



# Introduction to Free Trade Agreements

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# What is an FTA?



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- A preferential trade agreement among two or more countries that, over time, reduces most tariffs to zero.
- Tariff elimination/reduction/phase out on qualifying goods.

# FTA goals

- Eliminate tariffs
- Intellectual property protection & enforcement
- Open the services markets
- Fair treatment for investors
- Telecommunications
- Labor
- Environment

# Agenda



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- Existing & Future FTAs
- FTA similarities & differences
- Brief look at Qualifying Products
- NAFTA Certificate of Origin, other documentation
- Resources

# A Free Trade Agreement is...

- A preferential trade agreement among two or more countries that, over time, reduces most tariffs to zero.
- Tariff elimination/reduction/phase out on qualifying goods.

# What is qualifying?

- Just because your product is made or assembled in the U.S. does not automatically mean that it qualifies for FTA tariff reductions.
- Rules vary in the FTAs but must prove “value added” content or work from within the FTA

## Can I still send my product if it doesn't qualify for the FTA?

- Yes, but your customer cannot claim reduced FTA tariffs
- You cannot (and should not) use the FTA Certificate of Origin
  - (if there is one – Israel, NAFTA)

# FTAs in Effect

- Israel (1985)
- NAFTA (1994)
- Jordan (2001)
- Singapore (2004)
- Chile (2004)
- Australia (2005)
- Bahrain (2006)
- Morocco (2006)
- CAFTA-DR (2005):
  - Guatemala
  - Honduras
  - Nicaragua
  - El Salvador
  - Dominican Republic
  - Costa Rica
- Oman (2006)
- Peru (2007/2009)





# Future FTAs

- Panama
- Colombia
- Korea

Others in negotiation:

Malaysia, Thailand, UAE, South African Customs Union

# 2 Types of FTAs

- Product Specific Rules of Origin
  - Some level of qualification through value-added production in the US (or FTA territory)
    - NAFTA
    - Chile
    - Singapore
    - Australia
    - CAFTA-DR

- "Substantial Transformation"
  - Israel
  - Jordan
  - Morocco
  - Bahrain
    - (does have a few specific rules of origin)

# Substantial Transformation

1. Wholly Obtained/Substantial Transformation
  - New name, character and/or use
2. 35% Domestic Content
  - Based on the value of U.S. materials
  - Based on the value of U.S. processing costs
  - Based on a combination of the two
3. Direct Transport

# HS Specific Rules of Origin



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- You must prove value-added production in the US or FTA territory.
  - How much? Specified by your rule.
  - Rules are based on Harmonized System (HS) classifications
  - 2 methods: Tariff Shift or Regional Value Content
- Just because your product is made or assembled in the U.S. does not automatically mean that it qualifies for FTA tariff reductions.
- How do we qualify a product?

# 2 Types of FTAs



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- Similarities

- Prove there is real value put into the product in the signatory territories of the FTA
- Some type of declaration of qualification or proof must be provided to the importer
- Advanced ruling procedures if you are unsure

- Differences

- HS# specific rules that can vary greatly between products
- More detailed rules about everything
- Documentation
- Implementation timetables

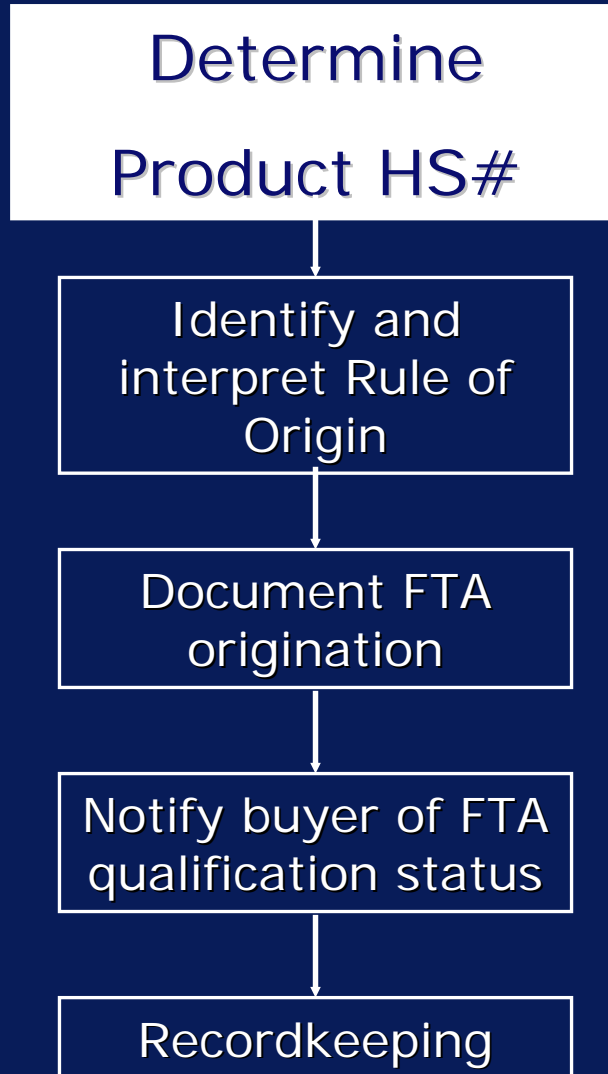
# Free Trade Agreements: Qualifying Products

