# LATIN AMERICA TRADE AND TRANSPORTATION STUDY (LATTS) II

Foreign Trade Zones (FTZs) allow companies to maintain the competitiveness of their U.S. based operations vis-à-vis their international competitors, who typically pay U.S. Customs duties at lower rates. FTZs are important trading partners with Latin America. Some 62 percent of all activity occurring under FTZ status in the U.S. takes place within the Alliance Region.

## Theory and Purpose

Foreign Trade Zones (FTZs) are secure areas under U.S. Customs supervision that are generally considered outside the Customs territory upon activation. Located in or near U.S. Customs ports of entry, they are the United States version of what are known internationally as free-trade zones.

The function of a FTZ is to allow tenants (typically manufacturers or logistics companies) to perform certain activities to add value (process) to products sourced from outside the U.S. that are either destined for re-export, or for ultimate import into general commerce within the United States, and to defer/eliminate/reduce customs related fees and duties on such products. Authority for establishing these facilities is granted by the Foreign Trade Zones Board, located within the Import Administration of the U.S. Department of Commerce in Washington, D.C.

Foreign and domestic merchandise may be moved into zones for operations, not otherwise prohibited by law, including storage, exhibition, assembly, manufacturing, and processing. All zone activity is subject to public interest review. FTZ sites are subject to the laws and regulations of the United States as well as those of the states and communities in which they are located.

Under zone procedures, the usual formal Customs entry procedures and payments of duties are not required on the foreign merchandise unless and until it enters Customs territory for domestic consumption, at which point the importer generally has the choice of paying duties at the rate of either the original foreign materials or the finished product. Domestic goods moved into the zone for export may be considered exported upon admission to the zone for purposes of excise tax rebates and drawback.

FTZs are sponsored by qualified public or private corporations, which may operate the facilities themselves or contract for the operation with public or private firms. The operations are conducted on a public utility basis, with published rates. A typical general-purpose zone provides leasable storage/distribution space to users in general warehouse-type buildings with access to various modes of transportation. Many zone projects include an industrial park site with lots on which zone users can construct their own facilities. General purpose zones are speculative in nature and often used as a tool to promote economic development.

Subzones are normally private plant sites authorized by the Board and sponsored by a grantee for operations that usually cannot be accommodated within an existing general-purpose zone.

## FTZs in the Alliance Region

Research into FTZs is the Alliance Region, including analysis of data provided by the Foreign Trade Zones Board and interviews conducted with more than 30 FTZs and subzones yielded the following findings:

- There were 98 general purpose FTZs and 206 subzones located in the Alliance Region as of February 2003.
- Approximately 200,000 persons are employed at more than 1,200 firms that

operate in the Alliance Region under FTZ status.

- The combined value of shipments into Alliance Region general purpose zones and subzones totaled $148.4 billion in 2001. This represents 61.6 percent of the U.S. total for all general purpose zones and subzones.
- The level of domestic status inputs (62 percent) used by FTZ operations indicates that FTZ activity tends to involve domestic operations that combine foreign inputs with significant domestic inputs.
- Exports (shipments to foreign countries) from Alliance Region facilities operating under FTZ procedures amounted to $10.0 billion and shipments to the U.S. comprised $140.7 billion.
- Some 85 percent of zone activity took place at Alliance Region subzone facilities, which is consistent with the historical pattern in the region and for the rest of the U.S.

