workers in Mexico; now it employs none. The Mexican facility assembled U.S. supplies and materials into its final product under the maquiladora program. In 1993, Berkley, Inc., consolidated all Fenwick's manufacturing efforts in Taiwan, where Berkley, Inc., has been conducting its manufacturing for the past 20 years.

Berkley, Inc., has maintained Fenwick's U.S. office to serve as a marketing company for fishing rods and other products, according to a Berkley, Inc., representative.

In 1989, the Chairman of Operadora Amerimex and several other individuals purchased over 50 percent of the shares of San Angelo Sports, according to a San Angelo Sports representative. At the same time, they purchased another U.S. company, called U.S. Sporting Products, and renamed it San Angelo Sports. Both San Angelo Sports and U.S. Sporting Products produce hunting and camping equipment.

For the past 2 years, the Chairman of Operadora Amerimex and the individual investors have been helping U.S. Sporting Products move its Hong Kong manufacturing operation to

Mexico. U.S. Sporting Products previously produced all of its products in Hong Kong for the U.S. market.

In 1990, San Angelo Sports also moved some of its manufacturing operations to Mexico. A San Angelo Sports representative said that San Angelo Sports has 15 U.S. employees, who do some manufacturing, packaging, and shipping. In 1990, San Angelo was facing financial difficulties and moved some of its manufacturing to Mexico. Before moving to Mexico, San Angelo would hire additional workers on a seasonal basis to do this manufacturing work. San Angelo no longer employs as many seasonal workers in the United States.

The San Angelo Sports representative added that if the Chairman of Operadora Amerimex and his investors had not invested in San Angelo, the company probably would not be in business today. The Chairman of Operadora Amerimex and his investors provided working capital that San Angelo could not get and saved the San Angelo jobs, according to a San Angelo Sports representative. According to the Chairman of Operadora Amerimex, the new company in Mexico is named Articulos de Caza San Angelo. The Mexican plant uses U.S. supplies and materials to assemble its final equipment under the maquiladora program.

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We discussed our findings with representatives from NAFINSA, AMF, the other investment funds identified, and companies acquired by these funds and incorporated their comments where appropriate.

We are sending copies of this letter to the organizations we contacted and other interested parties. We will also make copies available to others upon request.

Please contact me on (202) 512-4812 if you or your staff have any questions concerning this letter. The information in this letter was developed by Curtis F. Turnbow, Assistant Director; Anne M. Pond, Evaluator-in-Charge, and Juan Gobel, Evaluator.

Allan I. Mendelowitz

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