

Foreign Trade Zone Policy

Background: Foreign-Trade Zones (FTZ)

According to the U.S. foreign-Trade Zone Board, a foreign-trade zone is a defined physical area within the United States that, for customs purposes, is treated as if it is outside U.S. borders. FTZs are often at ports, airports, or industrial parks. Companies may use FTZs for both storage/distribution activities or, after specific approval by the U.S. FTZ Board, for manufacturing. In the U.S., FTZs may be oriented entirely or almost entirely towards trade, or may permit or encourage some degree of value-added activity. Additionally, products manufactured or value-added in a FTZ can later be sold domestically or re-exported. Finally, FTZs may be defined strictly geographically with restricted access, fences and guards, or defined instead by the firms registered under the program.

The “zone” notion is both appropriate and misleading. While there are hard boundaries to these zones, they are not necessarily confined to a contiguous space. For example, six locations spread among four cities make up the Minneapolis-St. Paul FTZ and include such sites as the airport, two industrial parks and the Minneapolis Convention Center. Importantly, the FTZ program also allows individual firms to receive special “sub-zone” designation, whereby FTZ rules apply at an existing firm location.

The 67th annual report of the Foreign-Trade Zones Board to the Congress of the United States, reported that in 2005, the combined value of shipments into general-purpose zones and subzones totaled \$410 billion, compared with \$305 billion the previous year. Of this, general-purpose FTZs received \$69 billion in merchandise, while subzones received \$341 billion worth of shipments – 83 percent of zone activity took place at subzone facilities, which is consistent with the pattern over the past 15 years. Finally, approximately 340,000 persons were employed at some 2,500 firms that operated under FTZ procedures during the year.

FTZs have exhibited strong growth and economic success throughout the world. There are currently more than 500 distinct FTZs worldwide, a number that have more than tripled in the past 30 years. In the United States alone, there are nearly 250 general purpose FTZs in addition to over 460 sub-zones in all 50 states and Puerto Rico.

Whether a general FTZ or subzone, the program has been designed to give U.S. firms a financial incentive for value-added manufacturing and processing by allowing them to source low-cost materials from outside the U.S. for incorporation into final products. This arrangement helps to level the playing field with international low-cost competitors.

Export Distribution Centre (EDC) Program

There are currently no FTZs in Canada. The closest parallel to an FTZ in this country is a combination of the Export Distribution Centre Program and the Duty Deferral Program. The Duty Deferral Program was introduced in 1996 to provide relief for re-exported goods, and deferral of duties on goods bound for the domestic market. This program helps to alleviate the impediments to trade caused by duties. However, duties are not the only impediment to trade, as the GST still has to be paid on imported goods, even if they are to be re-exported. In fact, as duties are reduced or eliminated through trade liberalization, the tax component has become more of an impediment.

The Export Distributions Centre (EDC) Program was created in 2001 to complement the existing Duty Deferral program and approximate FTZ advantages for eligible companies. The EDC Program allows for the relief of GST (or HST) on goods imported into Canada, and on inputs used to process those goods, provided that the goods are subsequently re-exported. However, the types of activities allowed under the EDC program are more restrictive than those in U.S. FTZs. For example, while activity in FTZs is unrestricted and can include all forms of manufacturing and other value-added activity, the EDC Program limits the amount of value-added activity that can occur.

Specifically, to be eligible for an EDC certificate, a company must apply to the Minister of National Revenue and meet the follow three criteria during a given year: the company will not substantially alter the property; company revenue from exports must be at least 90 percent; and the company engages in only limited amounts of value-added activity (generally speaking, the limit is 10 percent of the final value of goods). As a result, companies that engage in significant value-added activity are not eligible to use the EDC Program. As of September 2004 only 30 companies had used the EDC Program and only 12 accessed the Duty Deferral Program.