## Nature of Alliance Region Trade

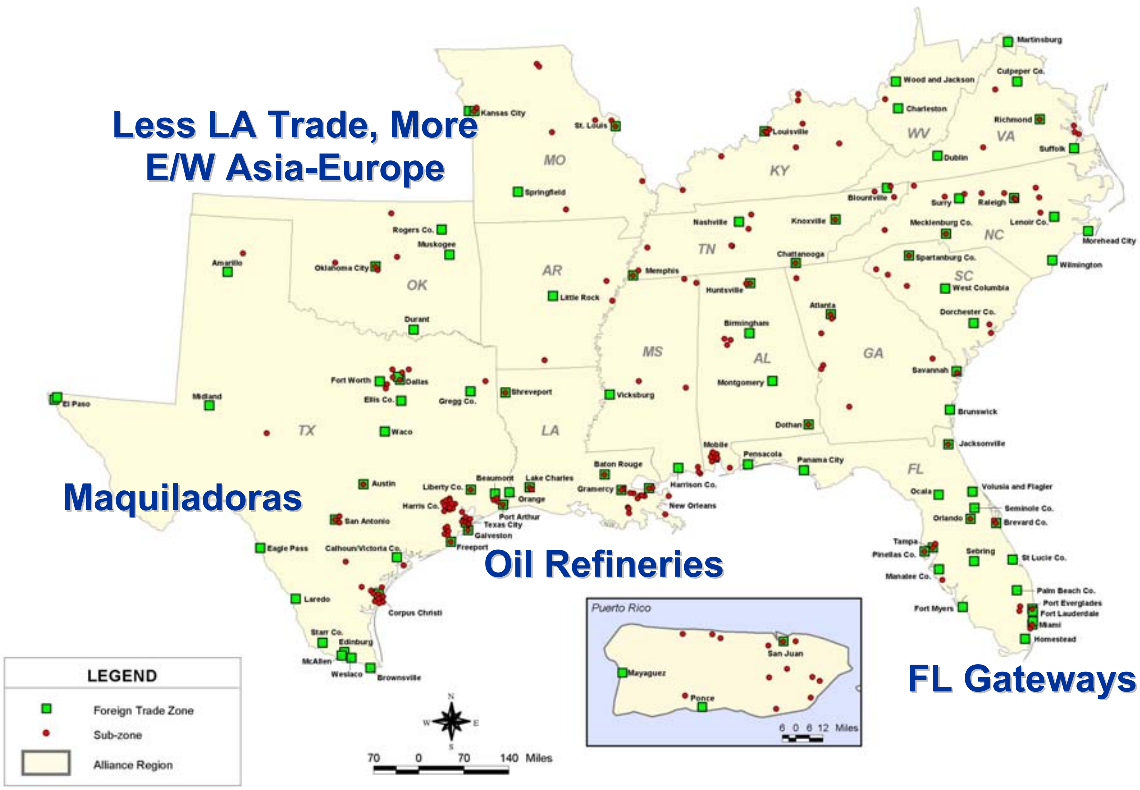
FTZs and subzones in the Gulf Coast states of Texas, Louisiana, Mississippi, Alabama, and Florida are the most active in the Alliance Region in terms of trade with Latin America. Texas and Louisiana dominate FTZ activity in the Alliance region (45 and 25 percent of trade respectively). Oil refinery subzones are the primary driver of this result, along with Texas' trade with Mexican Maquiladora industries and Louisiana's shipbuilding industry. Crude oil coming from Venezuela and the Middle East generates tens of billions of dollars in activity at oil refinery subzones in Texas and Louisiana annually – dominating FTZ trade statistics. The subzones provide value added refinement of crude oil and reap the duty reduction benefits of an FTZ. In addition, nearly all of the special heavy crude oil used for asphalt comes from Venezuela. Refined oil and asphalt products are trucked on highway system, transported by rail, or loaded onto barges which make their way up the Mississippi.

The border situated FTZs in Texas such as El Paso, Laredo, and McAllen conduct more than 90 percent of their trade with Mexican maquiladoras. The nature of this trade has shifted however since the implementation of NAFTA. Prior to NAFTA these border FTZs were often used heavily by automobile manufacturers for the importation of auto parts. Since NAFTA, trade at these FTZs has transitioned toward exports of production inputs coming from Asia, Europe and domestically and going to Mexican maquiladoras for value added production. By combining the non-NAFTA inputs with U.S. inputs, the products can be exported as a NAFTA good by an FTZ – providing a duty benefit. Finished products from Mexico are then warehoused and shipped worldwide out of these FTZs. Here weekly entry and inventory provisions provided by the FTZ program yield cost savings to users.

Florida, and in particular the Miami FTZ, conducts a significant amount of trade with Central and South America. Textile and electronic inputs from Latin America and Asia are used for value added production and then final products are shipped to Latin America and the rest of the world from FTZ plants.

As one moves north in the Alliance Region, trade at FTZs becomes much more Asia and Europe focused with less and less Latin American influence as you move north. A significant amount of the trade is in electronics and textiles, mostly from Asia, which are re-exported (in many cases with additional value added) to destinations worldwide. One interesting exception is the growth in foreign-owned FTZ automobile manufacturing plants in the Sunbelt states, for example Mercedes in Birmingham, AL, and Hyundai in Lincoln, MS. Reduced NAFTA-country parts costs and the ability to use the FTZ to reduce duty costs on Asian and European parts used in production has attracted these overseas interests to U.S. automobile production.