# Product Specific FTAs



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# Harmonized System Numbering

- Every item is assigned an HS number. Some are more specific than others.
- Every 6-digit item is part of a series of progressively broader product categories
  - 20 - Preparations of Vegetables, Fruit, Nuts etc.
  - 2009 -- Fruit Juices
  - 2009.11 – Frozen Orange Juice



# Harmonized System Numbering

- The HTS assigns 6-digit codes for general categories. Countries which use the HTS are allowed to define commodities at a more detailed level than 6-digits, but all definitions must be within that 6-digit framework.
- US import and export codes will be 10 digits
- Exporters from the US may refer to their HS number as a "Schedule B" code – same as HS# at the 6 digit level.

# How to Read the HS#

- Chapter: 85 Electrical Machinery and Equipment and Parts...
- Heading: 8509 Electromechanical domestic appliances...
- Subheading: 8509.40
  - Food grinders, processors and mixers; fruit or vegetable...



# Where to find HS codes:

- U.S. Census Bureau Foreign Trade Division:  
chapters 1-71: 301-763-3259  
chapters 72-99: 301-763-3484
  
- "Schedule B" Search Engine:  
<http://www.census.gov/foreign-trade/schedules/b/index.html>
  - Choose "Search" to look by keyword - make sure to enter only one keyword at a time
  - Choose "Browse" if you want to check on the number you're using and choose the appropriate chapter
  - 6 Digit Alphabetical Index can also help
  
- Customs & Border Patrol (CBP) – previous classification rulings:
  - If you must have a ruling in writing, that request is made through CBP, not Census. These classifications are made public.
  - <http://rulings.customs.gov>

