Free Trade Agreements: Increase Your Bottom Line with FTA Compliance

A QAD Leadership White Paper for
Global Trade and Transportation Execution

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FREE TRADE AGREEMENTS:
INCREASE YOUR BOTTOM LINE WITH FTA COMPLIANCE

INTRODUCTION

In October 1947, twenty-three countries signed a document that changed global trade forever. The aim of this landmark agreement — the General Agreement on Tariffs and Trade — was to promote international trade by eliminating tariffs and quotas. It would be an understatement to say it was successful. GATT brought about the expansion of world trade in the 20th century and gave rise to the World Trade Organization, which came into effect in January 1995.

Modern free trade agreements can be traced back to GATT, but trade agreements have existed for centuries — although these were not always reciprocal. Throughout history, powerful states such as the Romans and the Ottomans, and later the British Empire and Soviet Union, used their might to create political and economic spheres of influence that gave them access to foreign goods and markets. Bilateral agreements have existed for centuries as well, but the idea of multifaceted, multinational trade agreements dates from the 18th and 19th centuries, promoted and advocated by theorists and economists such as Adam Smith and David Ricardo.

Free trade may have come under attack in recent times – and indeed people have been debating the value of free trade for as long as free trade agreements have existed – but free trade is the cornerstone of the contemporary global economy. Since GATT, hundreds of trade agreements have been made. Since GATT, hundreds of trade agreements have been made covering every region of the world.

It is easy to define what a free trade agreement is: A free trade agreement (FTA) is an arrangement between two or more countries under which they agree to reduce/eliminate tariffs and non-tariff barriers on substantial trade in goods among themselves.

FTAs are also known as:

- PTA - Preferential Trade Agreement
- RTA - Regional Trade Agreement
- EPA - Economic Partnership Agreement
- CEPA - Comprehensive Economic Partnership Agreement
- CECA - Comprehensive Economic Coop. Agreement
- Custom Union / Common Market / Economic Market

FTAs are negotiated by governments, but they are put into practice by companies. Participation is voluntary. Any manufacturer, importer or global shipper who leverages a free trade agreement when their goods qualify for preferential duties – that is no tariffs – have a distinct competitive advantage as they can supply goods at a reduced rate and with no tariffs to be paid. Despite this, many companies do not take advantage of FTAs because compliance with all the regulations governing these agreements is complex and time-consuming. There are also stiff penalties for companies who break the rules.

In this white paper we will discuss FTA compliance and how companies can simplify this process with software solutions.

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HOW DO FREE TRADE AGREEMENTS WORK?

Government bodies issue what is called "Rules of Origin" that dictate the metrics on how to qualify a good under a particular FTA. These rules typically involve tariff shift requirements, a calculation formula for Regional Value Content (RVC) as well as a de minimis provision. This can be further defined as follows:

- Tariff shift is where non-originating material inputs have been sufficiently changed through manufacturing into a new finished good
- Regional Value Content is where the rule requires a certain amount of materials from the signatory countries of the agreement
- De minimis is a threshold where the non-originating non-shifting materials are so small that they are removed from the equation

If the finished good successfully qualifies for the FTA of interest then the good has preferential treatment status. It can be sold to your customers with reduced or no duty to pay.

FTA CHALLENGES

Those involved with global supply chain management will tell you that keeping up with FTA compliance regulations is a complex challenge regardless of industry. As companies expand into new areas, these challenges multiply. Without a Global Trade Management system in place there is significant risk, time and cost spent on:

- Soliciting and managing sourced materials from suppliers
- Obtaining up to date rules of origin
- Calculating regional value content
- Performing tariff shifts
- Checking de minimis thresholds
- Preparing certificates of origin and declarations for customers
- Abiding by data retention requirements

These are just some of the tasks that must be done every time you perform a FTA origin determination. Done manually or with poor processes can result in incorrect FTA qualification status. Plus, if you do not have readily available Certificates of Origin, you can receive severe penalties and fines.

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FTA SOLUTION DEFICIENCIES

The good news is that today, there are FTA solutions available to comply with customs compliance rules and regulations. The bad news is that these solutions sometimes:

- Don't offer all of the needed free trade agreements
- Don't cover all the HTS headings needed
- Are not fully integrated to allow the free flow of Cost, BoM, HTS#
- Are inaccurate and therefore cannot provide a detailed origin audit trail
- Cannot respond to a government audit
- Use out of date rules of origin content

MISSED OPPORTUNITIES

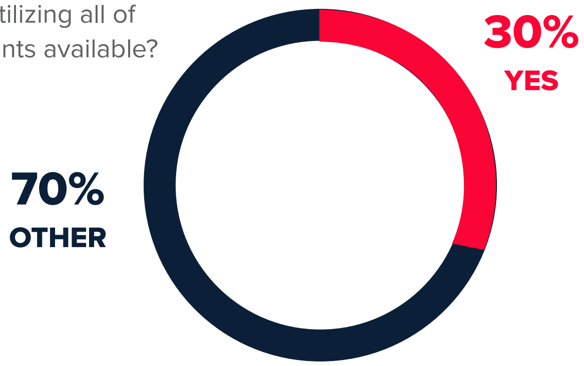
According to an industry survey, organizations around the world miss out on 70% of the FTAs available to them.

WHO BENEFITS FROM FREE TRADE AGREEMENTS?

