The USITC FTZ Investigation:

Foreign Trade Zones (FTZs): Effects of FTZ Policies and Practices on U.S. Firms Operating in U.S. FTZs and under Similar Programs in Canada and Mexico

What is this investigation and how did we get here?

This groundbreaking study on the competitiveness of U.S. Foreign Trade Zones (FTZs), available here, has been several years in the making. The investigation was initiated by the USTR on December 14, 2021. However, it is important to note that the groundwork for this request was laid by the NAFTZ, in collaboration with its public affairs advisors and key Congressional members.

To gather comprehensive data and insights, a public hearing took place on May 17, 2022, and an industry survey was conducted during the summer of last year. Throughout 2022, field visits were undertaken by the USITC team to various FTZ locations. Finally, on May 15, 2023, the comprehensive final report was published, encompassing the findings of the study.

What was NAFTZ's role in the investigation?

The NAFTZ takes great pride in its pivotal role in initially encouraging the investigation into FTZs. Furthermore, we are proud of the active support we provided to the USITC research team since early 2022. These efforts encompassed various activities, such as extensive educational training sessions, granting access to our library of educational and training materials, preparing oral and written testimonies, promoting survey participation, hosting webinars to facilitate survey completion, and facilitating on-site visits by the USITC team to FTZs.

In response to the USTR's request for the study, the NAFTZ swiftly assembled a task force to effectively support the aforementioned endeavors. The NAFTZ ITC Task Force members include:

- Jeff Tafel
- James Grogan
- Shannon Fura
- Sean Lydon
- Frankie Bryson
- Melissa Irmen
- Jeremy Page
- Shane Williams
- Will Cawthern
- Brian Murphy
- Chris Carney
- Robert Balli
- Justin Huguet
- Wayne Lin
- Mark Leventhal
- Kelly Todd
- Alec Hajimihalis

Key Takeaways from the Report

1. The report contains an incredible volume of useful data

This study marks a significant milestone as it is the first of its kind since the 1980s. The breadth and depth of data, research, and anecdotal stories compiled in this report are unparalleled. The report presents an extensive collection of both macro and micro data, covering the FTZ-type programs of all three countries involved.

One notable aspect of this study is the inclusion of "new" types of data that have not been previously available. These include a breakdown of admission data by origin, providing insights into the diverse sources of FTZ activity. Additionally, the report delves into zone status splits, shedding light on the distribution of zone usage and their respective characteristics. Detailed employment data by sector offer a comprehensive understanding of the workforce dynamics within FTZs.

Furthermore, the study presents a thorough analysis of export splits, differentiating between direct and indirect exports. This information enables a nuanced examination of trade flows and the economic impact of FTZs. Investment trends are also meticulously examined, providing valuable insights into the patterns and drivers of investment within the FTZ ecosystem.

To supplement the research team's comprehensive findings, the study also includes a summary of six other pieces of FTZ research and previously published literature. This synthesis of additional sources enhances the depth and credibility of the report's overall conclusions, bolstering its value as a comprehensive resource in the field of FTZ analysis.

2. Mexico has significantly more FTZ-type program activity, particularly in the automotive sector

Report excerpt:

> *5,191 establishments had IMMEX authorizations during 2021. They employed approximately 2.8 million workers, significantly higher than the 480,000 employees in the U.S. FTZ program…According to the limited information available on PROSEC, almost 4,000 firms participated in PROSEC in 2022. (pg. 36).*

Mexico’s use of FTZ-type programs compared to the U.S. is striking in absolute terms; however, when you compare the differences between the U.S. and Mexican economies and populations, it’s a cataclysmic difference. The development of the IMMEX and PROSEC programs in 2002 and 2006, respectively, were created to incentivize manufacturing investment and as a result, were major drivers of this increased usage. The U.S. did not take similar action to level the playing field for its manufacturers.

From an automotive perspective, two thirds of vehicle production in the U.S. occurs outside of FTZs. In Mexico, however, **all** vehicle manufacturers in Mexico, as well as 60 of the 100 largest parts producers in North America, participate in PROSEC.