In 2005, a transportation and tourism consulting group evaluated the EDC Program to determine why it has not been more fully utilized. Their analysis has led to the following shortcomings of the EDC program in Canada:

Lack of an ‘operator’ concept:

The EDC and Duty Deferral programs are defined by the companies that are registered to use them, rather than a defined geographical area. This has been cited as an advantage of the program because it does not restrict goods and activities to certain locations, making it more convenient for the company. However, this means that every company that wants to use the EDC and related programs must apply individually and is responsible for the related paperwork and other regulations. As a result, smaller companies and occasional users may find the program time consuming and expensive to administer.

An operator concept would allow smaller users to benefit if an operator (such as an airport) was registered under the program and its certificate allowed smaller users to operate under the umbrella of the airport’s program.

Restrictions on value-added activity:

The EDC program is available only to companies that engage in limited amounts of value-added activity. This is substantially different from FTZs in the U.S.

Applicability to re-export only:

While U.S. FTZs provide advantages for both re-export and eventual entry to the domestic market, the EDC program only benefits re-export. Companies that serve the domestic market to a significant extent (10 percent of revenues or more) are not eligible for the program even for the part of their business that is based on foreign exports. Thus, companies that distribute products or perform services for the entire North American market are likely to fail this requirement.

Failure to develop the ‘single-window’ concept:

The EDC Program was intended to be a streamlined approach, so that even though the ‘EDC’ program entailed a myriad of programs behind the scenes, a single application form would be all that is required. However, the single window concept, as well as proposals to streamline the Duty Deferral and EDC programs, appears to have been sidelined and in particular have been made more complicated by the division of the Canada Customs and Revenue Agency into the Canada Revenue Agency (CRA) and Canadian Border Services Agency (CBSA). Now, any user that wants to utilize both the EDC Program and the Duty Deferral Program must apply separately to each respective department.

Complicated customs and program requirements:

Canadian customs require goods to be tracked and documented at every step, from when they are imported into the country until they enter the domestic market or are re-exported. This can involve a number of separate steps, each of which may require the use of a customs broker, which adds costs. Furthermore, any special circumstances with a shipment may require obtaining clearance directly from customs before proceeding. Complicating this even further is the fact that there are a number of different tax and duty relief programs which may apply alone or be used in combination, thus affecting the requirements and documentation needed. Although the U.S. FTZ program requires a similar level of documentation, it is bundled in a single window system common to all users.

Lack of government promotion:

Since the program has been introduced, there has been little done in terms of formal promotion or publicity by the federal government and the various departments and agencies responsible for the programs. No brochures or other promotional materials have been produced to foster awareness of the program and information is even difficult to obtain for those who are actively seeking it. This difficulty has been exacerbated by the split of the CCRA into the CRA and CBSA.

Limited awareness of the program among government trade officials:

Program promotion is further hindered by the lack of awareness of the program by government officials not directly involved in its administration. In fact, InterVISTAS contacted several trade and investment officials at overseas embassies and consulates and found that most were not aware of the program when contacted, and could therefore not be expected to promote the program to foreign firms which might be interested in its benefits.

Lack of industry awareness:

The program is of particular use to companies primarily concerned with distribution, import/export, and limited value-added activity, so it would be expected that industry organizations representing these industries would be interested in promoting the program or informing their members about the potential benefits. Research found that this is simply not the case.

Timing issues:

Canada has been comparatively late in introducing legislation allowing FTZ-like powers. It is the last of the G-8 nations to allow these powers, and was behind a number of OECD and developing nations. By the time Canada introduced EDC legislation, FTZs elsewhere had already seen impressive growth, with Canada missing out on the momentum. Furthermore, the EDC Program and related enhancements only became effective in June 2001. The terrorist attacks on September 11, 2001, caused significant setbacks for the new program. The negative economic impacts of the attacks to the transportation sector were compounded by shifts in the attention and budgetary resources of border agencies towards security, with far less attention to facilitating trade.

Overall, the Government of Canada's policies and programs with respect to Duty Deferral and Export Distribution Centers have failed to produce the intended results leaving Canada very uncompetitive in the world of value-added trade activity.

Therefore, the Edmonton Chamber of Commerce Recommends that the Government of Canada:

- Optimize the existing Duty Deferral program and structure, and immediately enact legislation to replace the EDC Program with a well published and easily accessed FTZ program equivalent to programs available in Europe and the U.S.