# Example: Guitar

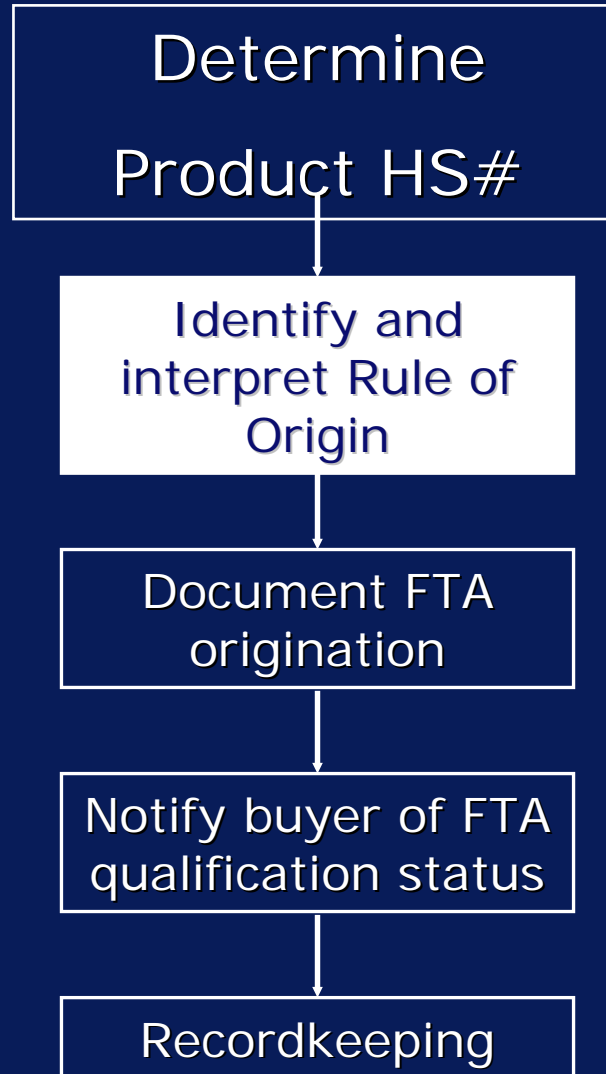


9201	Pianos, including player pianos; harpsichords and other keyboard stringed instruments:
9201100000	Upright pianos .....No.
9201200000	Grand pianos .....No.
9201900000	Other .....No.
9202	Other string musical instruments (for example, guitars, violins, harps):
920290	Other:
9202100000	Played with a bow .....No.
<b>9202903000</b>	<b>Guitars</b> ..... <b>No.</b>
9202906000	Other .....No.
9203000000	Keyboard pipe organs; harmoniums and similar keyboard instruments with free metal reeds .....No.

Guitar: Chapter = 92 Heading = 9202 Subheading = 9202.90

- “No.” refers to how the classified item is counted — No. = Number. When reporting the export of this item, you would provide the number of guitars exported. Other goods might be quantified by kilograms or square meters

# How to Proceed



# Finding the Rules of Origin



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[www.ustr.gov](http://www.ustr.gov)

[www.export.gov/fta](http://www.export.gov/fta)

General Notes USHTS

<http://www.usitc.gov/tata/hts/bychapter/index.htm>

# Goods vs. Materials

- **Material** – a good that is used in the production of another good, a part or an ingredient
  - In our example, sugar, food coloring and flavoring are materials
- **Good** – the product or item we are trying to qualify under the rules
  - In our example, lemon drops are the good
- *Some of your materials may be someone else's good or your good may be someone else's material!*
- *Replacement parts – was a material but if shipping separately, it's now a good and must be qualified on its own*

# Example of a Rule

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## Lemon Drops



The rule for hard candy (HS#170490) states:

“A change to heading 1704 from any other heading.”

*Remember: Heading = HS # first 4 digits*





# What does this rule mean?

## *Tariff Shift*

The materials must undergo a significant shift in classification as compared to the classification of the finished good

*Rule of Origin for 1704.90:*

"A change to heading 1704 from any other heading."

The materials must undergo this change from at least the heading level (4 digit classification level)



# What does this rule mean?

## *Tariff Shift*

The materials must undergo a significant shift in classification as compared to the classification of the finished good

Hard candy HS# 1704.90

- Sugar is 1701, origin = Barbados
- Food coloring comes from Ch. 32, origin = Thailand
- Flavoring comes from Ch. 33, origin = Spain

*Rule of Origin for 1704.90:*

"A change to heading 1704 from any other heading."

# Example of a Rule

## From NAFTA:

### 8509.10-8509.40

(A) A change to subheading 8509.10 through 8509.40 from any subheading outside that group, except from heading 85.01 or tariff item 8509.90.aa; or

(B) A change to subheading 8509.10 through 8509.40 from heading 85.01 or tariff item 8509.90.aa, whether or not there is also a change from any subheading outside that group, provided there is a regional value content of not less than:

- (a) 60 percent where the transaction value method is used, or
- (b) 50 percent where the net cost method is used

- This is the rule for an electric blender:
  - HS# *8509.40*

# What does this rule mean?

- (A) – tariff shift – like the Lemon Drops
  - You take widgets classified under one subheading
  - Final product is something new, classified under a different subheading
- (B) – regional value content
  - A required percentage of the good is originating

# What is Regional Value Content (RVC)?

- To benefit from an FTA, your product must have content (materials, labor, etc.), i.e. *added value*, from within the countries of the FTA)
- This value might derive from the cost of FTA region-sourced materials or, with skilled labor input in several forms.
- Encourages companies to source with other suppliers in the US or the FTA country.

# How is RVC calculated?

- Most of the time it's based on the Transaction Value (selling price) of the good
- The rule will specify what methods and what % you must meet
- NAFTA has a unique method called Net Cost which takes into account production cost
  - Otherwise you get credit for your production costs as they are reflected in the selling price in the other FTAs

# Qualification Options

- If the rule allows for both a tariff shift & RVC calculations
  - You only have to meet ONE of the 3 thresholds
  - 1. Tariff Shift is the easiest
  - 2. Transaction Value Method is the next choice
  - 3. Net Cost method is the last option