3. U.S. FTZs are at a competitive disadvantage compared to firms operating under Mexico's FTZ-type programs

Through direct data and industry testimonials, the USITC team acknowledges throughout the report that Mexican companies are not hindered by the USMCA restrictions like U.S. FTZs are.

> Report excerpt:
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> *"…the requirement that firms producing in U.S. FTZs pay duties on their foreign-status materials both for domestic shipments and exports to Canada and Mexico creates a cost disadvantage for these facilities in the United States. This cost disadvantage occurs because producers in Canada and Mexico have multiple mechanisms to reduce or eliminate duty costs on those materials. This includes MFN duty rates of free, preferential rates under FTAs, and* ***reduced duty rates offered through PROSEC and regla octava in Mexico (which are not subject to the restrictions of USMCA****)." (pg. 40).*

4. Most exports from U.S. FTZs are indirect

In the last five years, over three quarters of U.S. FTZ exports were not exported directly. They were first entered for consumption before being exported (i.e., exported indirectly). Companies do this for several reasons: the finished goods might already be duty free; they might wish to save on T&E bonded transportation; drawback savings may outweigh bonded/direct export savings; and/or direct exports of manufactured goods to Mexico or Canada generally receive no benefit under USMCA.

> Report excerpt:
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> *During 2016–21, only 23 percent of export shipments by firms producing in FTZs were directly exported from an FTZ without first being entered into U.S. custom territory for consumption (direct export shipments).* ***About 77 percent of export shipments were indirectly exported****—having previously entered the U.S. customs territory for consumption before being sent to foreign markets (indirect export shipments), including 14 percent destined for Canada and 22 percent destined for Mexico. (p.34).*

This statistic highlights the fundamental flaw of the NAFTA (and now USMCA) duty deferral restriction. Because of this competitive disadvantage, American companies clearly recognize that the U.S. FTZ program does not offer the same benefits that drawback does (particularly for automotive and petroleum FTZs), and the direct export benefits to USMCA partners are virtually nonexistent. By contrast, Mexican manufacturers can completely eliminate duties on almost all manufactured goods that are exported to the U.S. through a number of duty-reduction mechanisms.

5. The Section 321 de minimis provision puts U.S. FTZs at a competitive disadvantage

De minimis was not originally part of the USITC team's focus for this investigation; however, the NAFTZ and Ship Safe Coalition's continuous efforts to highlight this problem resulted in the report appropriately addressing the disparity for U.S. FTZs.

Report excerpt:

*U.S. de minimis provisions that give duty-free access for small-value import shipments into the United States present a **significant challenge for U.S. FTZ warehousing and distribution operations…De minimis provisions have likely been a substantial contributing factor driving investment in facilities in Canada and Mexico that are used to serve the U.S. market from the other side of the border.** A warehouse in Canada or Mexico can import bulk shipments of foreign goods and, if operating under an FTZ-type program, not pay duties (or receive drawback in Canada) on goods destined for re-exportation. U.S. importers—which could include individual consumers using an e-commerce platform—that purchase goods from these facilities would not pay duties on shipments valued at or below the U.S. de minimis threshold ($800). In contrast, U.S. FTZ warehousing and distribution operations can defer—but must ultimately pay—duties on goods admitted into FTZs and then shipped to U.S. customers, including low-value shipments. (p.44).*

*Industry representatives also reported impacts of U.S. de minimis policy on their competitiveness compared to companies providing warehousing and distribution services in Canada and Mexico…Industry representatives claimed that this ruling disadvantaged U.S. warehouse/distribution operators in U.S. FTZs compared to foreign distributors. For example, a company with a warehouse or distribution center in Ontario, Canada, could import bulk merchandise, repackage it into multiple shipments valued at less than $800, and **send these shipments to a U.S. customer free of duty using the U.S. de minimis rule. Meanwhile, distributors operating in U.S. FTZs could not do the same** with bulk shipments. In response, some **companies have reportedly moved or set up warehouse/distribution facilities in border regions of Canada and Mexico** where they can hold third-country goods for de minimis sales to U.S. consumers. (p. 98)*

