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Section 301 Committee  
Office of the United States Trade Representative  
600 17th Street, N.W.  
Washington, DC 20508

Re: Docket Number USTR-2018-0005  
National Association of Foreign-Trade Zones (NAFTZ) Statement on Proposed  
Determination of Action Pursuant to Sec. 301: China's Acts, Policies, and Practices  
Related to Technology Transfer, Intellectual Property, and Innovation

The National Association of Foreign-Trade Zones (NAFTZ) appreciates the opportunity to submit the following statement pursuant to a request for comments published in the Federal Register on April 6, 2018 (83 Fed. Reg. 14906) on proposed action pursuant to Section 301 of the Trade Act of 1974 (19 U.S.C. §2411) regarding acts, policies, and practices of the People's Republic of China related to transfer of U.S. technology, intellectual property, and innovation.

## 1. Background

NAFTZ is the voice of the U.S. Foreign-Trade Zones (FTZ) Program and its stakeholders – communities, companies, and service providers in the United States that use and rely on the FTZ program. The program was established by Congress in 1934 to help “level the playing field” for U.S.-based companies facing competition from firms in foreign countries exporting to the United States. Since manufacturing was first allowed in FTZs in 1950, the program has been a critical tool for delivering rational tariff policy to the benefit of U.S. manufacturing. FTZ participation helps U.S.-based firms improve their global competitiveness, maintain U.S.-based activity and jobs, encourage production closer to market, and boost exports through lower effective-duty rates and special customs-entry procedures that improve cash flow and production efficiency.

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.<sup>1</sup>
- **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.

Congress provided all these FTZ benefits to bolster the global competitiveness of U.S.-based operations. FTZs account for a significant portion of total U.S. trade. In 2016, the last year for which complete data are available, exports from facilities operating under FTZ procedures totaled \$76 billion, or 5.2 percent of all U.S. goods exported. Imports into FTZs totaled \$225.3 billion, or 10.2 percent of total goods imported into the United States. Over 420,000 American workers are employed at FTZ operations in all fifty states and Puerto Rico.

## 2. General Comments

On March 22, 2018, the U.S. Trade Representative determined that certain laws, policies, and practices of the Chinese government related to U.S. intellectual-property rights, innovation, and technological development were unreasonable and discriminatory and burden or restrict U.S. commerce. In response, the Administration proposes to impose an additional 25 percent duty above the most-favored-nation (MFN) duty rates on a broad list of products from China totaling \$50 billion in value.

The NAFTAZ agrees that the long-standing problem of China’s intellectual property rights violations, forced technology transfers, and state interventions harms U.S. companies, workers, consumers. We also agree that an appropriate response is warranted to spur changes in China’s actions and improve global conditions of competition.

However, NAFTAZ shares the serious concerns voiced by many U.S. business organizations about the sweeping tariffs proposed by the Administration, which will have significant adverse consequences for U.S. manufacturers, consumers, and exporters. First, the sheer size and scope of the proposed tariffs, possible imposition of the tariffs on an additional \$100 billion worth of Chinese-origin products, and retaliatory tariffs the Chinese government could impose on U.S. exports to China, will impact every U.S. manufacturing sector, including those operating in U.S. FTZs.

More specifically, many products listed in the Annex to the April 6 Federal Register notice are not readily available from U.S. sources and are necessary to support U.S. manufacturers’ production and export activities. Those articles should not be subject to the additional tariffs because doing so will result in the transfer of U.S. production, including that conducted in U.S. FTZs, to foreign countries, thereby decreasing U.S. economic activity and employment and diluting the effectiveness of the tariffs in spurring needed changes in Chinese behavior. Comments from NAFTAZ member companies confirm that substantial new duties on inputs used

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<sup>1</sup> The sole exception to this benefit is exports of manufactured goods from a U.S. FTZ to NAFTA partner countries (Canada and Mexico), which NAFTAZ argues is an unfair restriction and should be removed.

in U.S.-based FTZ manufacturing utilizing necessary Chinese-origin materials will also: (1) undercut an important goal of the FTZ program to sustain U.S.-based manufacturing and jobs by equalizing duties on U.S.-made and foreign-made products; and (2) recreate a problem impacting competitiveness that the U.S. FTZ system is designed to eliminate – where U.S. manufacturers pay significantly more than foreign exporters in U.S. duties because duties on inputs are higher than on the final product (aka “inverted tariffs”). In short, the proposed tariffs are likely to make imported goods, including those using Chinese inputs, more competitive in the U.S. market than goods manufactured domestically, and create strong disincentives to manufacture in the United States.

