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NAFTZ
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June 12, 2017

The Honorable Robert E. Lighthizer
United States Trade Representative
600 17th Street, NW
Washington, DC 20508

RE: NAFTA Negotiations (Docket Number USTR-2017-0006)
Comments Submitted via www.regulations.gov

Dear Ambassador Lighthizer:

The National Association of Foreign-Trade Zones (NAFTZ) is pleased to submit the following comments on negotiating objectives regarding modernization of the North American Free Trade Agreement with Canada and Mexico (82 Fed. Reg. 23699 (May 23, 2017).

NAFTZ is the collective voice of the U.S. Foreign-Trade Zones (FTZ) Program. The program was established by Congress in 1934 to help "level the playing field" for U.S. companies facing competition from firms located in foreign countries exporting to the United States. In many cases, FTZ participation can help U.S.-based firms to be more competitive and maintain U.S.-based activity, encourage production closer to market, and boost exports through lower effective duty rates and special customs entry procedures.

The FTZ program provides valuable incentives for companies to manufacture and operate in the United States, rather than in foreign countries, including:

- Duty Deferral – U.S.-based companies operating in an FTZ may delay payment of customs duties until goods are transferred out of the zone and into U.S. Customs territory.
- Duty Elimination – No duties are paid on merchandise exported from an FTZ to a foreign country, which simplifies management of a company's cash flow.[1]
- Duty Reduction – FTZ users may elect to pay duty at either the rate applied to the foreign inputs used or the rate for the finished product ("inverted tariff"), whichever is lower, thereby reducing customs duty burdens for U.S.-based manufacturers in FTZs and promoting manufacturing in the United States.

FTZs account for a significant portion of total U.S. trade. In 2015, the last year for which complete data are available, exports from facilities operating under FTZ procedures totaled $84.6

[1] The sole exception to this benefit is exports of manufactured goods from a U.S. FTZ to NAFTA partner countries (Canada and Mexico), which the comments below argue is an unfair restriction and should be removed.

billion, or 5.6 percent of all U.S. goods exported. Imports into FTZs totaled $244.8 billion, or 10.8 percent of total goods imported into the United States. Over 420,000 American workers are employed at FTZs in all fifty states and Puerto Rico.

NAFTZ and its members have been strong supporters of the NAFTA and believe it has been an important factor in making U.S. manufacturing more globally competitive, supporting high-value-added employment in the United States, expanding export markets for U.S. products and services, promoting efficient supply and value chains, and improving standards of living. However, we recognize that an agreement negotiated over 25 years ago needs updating to give American companies and workers new opportunities for growth and prosperity and to reflect commerce and the economy of the 21st Century. NAFTZ strongly supports NAFTA renegotiation aimed at achieving these goals and positioning the FTZ program to do much more to promote American competitiveness in the NAFTA region through specific reforms discussed below.

Among the items that should be addressed to modernize and improve the NAFTA are certain provisions that prevent U.S.-based manufacturing firms from taking full advantage of the FTZ program's intended benefits and consequently put them at a competitive disadvantage to manufacturers exporting from Mexico and Canada.

Renegotiation of NAFTA and passage of new implementation legislation provide an opportunity to update these provisions and restore the level playing field that the FTZ program and NAFTA were both originally intended to provide.

Problem Area 1: Harmful Duty-Deferral Restrictions in NAFTA and the Foreign-Trade Zones Act. These restrictions place U.S.-based FTZ manufacturers at a disadvantage to their Mexican and Canadian manufacturing counterparts by treating U.S. exports from an FTZ to Canada and Mexico initially as imports into the United States, which has the effect of discouraging U.S. manufacturing and exports.

Source of Problem: Duty deferral restrictions in Article 303 of NAFTA and the sixth proviso of 19 U.S.C. §81c(a) require that certain goods imported into a United States duty deferral program and subsequently withdrawn from the program for export to Mexico or Canada must be treated as if withdrawn from the duty deferral program for consumption in the United States. FTZs are one of several such programs, which also include duty drawback, temporary importation bonds, and manufacturing bonded warehouses.

Description of Problem: U.S. FTZ-based manufacturers exporting products to Mexico or Canada that have been "manufactured or changed in condition" in U.S. FTZs must treat those products, for U.S. Customs duty payment purposes, as if they are being consumed in the United States, when in fact they are being exported. The restriction does allow U.S. companies to reduce duties owed to U.S. Customs by the amount of any duties paid to Mexico and Canada when the products are imported into those countries. However, since NAFTA-qualified products shipped to Mexico and Canada have zero duties upon importation, U.S. FTZ manufacturers often must pay full duties to U.S. Customs on products exported to Mexico and Canada.