Other than statistical data confirming that trade supports economic growth and development, and helps reduce poverty around the world, those

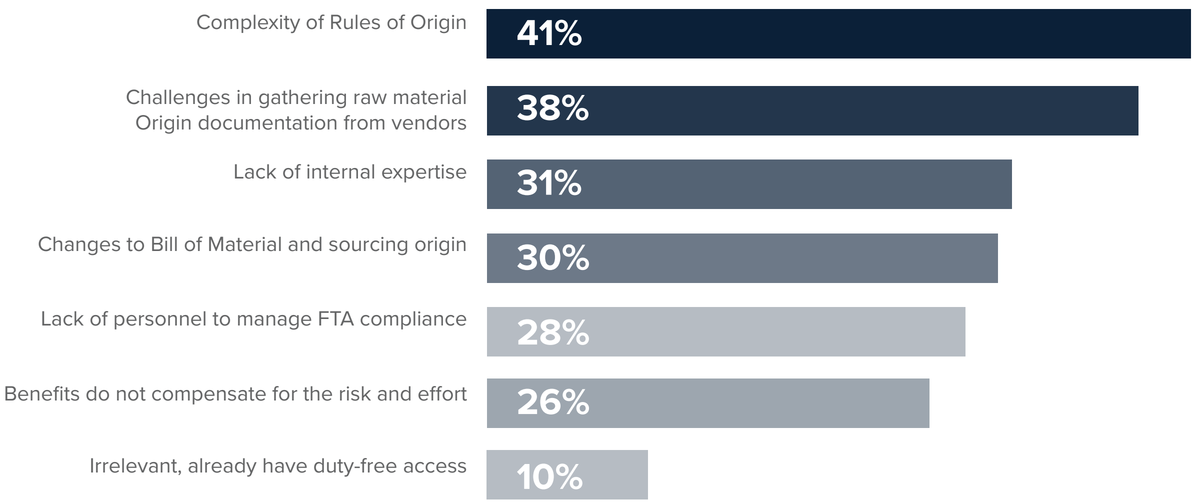
FTA UTILIZATION

Is your company fully utilizing all of the free trade agreements available?



FTA CHALLENGES

What are the biggest challenges in using FTAs for import or export?



who directly benefit from FTAs are manufacturers and their customers. Manufacturers can sell their goods at a reduced price as long as they have the documentation to prove it. When goods qualify for preferential treatment, the duties normally paid by the customer are reduced or eliminated. Manufacturers leverage FTAs for the competitive advantage to maximize the profit through cost reduction while reducing the risk by using integrated automated FTA solutions.

When GATT came into effect in 1948 it impacted one fifth of the world's trade and eventually resulted in 128 countries taking part. The number of trade agreements increases every year. As of February 2021, there are 549 trade agreements in force.

BEST IN CLASS FTA SOLUTIONS

Best in class FTA solutions allow companies to attain a competitive advantage by maximizing profit from cost reduction through reduced customs duties while minimizing risk through automated rules based software. This includes:

- Solicitation for inbound Certificates of Origin
- Tariff shift (both intermediate and base shift)
- RVC calculations
- De minimis checks
- Rule portion determination
- Allows for country specific HTS numbers
- Currency conversion
- Real-time origin determination under a FTA
- Origin audit trail
- Preparation of Certificates of Origin
- Electronic archive of documents for retention requirements

BEST PRACTICE COMPANIES

To achieve trade compliance excellence, best practice companies:

- Realize improvements in automating import/export compliance and documentation processes
- Maximize free trade agreement program benefits
- Automate Certificate of Origin management with suppliers
- Create paperless workflows with brokers to lower document costs and increase classification consistency

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THE BOTTOM LINE

A recent study by EY identifies FTA as the quickest payback (6 month average) and greatest ROI (500% average after 3 years) from an overall GTM project scope that includes in addition to FTA: Admissibility, Exports, HTS, Imports, Landed Cost, Post Entry Review, Reconciliation and Screening.

DID YOU KNOW?

FTA rules of origin must be updated as legislation changes to stay in compliance. Legislation can change multiple times within the same year.

Purchasing materials from local vendors does not imply the good originates nor can it assume the country of origin.

Just because most of the materials in your manufactured finished good qualified under the Free Trade Agreement does not imply the good also qualifies

FTA origin status is not static. It should be reassessed, depending on the agreement, every calendar year or when changes to cost, bill of materials or suppliers occur.

Document retention requirements regarding certificates of origin are not specific to the Free Trade Agreement but to the country. You can have 5 years for one country, 7 years for another and 10 years for the third.

When sourcing materials used in your manufacturing process do not assume that if the country of origin is one matching a signatory country of the free trade agreement then you are sourcing an FTA originating material. It is common for sourced materials to not originate under a free trade agreement even though their country of origin is a signatory country. The only way to make sure that you are sourcing an FTA originating material is to obtain the certificate of origin or declaration statement for the said FTA and material from your supplier.

Supplier source information such as material HTS# and material FTA origin status should be vetted before using it in your origin determination process. Inaccurate source information is no excuse when faced with an audit.

When manufacturing finished goods, FTA origin status can be determined using rules of origin. The country of origin however should never be part of the FTA determination. It is the country of last substantial transformation of the good and should be known by the manufacturer.

ABOUT QAD - TRUSTED GLOBAL TRADE AND TRANSPORTATION EXECUTION (GTTE)

QAD GTTE provides industry-leading global trade compliance, and multi carrier transportation execution solutions from a single, integrated platform. An ISO-certified company, QAD assists companies to streamline their import, export and transportation operations, optimize deliveries, and increase logistics ROI. QAD GTTE is a scalable and extensible solution that integrates with existing ERP and WMS solutions. Industry leaders in every region of the world rely on QAD to leverage thousands of carrier services and manage millions of global trade and shipping transactions every day.

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