# Calculating RVC



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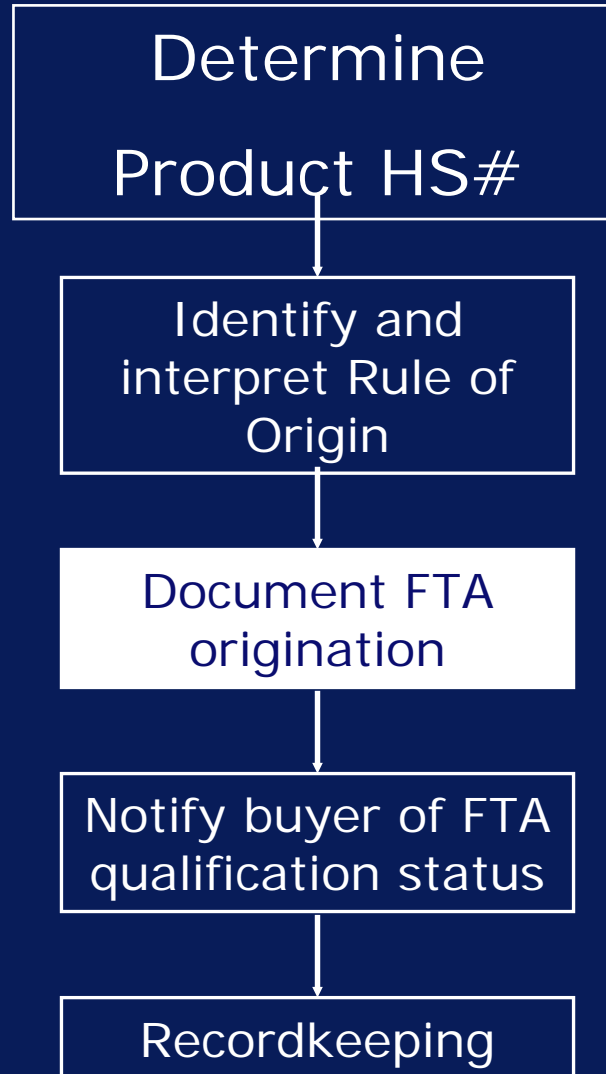
- NAFTA:
  - Transaction Value Method (TVM)
  - Net Cost Method
- Other Rules of Origin FTAs:
  - Build Up method
  - Build Down method
- What you need: costed bill of materials that includes their origin, selling price, PATIENCE!



**If you cannot confirm the origin of a component, you should assume the component originates in the U.S.**

- True
- False

# How to Proceed





# A Costed Bill of Materials

## Costed Bill of Materials

LXT 3500 household Blender HS#8509.40

<u>Components</u>	<u>Price/unit</u>	<u>HS#</u>	<u>NAFTA</u> <u>Cert. (Y or N)</u>
1) Motor	\$ 4.89	8501.20	N (imported)
2) Plastic base	\$ 1.83	Ch 39	Y (in house)
3) Glass jar	\$ 2.03	7010.90	Y
4) Blade	\$ 1.97	820830	N (imported)
5) Rubber gasket	\$ .09	4016	N
6) Power cord	\$ 3.14	8544	N
7) Switches	\$ 2.55	8536.50	Y
8) nuts, bolts & screws	\$ .61	Ch 73	N
<i>Total cost of parts:</i>	\$17.11		
Total cost of non-originating:	\$ 10.70		

# TVC/Build-down

$$RVC = \frac{TV - VNM^*}{TV} \times 100$$

TV= Transaction Value

VNM (value of non-originating material)

- Now we know the value of non-originating material= \$10.70
- For all the other materials we have done the NAFTA origination for them or we have signed NAFTA Certificates for them from our suppliers.

$$\frac{\text{TV (39)} - \text{VNM (10.70)}}{\text{TV (39)}} \times 100 = 72.56\%$$

We exceed the 60% required by our rule of origin and qualify for NAFTA!

# Regional Value Content Formulas

## Build-up Method

$$RVC = \frac{VOM}{AV} \times 100$$

RVC = Regional Value Content

AV = Adjusted Value  
(selling/transaction value)

VOM = value of originating materials  
used in production of the good

## Build-down Method/ NAFTA TVM

$$RVC = \frac{AV - VNM}{AV} \times 100$$

RVC = Regional Value content

AV = Adjusted Value (selling/transaction  
value)

VNM = Value of non-originating materials  
used in the production of the good

# Acronym Soup



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- TV = Transaction Value – selling price
- AV = Adjusted Value – selling price
- VNM = Value of Non-Originating Material
- VOM = Value of Originating Material
- NC = Net Cost
- RVC = Regional Value Content

## More FTA concepts:

Accessories & Spare Parts  
Fungible Goods & Materials  
De Minimus  
Low Value Shipments  
Documentation  
Recordkeeping



