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NAFTZ Issue Brief

Delivering Trade Equality for American Manufacturers

The ability of the U.S. Foreign-Trade Zones program to attract investment, promote manufacturing, and create jobs in the United States will be in jeopardy if the program is not modernized to reflect the changing realities of today's global trading system.

In the past 30 years the United States has signed Free Trade Agreements with 20 partner countries. That means that more than 40 percent of imports to the United States today are sourced from Free Trade Agreement-partner countries. With the recently concluded Trans-Pacific Partnership and the proposed Transatlantic Trade and Investment Partnership with the European Union, the FTA share of U.S. imports will expand to more than 60 percent.

These new trade realities stand in sharp contrast to the trade world that existed when Congress passed the Foreign-Trade Zones Act in 1934. Back then, U.S. duties were historically high. To help revive trade and output during the Great Depression, the FTZ program allowed U.S. companies to eliminate duties on merchandise that was re-exported from their zone, and defer or reduce duties on merchandise that entered the U.S. market.

When manufacturing was permitted in zones beginning in 1950, U.S. manufacturers could bring components into their zones and produce finished goods with imported and domestic components and U.S. labor at the same duty rates enjoyed by foreign manufacturers of competing goods. Over the decades, the FTZ program has enabled U.S. companies to compete more effectively in the global market, allowing them to keep their factories in the United States or return production and distribution activity to the United States rather than locating those activities abroad.

The dramatic growth in free trade agreements in recent decades has served the nation's interests well on balance, but more needs to be done. Some agreements have unintended effects that may damage the competitiveness of U.S. manufacturers. The foreign-trade zone program can remedy those damaging effects.

The FTZ program remains today an important component of U.S. trade and economic policy. The FTZ Board reports that 2014 exports from FTZs reached a record \$99.2 billion, a 400% increase in the past 10 years. The 2,700 companies operating in zones employ a record 420,000 American workers in their zone operations.

Although the program continues to deliver tremendous benefits, FTZ-user companies and their American workers are finding themselves at a disadvantage when competing against products

made in countries that have entered FTAs and other agreements with the United States. *While final products made in FTA-partner countries typically enter the U.S. market duty free, comparable goods made by U.S. workers on U.S. soil in an FTZ can still face significant U.S. duties.*

For decades, a core purpose of the FTZ program has been to put U.S. manufacturers on an equal footing with their foreign counterparts. The international auto sector in the United States is a prime example. A foreign-made car imported to the United States is subject to a 2.5 percent U.S. duty, which applies to all foreign-sourced components. A U.S.-made car contains key imported components subject to duties higher than 2.5 percent. This puts U.S. manufacturers at a disadvantage compared to their foreign competitors. The situation is much more troubling when an FTA partner sells its cars in the U.S. free of duty, including non-FTA components, as long as the rules of origin are met. These “inverted duties” on manufacturing inputs create an unintended but powerful incentive to locate production processes offshore. A car might be made abroad because a car manufactured abroad receives more favorable U.S. duty treatment than one made on American soil!

There is an easy way to rectify this problem before it does real damage. The National Association of Foreign-Trade Zones believes it is time for federal policymakers to recognize this disparity and develop a practical solution:

- **The FTZ Act should be amended to allow producers in a U.S. zone to qualify for the same duty-free treatment as comparable final products made in an FTA-partner country. Under that proposal, any product made in a U.S. FTZ would qualify for duty-free entry into the United States if an FTA-country competitor qualifies for duty-free entry of a competing product into the United States.**
- **The NAFTA implementing legislation should be amended to allow goods produced in a U.S. FTZ to enter U.S. commerce at the NAFTA-eligible rate if it meets the applicable rule of origin under NAFTA for that product. No other FTA has such a restriction, which is aimed squarely at U.S. factories.**
- **A NAFTA provision requiring duty payment before exporting a NAFTA-originating product to Canada and Mexico should also be reviewed. The Chile implementing legislation has a similar provision.**

These three improvements would give U.S.-based manufacturers the same duty treatment they can now get by producing in a free-trade agreement country — under the same rules that apply to imports from that country. As a result, U.S. producers would enjoy a greater incentive to locate and keep value-added production in the United States.