The original intent of this provision was to prevent so-called "platforming" of goods from countries not party to the NAFTA – a concept whereby manufacturers could potentially avoid paying full duties on non-NAFTA content by using a duty-deferral program, such as FTZs. Unfortunately, while this restriction still applies to U.S. duty-deferral program manufacturers, both Mexico and Canada have unilaterally over the years implemented extensive networks of FTAs globally and reduced their duty rates on non-NAFTA manufacturing inputs to zero in most cases, in part to render ineffectual the NAFTA duty-deferral restriction for their manufacturers. As a result, products that have been manufactured or changed in condition in Mexico and Canada by duty-deferral program manufacturers can be exported to the United States without paying Mexican or Canadian duties (and qualify for NAFTA duty-free benefits into the United States).

This situation puts U.S. FTZ manufacturers at a fundamental disadvantage, that must be redressed if we are to encourage U.S. manufacturing and exports. The NAFTA is one of only two FTAs that contain this antiquated restriction, to the detriment of U.S.-based companies. All other FTAs have no such restrictions. U.S. FTZs should be able to export products that have been manufactured or changed in condition in the United States to Mexico or Canada with unrestricted U.S. duty elimination benefits.

Recommendation: Amend Article 303 of NAFTA and eliminate the sixth proviso of 19 U.S.C. §81c(a) to remove the requirement that goods imported into a United States duty-deferral program, manufactured and subsequently withdrawn from the program for export to Mexico or Canada must be treated as if entered for consumption in the United States. The recommendation outlined would eliminate disincentives for U.S.-based manufacturers that export and put them on an equal footing with Mexican and Canadian producers. As a result, U.S. producers would enjoy a greater incentive to keep value-added production in the United States.

Problem Area 2: Restrictions on U.S. FTZs Regarding NAFTA Rules of Origin. Some FTZ-based manufacturers face unbalanced duty competition from NAFTA imports. Specifically, U.S. manufacturers are currently denied similar duty treatment on components used in U.S. FTZ-based production to that provided to producers in Mexico and Canada.

Source of Problem: The 1993 NAFTA implementing legislation includes a section on Rules of Origin [19 U.S.C. §3332(a)(2)(A)] that specifically excludes goods produced in a U.S. FTZ from qualifying for NAFTA preferential-duty treatment when entered into the United States.

As noted in the discussion above, the intent of this provision was also to address the so-called "platforming" concern. However, it is now evident that only changes to rules of origin would eliminate the introduction of imported merchandise from non-member countries. For example, where the Regional Value Content (RVC) requirement of an item is 60 percent, as is commonly found in the NAFTA, the remaining 40 percent of the value may come from *any* other country. The only way to stop so-called "platforming" would be to raise the 60 percent RVC requirement or otherwise revise the NAFTA rule of origin. Discriminating against FTZ manufacturers in the United States by precluding application of the same NAFTA rules of origin used by Mexican and Canadian producers is not a proper or effective response to the "platforming" issue.

Description of Problem: The following example illustrates how this provision places U.S. manufacturing at a disadvantage.

A U.S. FTZ-based automotive parts supplier manufactures radiators using radiator hoses produced in a non-NAFTA country imported under HTS subheading 3917.39 at 3.1 percent. Using FTZ procedures, this manufacturer can reduce the effective duty rate on the part to the 2.5 percent rate applicable to finished radiators under HTS subheading 8708.91. However, Mexico is permitted under the NAFTA to set its own duty rates and has eliminated duty on imported hoses used in products, like the radiators, subsequently exported to the United States. So, a comparable Mexican-based company can produce its radiators duty-free. Only the U.S.-based firm in the FTZ must pay duty on its components, even though it produces a radiator that would otherwise qualify for duty-free treatment under NAFTA.

This penalty for manufacturing products in the U.S. makes it more difficult for domestic firms to remain competitive with similar firms located in Mexico, even though all the vehicles with the finished radiators are sold in the United States. While such a provision might not have influenced the location of automotive parts suppliers at the outset of NAFTA, the subsequent development of the Mexican industrial base has resulted in strong competition from Mexican firms, and this prohibition in the U.S. implementing legislation adds an additional incentive to relocate manufacturing of automobile parts from the United States to Mexico.

Recommendation: The NAFTZ recommends that 19 U.S.C. §3332(a)(2)(A) be repealed and replaced with a clear directive from Congress that inverted tariffs created by the NAFTA should be addressed through the Foreign-Trade Zones program for qualifying goods manufactured in the United States. This change would not require renegotiation of any provisions in the agreement. The restriction was unilaterally imposed on U.S. manufacturers through the original implementing legislation and can be addressed in legislation to implement the terms of a renegotiated NAFTA.

Additional Recommendation:

The NAFTZ also wishes to stress the critical importance of retaining the existing NAFTA provision which confirms that U.S. FTZs, while not being within the U.S. Customs territory, are a constituent part of the NAFTA territory. <u>See</u> NAFTA Treaty Annex 201.1: Country-Specific Definitions, which defines "territory" of the United States as including at (c)(ii) "the foreign trade zones located in the United States and Puerto Rico". Also see 19 U.S.C. § 3332(p)(31).

In closing, NAFTZ looks forward to further opportunities to comment and work with the U.S. trade negotiators during the NAFTA renegotiations.

Sincerely,

Erik O. Autor

Erik Autor
President