

## **Rules of Origin for Products Manufactured in a U.S. Foreign-Trade Zone**

**The NAFTA Problem:** The North American Free Trade Agreement (NAFTA) Implementation Act severely hindered the ability of U.S. foreign-trade zones (FTZs) to realize the full intended benefits of the FTZ program by imposing unfair restrictions on the ability of FTZ manufacturers to use the NAFTA rules of origin to compete equally and effectively with products imported under those rules into the U.S. from Canada and Mexico.

Specifically, the 1993 NAFTA Implementation Act [19 U.S.C. §3332(a)(2)(A)] excluded goods produced in a U.S. FTZ from qualifying for NAFTA preferential treatment when entered into the commerce of the United States, thereby denying U.S. manufacturers comparable duty treatment on components used in U.S. FTZ-based production to that provided by Canada and Mexico to manufacturers in their countries.<sup>1</sup>

This unilateral U.S. restriction on American FTZs in the NAFTA implementing legislation was not required by the agreement, but it has resulted in significantly handicapping U.S.-based manufacturers vis-à-vis competing manufacturers in Canada and Mexico, discouraging the location of production in the United States, and undermining core goals of the FTZ program – to allow U.S. manufacturers to compete on equal tariff terms with imports and promote U.S. exports.

A U.S.-based FTZ manufacturer making a product for U.S. consumption that complies with the NAFTA origin rules must still pay U.S. duty on any non-NAFTA components, but a Mexican-based manufacturer making the same product with identical components from the same suppliers can, under NAFTA and the Mexican Prosec program, export the product to the United States or ship for domestic consumption in Mexico without paying Mexican or U.S. duties on non-NAFTA components.<sup>2</sup>

In an effort encourage production to move to the United States, U.S. negotiators insisted on creating stricter rules of origin for some industries in the USMCA than under NAFTA, including a new minimum-wage requirement for the automotive sector. But unless the NAFTA Implementing Act restriction on FTZs is eliminated, the cost disadvantage that restriction has imposed on U.S.-based FTZ manufacturers will continue to favor locating that production in Mexico and, even more likely, in Canada, which can easily meet any new wage requirements in the USMCA rules of origin.

**USMCA Resolution:** The USMCA Implementation Act eliminated the NAFTA Implementation Act, including the provision penalizing U.S. manufacturers compared to their Mexican and Canadian counterparts. This change encourages more FTZ manufacturing that meets those rules

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<sup>1</sup> In addition to NAFTA duty benefits, Canada's Duty-Free Manufacturing Tariff Regime offers targeted domestic-tariff exemptions, allowing duty-free entry for non-NAFTA components used to manufacture products in Canada destined for export, including to the United States. Mexico's Prosec program allows Mexican-based manufacturers to import goods at preferential tariff rates for use in developing specific products for both Mexico's domestic and export markets, including the United States.

<sup>2</sup> This means a U.S.-based FTZ manufacturer making a product (e.g., radiators) for U.S. consumption that meets the NAFTA rule of origin, must still pay U.S. duty on any non-NAFTA components (e.g., radiator hoses), whereas a Mexican-based manufacturer making the same product with identical components from the same suppliers can export that product to the United States duty free.

of origin, including the use of more U.S. content in manufacturing.

NOTE: This change does *not* impact the ability to collect Sec. 301 or other special trade-action duties on subject merchandise admitted into an FTZ in privileged-foreign (PF) status and subsequently entered into U.S. Customs territory in its original form or as a component of a finished article.

The NAFTAZ and others have long advocated for the change in the NAFTA statute that was finally accomplished with passage of the USMCA Implementation Act. We urge Congress to resist any attempt to restore the unfair treatment of U.S.-based manufacturing resulting from the now-repealed Section 3332(a)(2)(A) of the NAFTA Implementation Act.

**Illustration: Rule of Origin/Duty-Deferral Issue With & Without NAFTA FTZ Restriction**

	<b>NAFTA/USMCA Duty Treatment for Imported Inputs to Specific Products Manufactured in Mexico or Canada</b>	<b>NAFTA Duty Treatment for Imported Inputs to Specific Products Manufactured in U.S. FTZ</b>	<b>USMCA Duty Treatment for Imported Inputs to Specific Products Manufactured in U.S. FTZ (Without NAFTA Restriction)</b>
	Manufacturer in Mexico or Canada enrolled in or qualifies for <u>MX Prosec</u> program or <u>CDN Duty-Free Manufacturing Tariff Regime</u>	Manufacturer in U.S. granted unrestricted production authority to import specific inputs for production of specific finished products in U.S. FTZ	Manufacturer in U.S. granted unrestricted production authority to import specific inputs for production of specific finished products in U.S. FTZ
	Components imported into Mexico or Canada	Components imported into U.S. FTZ	Components imported into U.S. FTZ
	Manufacturer in Mexico or Canada makes finished product	Manufacturer in U.S. makes finished product in FTZ	Manufacturer in U.S. makes finished product in FTZ
	Manufacturer in Mexico or Canada ships finished product to US customer or domestic MX customer (Prosec)	Manufacturer in U.S. ships finished product to domestic U.S. customer	Manufacturer in U.S. ships finished product to domestic U.S. customer
	<u>Effective duty rate on non-NAFTA imported inputs</u> = <b>ZERO</b> irrespective of whether finished product meets NAFTA/USMCA Rule of Origin	<u>Effective duty rate on non-NAFTA imported inputs</u> = <b>NTR Duty Applicable to Finished Product</b> irrespective of whether finished product meets NAFTA Rule of Origin	<u>Effective duty rate on non-USMCA imported inputs</u> = <b>USMCA Preferential Duty Applicable to Finished Product</b> <u>only</u> when finished product meets USMCA Rule of Origin
	<u>Duty Advantage</u> lowers MX & CDN costs vs competing U.S. products: <ul style="list-style-type: none"> <li>➢ Company production <u>more likely</u> to locate in MX or CDN</li> <li>➢ MX &amp; CDN product <u>more cost competitive</u> in NAFTA markets</li> </ul>	<u>Duty Disadvantage</u> (when finished product duty > Zero) increases U.S. costs vs competing MX/CDN products: <ul style="list-style-type: none"> <li>➢ Company production <u>less likely</u> to locate in U.S.</li> <li>➢ U.S. product <u>less cost competitive</u> in NAFTA markets</li> </ul>	<u>Equalized duty treatment</u> balances U.S. costs vs competing MX/CDN products: <ul style="list-style-type: none"> <li>➢ Company production <u>more likely</u> to locate in U.S.</li> <li>➢ U.S. product <u>more cost competitive</u> in USMCA markets</li> </ul>