6. Warehouse/distribution operations make up 90% of U.S. FTZ users, but production operations make up 80% of employment

This important statistic highlights that both "sides" of the U.S. FTZ program play an important role in economic development and achieving the original Congressional intent of the program. Much of the USITC team's focus was on the USMCA disadvantages for U.S. FTZ manufacturers; however, appropriate recognition of the de minimis disparity as well as the sheer volume of distribution facilities help illustrate that both "sides" significantly contribute to American jobs, capital investment, international trade flows, exports, and other indicators of economic growth. Not surprisingly, the NAFTZ intends to continue advocacy efforts for both production and distribution FTZ operations.

7. U.S. FTZs' have a positive, indirect "cluster" effect on economic development

In addition to capturing direct economic data on U.S. FTZ investment and employment, the report also underscored how major U.S. FTZ investments can stimulate additional employment and economic development benefits for surrounding regions.

Report excerpt:

> *U.S. FTZs may also have indirect impacts on U.S. firms that operate outside FTZs that supply goods or services to firms producing in U.S. FTZs…If FTZs incentivize the establishment or expansion of major manufacturing facilities, such as automotive assembly plants,* ***supplier firms may cluster around those facilities and create additional employment and economic development within the region.*** *For example, more than* ***150 companies*** *in Alabama supply goods to two major FTZ operations in the state: Mercedes-Benz and Hyundai. An industry representative described how another large vehicle assembler invested in their county, in part, because of the incentives provided by the FTZ. This investment, which has continued to grow,* ***led not only to thousands of jobs in the assembly plant itself but more than 10,000 indirect and multiplier-related jobs.*** *Many of those jobs resulted from new suppliers investing in the region. (p.170)*

Given the reshoring and onshoring trends spurred on in part by recent Federal legislation (e.g., the CHIPS and Science Act, the Inflation Reduction Act, the Infrastructure Investment and Jobs Act, etc.), this report highlights that the U.S. FTZ program can play a major "anchor" role in supporting new manufacturing investment. This "anchor" will then lead to downstream economic benefits throughout a project's supply chain, spilling into a variety of suppliers, customers, and service providers.

8. Domestic content and U.S. value add make up a significant portion of the U.S. FTZ story

The report brings attention to a key finding regarding the composition of U.S. FTZ shipments. It reveals that a mere 13% of the total value of these shipments comprised foreign status inputs, while the majority of the share consisted of value added in the U.S. (31%) and U.S. domestic content (56%). This insightful breakdown underscores a crucial point: the primary role of the U.S. FTZ program is to stimulate domestic job creation and foster economic development, rather than serving as a platform solely for reducing or eliminating duties.

By demonstrating that a significant portion of the value within FTZ shipments is attributed to value added in the U.S., the report highlights the integral role played by American workers and businesses in the FTZ ecosystem. This data signifies that FTZs serve as catalysts for employment opportunities and contribute to the growth of the domestic economy.

Moreover, the substantial proportion of U.S. domestic content further emphasizes the program's focus on utilizing local resources and inputs. This indicates that the U.S. FTZ program is deeply rooted in maximizing domestic production and leveraging the strengths and capabilities of the U.S. market.

Overall, these findings underscore the vital role of the U.S. FTZ program in bolstering the country's economic landscape and job market. The report effectively dispels any misperceptions about the program solely serving as a means to avoid duties, emphasizing its true essence as a driver of domestic economic growth and employment generation.

What's Next?

The NAFTZ will be hosting informational webinars in the coming weeks to address the report's findings and discuss next steps with our members. The report will also play a critical role in our upcoming advocacy efforts on the Hill as we work to achieve FTZ parity for all U.S. companies.

If you have questions, comments, or would like to get involved, please contact NAFTZ President Jeff Tafel (jtafel@naftz.org) or NAFTZ USITC Task Force Chair James Grogan (james.grogan@fticonsulting.com) for more information.