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FTZS may give P.R. firms an edge

Finding the equalizer

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- Alfonso Robles
U.S. Customs director. San Juan district

Local manufacturers – squeezed between the twin threats of Section 936 uncertainty and the North American Free Trade Agreement – should investigate foreign trade zones and so-called "subzones" ad mechanisms to save on customs duties in an increasingly global marketplace.

Foreign trade zone advocates and U.S. Customs officials alike touted that message Tuesday during a conference which attracted 70 executives from the pharmaceutical, packaging, shipping, freight-forwarding and banking industries, as well as the Puerto Rico's Economic Development Bank, which organized the event.

Simply put, an FTZ is a secured area located in the United States or its territories, yet considered to be outside the jurisdiction of U.S. Customs. Foreign or domestic merchandise may enter the zone without a formal Customs entry or the payment of duties or government excise taxes.

Under the 1934 Foreign Trade Zones Act, merchandise entering an FTZ may be assembled, manufactured, stored, relabeled, repackaged, salvaged, processed or destroyed, with no duty paid until the final product is imported into the United States. More importantly, the duty paid is the lower of that applicable to the product itself or its component parts. And if that product is exported, no U.S. Customs duty is levied at all.

Today, some $300 billion worth of business flows through FTZs nationwide, up from virtually zero in the 1960s, according to Marshall V. Miller, founder and general counsel for the National Association of Foreign Trade Zones.

"Every single motor-vehicle assembly operation in the United States is now done in a foreign trade zone," said Miller, estimating there are some 400 FTZs in operation and another 70 pending certification from the three-member Foreign Trade Zone Board. Together, they employ nearly 300,000 people and account for 2 percent of total U.S. commerce.

"When Congress passed the law, it was promptly forgotten about. But this changed in the 1970s," the Washington lobbyist said. "As companies became more global and parts were required to be sourced from other countries, customs duties became a bigger part of their bottom line. Even today, the board has a staff of 10 and is one of the most low-key federal agencies you'll ever find, yet FTZs are growing 100 percent a year. It's driven by private and local enterprise. There's no one in the U.S. government promoting it."

In Puerto Rico, general-purpose FTZs can be found at Puerto Nuevo, site of the 60-acre Foreign Trade Zone No. 61, and in Mayaguez, home of Guanajibo Industrial Park. The city of Ponce has also won permission to operate a foreign trade zone, following a lengthy certification process that took up much of the latter half of the 1980s.

Alfonso Robles, U.S. Customs director for the San Juan district, which includes all of Puerto Rico, says the two existing FTZs account for 3.5 percent of the island's foreign trade.

But Robles said the real interest here isn't so much in FTZs – which are usually sprawling industrial parks – but in "subzones" geared to a specific manufacturing sector. This subzone may be nothing more than one existing plant outfitted with extra security and certified as a subzone by the Foreign Trade Zone Board in Washington.

"They have to establish that the facilities are secure," Robles said. 'There can be no access to the facility because it's considered outside the U.S. Customs area, to insure there won't be smuggling or loss of merchandise. We do periodic inspections to make sure products don't enter the U.S. market."

Subzones, of which there are now

225 across the United States, are particularly useful to industries such as pharmaceuticals that import large amounts of raw materials. Duties on bulk chemicals from Germany and Switzerland, for example, may be quite high. But pharmaceutical firms that operate as subzones could import those chemicals without paying Customs duties until the final product actually leaves the premises. And the duty collected on a finished pill is usually far less than the duty on a specific chemical used to formulate that pill.

"Within three years, all the drug companies will be operating in subzones," Robles predicted. "Bristol Myers was granted subzone status one year ago. Searle's application is pending, and SmithKline Beecham is now applying. Once one or two companies in a particular industry become involved, it's not long after that others see the benefits and apply."

According to Marco Monrouzeau, finance director for Searle & Co., his company's Caguas operation will save $1.5 million a year by operating as a subzone, including more than $40,000 alone in interest equivalent by being allowed to defer the payment of Customs duties until the time of actual shipment to the U.S. mainland.

In the retailing sector, subzones are already being used to slash costs by large companies such as Wal-Mart that import millions of dollars worth of items from the Far East.

In a normal shipment of boxed girls' dolls, says Miller, "more than half of the box is air." Why not just import the dolls in huge bulk crates without packaging, and do the packaging and labeling locally, saving money and creating local jobs in the process?

With the North American Free Trade Agreement looming on the horizon, FTZs could assume even greater importance. Miller said the 1,700-page, single-spaced document – if and when it's ratified by the U.S. and Mexican governments – will have an "enormous" impact on Puerto Rico.

"Whether or not NAFTA passes, the business environment has already changed," he said, estimating that in the last five years, U.S. firms have invested more than $11.5 billion in Mexico.

"The focus of many companies today is on the Mexican economy. Apparel provisions (contained in NAFTA) will most certainly make Mexico a more attractive place," he said. "Yet low wages are only one factor. A good *maquila* operation has 30 percent employee turnover a month. If you don't have good management there, forget it."

`Nevertheless, Miller said "Puerto Rico must take strong affirmative action" to argue its case before potential investors also looking at Mexico. Adds Robles: "FTZs could be one of the tools Puerto Rico uses to retain its competitive advantage."

`There are, however, several drawbacks to FTZs and subzones. The first is the $6,500 filing fee, which generally dissuades all but the most serious companies. The second is the Foreign Trade Zone Board's tough approval process, which takes about a year and involves lots of costly paperwork.

Said Miller: "You have to convince the FTZ board that it would be in the public interest." He added that all tariffs and duties must be filed electronically, by computer, since "there are no Customs inspectors at the site like there used to be. Customs just doesn't have the manpower anymore."

Also, drug companies that want to use FTZs to export medications which haven't been approved by the U.S. Food and Drug Administration can forget about it. The U.S. Commerce Department recently ruled that FTZs could not be used to produce, store or package non-FDA-approved pharmaceuticals, even if those drugs were destined for Mexico, South America or neighboring Caribbean islands, where FDA regulations don't apply.

And FTZs "absolutely" may not produce, import or expand lottery tickets, illegal narcotics, contraband or anything else against federal law, said Robles. "If it's prohibited in the United States, it's also prohibited in an FTZ located on U.S. territory."