# Accessories & Spare Parts

- “Customary”, “standard” accessories & spare parts that are delivered with the goods are considered originating
  - If the good originates
  - Invoiced & delivered in the same shipment
  - If using RVC, must factor in the accessories and/or spare parts

# Fungible Goods & Materials

- fungible goods and materials are interchangeable for commercial purposes, and have essentially identical properties.
- When a producer mixes originating and non-originating fungible goods, so that physical identification of originating goods is impossible, the producer may determine origin of those goods based on any of the standard inventory accounting methods (e.g., FIFO, LIFO) specified in the Uniform Regulations.
  - These provisions apply equally to fungible materials that are used in the production of a good.

Company Y supplies clips to airplane manufacturers. Some of the clips Y supplies originate in the US and others are made in Brazil. All of the clips are of identical construction and are intermingled at Y's warehouse so that they are indistinguishable. On January 1, Company Y buys 3000 clips of US origin; on January 3 it buys 1000 clips of Brazilian origin. If Company Y elects FIFO inventory procedures, the first 3000 clips it uses to fill an order are considered US (thus originating for FTA), regardless of their actual origin.

# De Minimus Rule



- If your good doesn't meet the tariff-shift Rule of Origin, the De Minimus Rule may be applied.
- This allows for a small % of the transaction value (selling price) of the good to be of foreign-origin.
  - NAFTA = 7 %
  - CAFTA = 10%, Australia = 10%
- A total of 7% of non-originating, not 7% of each non-originating component.

# Documentation



- Certificates of Origin
  - NAFTA Certificate of Origin
  - Israel = \*green\* certificate required,
  - Chile – using NAFTA knock-off but not actually required by FTA
- For those FTAs without a specific certificate
  - In general, except for NAFTA, it's up to the importer to claim FTA preference but the seller must help them document qualification
  - Certify on company letterhead that the product(s) qualifies
    - Include the Rule of Origin
    - Describe how it qualifies under the rule – either tariff shift or regional value content
  - Also recommended to put on invoice that products qualify under the FTA

# NAFTA Certificate Preference Criteria

- These are “origin criteria” which explain the way in which your product meets the NAFTA Rules of Origin. Only goods that satisfy one of these criteria can qualify for NAFTA tariff reductions.
- In general, most manufactured goods that qualify for NAFTA satisfy the Rules of Origin pertaining to either Preference Criteria B or C.
- *This is Box 7 on the NAFTA Certificate – this is what it’s all about!*



# Preference Criteria: review

- **A** – wholly originating only
- **B** – meets a rule of origin change
- **C** – all materials are qualified individually
- **D** – unassembled/kits
- **F** – certain food products

**Most manufactured goods are going to qualify under B or C**

If using C, we may still need to investigate Rules of Origin if we have to qualify any of the materials ourselves.

## Other NAFTA notes

- Box 8 – Producer
  - Yes or NO1, NO2 or NO3
- Box 9 – Net Cost – yes or no, not \$
- Box 10 – Country of Origin – US, MX, CA – nothing else
- Box 2 Blanket Period
- Who signs the CO?
  - That is the person who gets the first phone call
  - Make sure they know what they are signing!

## How long must the U.S. exporter/producer retain the Certificate of Origin?

- 5 Years
- 7 Years
- 10 Years
- 12 Years
- Don't need to retain this document - Use the Shredder



# Recordkeeping



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- 5 years
- Includes all the documentation that establishes the values for your materials
  - Especially important if you claim under RVC

# Resources

- Export.gov – US Government’s main trade portal
  - [www.export.gov/fta](http://www.export.gov/fta)
- Trade Compliance Center [www.tcc.mac.doc.gov](http://www.tcc.mac.doc.gov)
- US Trade Representative [www.ustr.gov](http://www.ustr.gov)
- Schedule B search engine
  - [www.census.gov/foreign-trade/schedules/b/index.html](http://www.census.gov/foreign-trade/schedules/b/index.html)

# Teaching Notes



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- Most attendees are usually shipping documentation managers
- Product classification is basic but essential
- Case studies are very helpful
  - CBP.GOV: NAFTA: A Guide to Customs Procedures
- 3 hours will usually cover the basics, case studies and Q&A time
- NAFTA Webinar – can view recording
  - [http://www.export.gov/mrktresearch/webinarschedule\\_marketresearch.asp](http://www.export.gov/mrktresearch/webinarschedule_marketresearch.asp)



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**Thank you!**