**Exhibit 1: Location of FTZs and Subzones – Alliance Region**




***Success Factors***

- Location along with the ability of FTZs to integrate into local economic environments are key success factors for successful operations. The most frequent barrier to success of FTZs appears to be lack of integration with local economic environments.
- Transportation access and supply chain logistics are very important. General purpose FTZs are located at or near airports and ports and therefore generally have good transportation access as a given. Many successful inland FTZs have located near key transportation trade corridors and railheads.
- Deepwater port access in Texas and Louisiana drives FTZ oil import and processing dominance. Texas and Louisiana dominate FTZ activity in the Alliance region (45 and 25 percent of trade respectively).
- Successful inland FTZs generally leveraged a particular manufacturing niche (for example specific electronics products, machinery, and pharmaceuticals) and expanded trade with Asian and European countries.
- Ability to adapt to change. NAFTA has opened up several FTZ benefits that NAFTA-zones can and do capitalize on. NAFTA has led to increased FTZ trade with Asia and Europe.
- Safety and Security. FTZs are known for being safe and secure trading areas. The Customs Trade Partnership Against Terrorism (CTPAT) has already been established for FTZs.

***Barriers***

- Some Latin American countries are countries well known for frequent changes in economic and administrative regulations. This makes the economic

climate very uncertain and risky from a foreign investor's point of view.
- Uncertain future regarding terrorism and homeland security. Security and theft in some Latin American countries can be a barrier. Transparency in the trade process is required for expansion in trade with FTZs.
- While FTZs are known being very safe, new regulations on freight security could be more and more of a barrier.
- Congestion at U.S. gateways and borders. As we move toward Free Trade of the Americas there will be increasing pressure on key ports, airports and borders.
- For many inland FTZs there is a lack of air service to Latin America making it difficult to promote trade.

***Impacts of Trade Integration of the Americas***
- The elimination of certain duties under NAFTA has reduced usage at many NAFTA-zones. However, NAFTA has opened up several FTZ benefits that NAFTA-zones can and do capitalize on.
- The FTZ program has continued to expand since the implementation of NAFTA and many FTZs have seen major increases in trade with Asia and Europe who are positioned to reap their trade benefits.
- FTZs interviewed expect that movement toward a Free Trade Area of the Americas will not aversely affect the FTZ program, just as the implementation of NAFTA did not.

## Global Free Trade Zones

There are many Global Free Trade Zones in Latin America which offer incentives to U.S. businesses including exemption from taxes and duties levied on profits or production, often no restrictions on profit transfer or capital repatriation, and customs duties often exempted for qualifying projects.
The role of free trade zones in Latin America is to provide a bureaucracy-free environment, free trade conditions (duty free machinery, equipment and materials) and stability of the "rules of the game" for investors (both local and foreign) who want to process raw materials for export. Latin American countries, especially those large ones like Brazil and Argentina, still face similar conditions. They exhibit high trade barriers and could benefit substantially from using free zones more intensively, not only for the attraction of foreign investments but for inducing domestic firms to engage in export production.

## Conclusions

**FTZs and Subzones are an important part of the supply chain.** State transportation officials should be aware of the trade importance of FTZs and subzones, their local economic role, and their transportation issues and needs.

**General purpose FTZs can be used for economic development attraction.** General purpose zones are speculative in nature and often used as a tool to promote economic development. Subzones, which account for 85 percent of FTZ activity, are normally private plant sites that usually cannot be accommodated within an existing general-purpose zone.

**Biggest success is in response to business with petroleum subzones in Texas and Louisiana showing biggest benefit.** Texas and Louisiana dominate FTZ activity in the Alliance region (45 and 25 percent of trade respectively).

**Gateway congestion a big issue – FTZs go where the demand is.** Interviews determined that it is primarily congestion on principal port and airport connectors that is the issue, and in some cases bottlenecks within the local port compound street network.

**DOTs should stay aware of how changes in trade policy and safety/security may impact FTZs.** Transparency in the trade process is required for expansion in Latin American trade with FTZs.