

Get in the Zone

Misunderstood or completely unknown, Foreign Trade Zones are a powerful tool for global trade.

By Perry A. Trunick

Despite the difficulty of comprehending the foreign trade zone program in the past, you still see tremendous growth, says Al Figuly, executive director of the Kansas City Foreign Trade Zone. "I think that speaks well for the dynamic international trade economy that's present," he continues, "because even in difficult times, we had significant growth."

Figuly's own zone has had an average annual growth rate of 20% over the last five years. Each year was not pegged at 20% growth, he admits, but when you take a low year at say 3% and combine it with years when the zone grew at 35%, the overall trend line is very strong.

Foreign trade zones may be one of the most misunderstood and under-utilized of the global logistics tools. If asked, few people would be able to tell you that Kansas City ranks first in the US on foreign trade zone space. Foreign trade zone sites in the region total over 10,000 acres, including assembly and storage areas as

well as manufacturing sub zones.

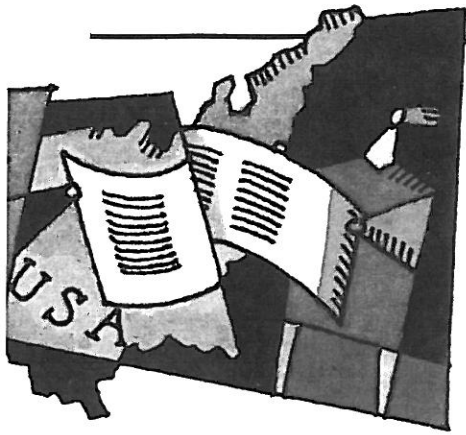
More importantly, quantifying the value of a foreign trade zone is, well, foreign to many companies. Figuly says some of his larger clients understand how a foreign trade zone (FTZ) can help facilitate just-in-time deliveries while offering financial benefits through duty deferral, duty elimination, and duty reduction. He rattles off some names, and it's interesting to note that his top-of-mind list includes only non-US global companies. Are American firms missing a bet?

The FTZ program, established by a 1934 law, is difficult to get your arms around, says Figuly. Most people are involved in their business and in terms of the regulatory requirements, there's not much transparency in the FTZ process, making it cumbersome or inaccessible to many. Smaller firms in the fast growing segment labeled as small to medium enterprises (SMEs) are even more focused on their business and less aware of their supply chain than larger businesses, suggests Figuly. When you look at the time, cost, and complexity to apply for FTZ status, they feel they have to be able to recov-

er substantial benefits in 12 to 18 months to consider undertaking the effort. There are public hearings and Federal Register notices and many other regulatory hoops to jump through, says Figuly.

Even discounting the resources necessary to pursue FTZ status, each situation is different, so explaining potential benefits isn't a simple matter of laying out a few quick examples.

Figuly points to one process manufacturer that was importing large volumes of a commodity it used in making its final product. That commodity carries a high duty to help protect a US industry. This particular company was manufacturing much of its finished product for export to Europe. Under the US regulatory scheme, the company could apply for duty drawback to reclaim the duty paid on the imported goods that were incorporated in the product that was later exported, but that involved a substantial lag between the initial cash outlay and the time the company would see any funds from duty drawback. For this SME-sized company, cash flow was very important. Moving its manufacturing process to the FTZ (or obtaining subzone status for its own plant) allowed the company to import its key component without paying a duty, complete its manufacturing process, and export those goods bound for foreign markets without paying a duty or without the need to apply for a refund. Any goods manufactured for US consumption were charged a duty when the finished goods moved out of the FTZ—and only on the amount of



goods that left the zone, not the goods that remained in storage. The bottom-line impact was significant.

In some cases, Figuly explains, components that may be subject to a duty if imported separately could be moved in bond to the FTZ and assembled into a finished product. That component, which would have been assessed a duty when imported, may then be subject to a lower duty or even no duty when assembled into a finished product.

FTZs are open to more than manufacturing processes. Warehouse operators and third party logistics companies (3PLs) have learned that they can receive goods into a zone and perform value-added steps that may change the tariff classification and lower duties for their customers. Importing goods in kit form and assembling the final product in the zone is one example of the value-added steps being performed in an FTZ, Figuly points out. Even if the tariff classification of the imported goods is not changed by the process, the duty deferral on the imported components while they are in the zone unassembled can be financially attractive. If the final products are configured to order and then delivered from the zone, the reduced waste and quick response to demand can add substantially to the value of the duty deferral.

US government literature is quick to point out that moving goods into an FTZ does not avoid quota restrictions. If a company is importing goods subject to a quota, it can receive goods into the zone and, if the quota has been reached, hold them there with no penalty until some

quota space is freed up and the goods can move into the market, or the goods can be re-exported should demand develop in another market.

There are softer benefits as well to the FTZ program. Security requirements for the zone can help a company reduce the risk of product losses and also help ease the burden of compliance with import security programs such as the Customs-Trade Partnership Against Terrorism (C-TPAT). Goods in a zone are also typically exempt from state and local taxes while they are in the zone. And, as Figuly's earlier example company learned, manufacturing in an FTZ can provide an alternative to manufacturing off shore. That company was ready to move part of its manufacturing to Europe until it learned it could make all of its product in the US and avoid duties on goods that were manufactured inside the zone and exported. Not only did the company avoid the expense of building a plant overseas, it retained jobs in the region. With demand in its

European market growing, that meant job growth that would accompany increased sales and production would occur in the Kansas City area. Those are some of the reasons economic development groups are beginning to look at FTZs as another asset for their region and they are promoting zone activity and even helping to find funding to expand the operations.

With warehouses and 3PLs operating in FTZs, the onerous task of applying for FTZ or subzone status can be avoided.

Information on foreign trade zones is available through the US Department of Commerce and from Customs and Border Protection. Determining the potential value of operating in an FTZ is a very individualized process and will require some research, but the National Association of Foreign Trade Zones (www.naftz.org) can help.

In an increasingly global economy with extended supply chains spanning the world, an FTZ may be the next big tool for many logistics operations. **LT**

Terms Related to Foreign Trade Zones

Duty exemption—no duties on or quota charges on re-exports.

Duty deferral—customs duties and federal excise tax deferred on imports.

Inverted tariff—in situations where manufacturing in a foreign trade zone results in a finished product that has a lower duty rate than the rates on foreign imports, the finished products may be entered at the duty rate that applies to its condition as it leaves the FTZ—subject to public interest considerations.

Logistical benefits—companies using FTZ procedures may have access to streamlined customs procedures such as weekly entry.

Other benefits—foreign goods and domestic goods held for export are exempt from state/local inventory taxes. Other state and local benefits unrelated to the Foreign Trade Zone Act may be available in an FTZ.

General-purpose zones—are usually located at ports or industrial parks. They must be open to multiple zone users. The most common use of general-purpose zones is warehousing and distribution activity, though manufacturing is permitted.

Subzones—are special-purpose Foreign Trade Zones. Usually located at a manufacturing plant, a subzone can be approved for use by one company for a specific activity. Applications for a subzone must demonstrate a significant public benefit in order to be approved.