NAFTZ represents a large number of internationally-competitive companies in a wide array of industries – including energy, automotive, aerospace, pharmaceuticals, and consumer electronics – to name a few. Therefore, it is not feasible to comment specifically, on a product-by-product basis, about the impact the proposed tariffs will have on individual companies manufacturing in FTZs. However, the NAFTZ notes that, as in U.S. manufacturing generally, most FTZ manufacturers rely on many countries, including China, to supply the inputs necessary for their U.S. production and many also include China as a key export market. Many of these companies are submitting individual comments regarding the impact the proposed tariffs on particular products are expected to have on their businesses and employment.

### 3. Exclusion Requests

To mitigate the problems identified in Section 2 above, the NAFTZ believes it is essential for the Sec. 301 process and other trade remedies actions to establish an effective on-going product-exclusion-request procedure, enabling companies to secure exclusions from duties for certain imported materials, including finished products manufactured in U.S. zones.

### 4. The Origin Issue for FTZ Production

A unique, but critical issue for FTZ manufacturers in the context of the proposed Sec. 301 action (and any other trade remedies proceeding) is that finished goods approved by the U.S. Foreign-Trade Zones Board (FTZB) for production in a U.S. zone must not be considered foreign origin for U.S. Customs entry purposes, and, as such, must be exempt from additional tariffs under the Sec. 301 Presidential Proclamations.

The following example from an NAFTZ member company illustrates the potential severity of this problem if it is not recognized and adequately addressed. The member company manufactures centrifugal/submersible pumps in a U.S. FTZ. These pumps are classified under 8413.70 (duty free) of the U.S. Harmonized Tariff Schedule (HTS) and are included in the list of products under the proposed Sec. 301 action.

Under the proposed action, the pump manufacturer would be required to admit Chinese-origin parts and components subject to the proposed Sec. 301 tariffs – *e.g.*, motors classified in HTS 8501.51/52 – into the zone under “privileged foreign” (PF) status, and pay the 25 percent duty on those components once the finished pump leaves the zone and is entered into U.S. commerce. Without proper clarification, the finished pump could also be subject to the additional 25 percent

duties, even though it was manufactured in an FTZ in the United States and would normally be considered a U.S.-origin product under customs law as having undergone a substantial transformation from the subject inputs.

This anomalous situation arises because, the highest-valued foreign-status component used to make the pump (*i.e.*, the motor) is Chinese origin, and, according to guidance from U.S. Customs and Border Protection (CBP) and U.S. Census,<sup>2</sup> the country of origin of the highest-valued component must report on the entry for statistical purposes only. The result is that both the country of origin and the HTS number on the FTZ entry of the finished pump will flag it as subject to the additional Sec. 301 duties, even though, under U.S. customs law, the pump originates in the United States because it undergoes a “substantial transformation” in this country.<sup>3</sup>

This problem was clarified to some extent in the revised Presidential Proclamations and CBP’s Cargo Systems Messaging Service (CSMS) notification on steel and aluminum imports subject to duties under Sec. 232 of the Trade Enhancement Act of 1962. Those documents clarified that the additional duties will not be assessed on either U.S.-origin products or goods manufactured in a U.S. FTZ “merely because” they originate in an FTZ.<sup>4</sup>

If these tariffs are to avoid serious harm to American manufacturing, any Presidential Proclamations issued in this Sec. 301 proceeding (or any other trade-remedy action) must include specific language exempting products manufactured in a U.S. FTZ from additional duties.<sup>5</sup> The NAFTAZ recommends the following language be used in Presidential Proclamations issued to date and in the future:

Merchandise approved by the Foreign-Trade Zones Board for use in production in a U.S. foreign trade zone is considered substantially transformed so that the finished item produced in the U.S. foreign-trade zone is of U.S. origin and not subject to additional tariffs under this Proclamation.

## 5. Issues Involving Privileged Foreign Status

The April 6 Federal Register notice specifically states “any merchandise subject to the increased tariffs admitted into a U.S. foreign trade zone on or after the effective date of the increased tariffs would have to be admitted as ‘privileged foreign status’ as defined in 19 C.F.R. 146.41, and would be subject upon entry for consumption to the additional duty.”

A separate concern regarding PF status is that any proclamation language on FTZs must avoid including the unprecedented language used in the Presidential Proclamations of March 22, 2018 (9711/9710) imposing the Sec. 232 tariffs on steel and aluminum imports – viz. “[a]ny steel [or aluminum] article that was admitted into a U.S. foreign trade zone under ‘privileged foreign status’ prior to 12:01 a.m. eastern daylight time on March 23, 2018 . . . will likewise be subject

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<sup>2</sup> Census Bureau Foreign-Trade Zones Guidelines – Block D, pg. 14; CBP FTZ Manual, Sec. 9.7.

<sup>3</sup> See, Customs Headquarters Ruling 216017 (July 21, 1983); CBP FTZ Manual, Sec. 8.5(a).

<sup>4</sup> See, Presidential Proclamations 9704 and 9705 (Mar. 8, 2018); CSMS #18-000315 (Apr. 30, 2018).

<sup>5</sup> Not including any inputs admitted into a zone in PF status.

upon entry for consumption to any ad valorem rates of duty related to the classification under applicable HTSUS subheadings imposed by . . . [this] proclamation.” (Emphasis added) The NAFTAZ is unaware of any past Proclamations that have contained such language imposing additional duties upon the filing of a customs entry on merchandise in an FTZ under PF status prior to the time such duties were scheduled to come into effect. Imposing this condition penalizes FTZ users for manufacturing in the United States and contravenes provisions in the Foreign-Trade Zones Act of 1934<sup>6</sup> and Customs regulations<sup>7</sup> regarding the election of PF status on merchandise in zones.

A final concern regarding PF status for subject merchandise admitted into U.S. FTZs arises from the three rounds of Proclamations issued on March 8, March 22, and April 30, 2018, on the Sec. 232 steel and aluminum tariffs. The first round was silent regarding the issue of required PF status. The second round included a PF status requirement similar to language included in the safeguards proclamations issued in January 2018 regarding solar cells and panels and large residential washing machines.<sup>8</sup> The third round added an exemption for goods admitted into an FTZ in domestic status, which includes imported goods on which duties have already been paid. These proclamations have created confusion due to inconsistent wording on the treatment of FTZ activity and merchandise and have also added a variety of new language that has not been seen in prior Proclamations.

To address these problems and provide clear guidance on the treatment of foreign-trade zone merchandise and activity, the NAFTAZ recommends the following language (in addition to that recommended in Section 4 above for U.S.-origin, FTZ-manufactured merchandise) be used in all Presidential Proclamations issued to date and in the future:

1. Articles admitted to a U.S. foreign-trade zone in Privileged Foreign (PF) status prior to the effective date of this Proclamation shall retain that status consistent with 19 C.F.R. 146.41(e) and is not subject to additional tariffs under this Proclamation.
2. Articles admitted to a U.S. foreign-trade zone in Domestic (D) status per 19 C.F.R. §146.43 is not subject to additional tariffs imposed under this Proclamation.
3. Articles admitted to a U.S. foreign-trade zone on or after 12:01 a.m. Eastern Daylight time on (applicable date) may only be admitted as “Privileged Foreign” status as defined in 19 C.F.R 146.41, and will be subject upon entry for consumption to any *ad valorem* rates of duty related to the classification under the applicable HTSUS subheading.
4. Articles required to be placed in Privileged Foreign (PF) status by the terms of this Proclamation and subsequently approved retroactively for an exemption from the additional duties imposed by this Proclamation, shall be entitled to full refunds of any additional duties that may have been collected when the articles were entered into the

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<sup>6</sup> 19 U.S.C. §81a(c).

<sup>7</sup> 19 C.F.R. §146.65(a)(1).

<sup>8</sup> See, Presidential Proclamation 7529.

customs territory of the United States and be permitted to re-establish the original foreign-trade zone status.

NAFTZ welcomes the opportunity to provide further technical assistance on these issues.

Respectfully submitted,

A handwritten signature in black ink that reads "Erik O. Autor". The signature is written in a cursive style with a large, prominent "E" and "A".

Erik Autor  
President  
National Association of Foreign-Trade Zones