

[Free Trade Agreements](#)

Chemical buyers can reduce importing costs

Astutely sourcing and choosing the right locales overseas for production can trim costly tariff charges.

By Gordon Graff
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Strategic sourcing at chemical and pharmaceutical companies usually involves managing suppliers and logistics in a systematic way. But managing customs duties for imported raw materials has seldom been a big part of the strategic sourcing equation.

However, with the recent proliferation of free trade agreements and foreign trade zones—which have provided new ways for importers to save money and expedite the flow of goods in their supply chains—things are changing. As a result, some accounting and software companies are now offering their advice and services to enable importers to squeeze maximum benefits out of these international agreements.

"The customs function is central to global strategic planning initiatives," says Christine M. Berghofer, a manager in the customs and international trade practice group of accountants Ernst & Young. Effective customs planning, she notes, should minimize risks of interruption in the supply chain and "facilitate the rapid and cost-effective movement of a company's materials and finished products."

One of the best ways strategic customs planners can meet these goals is to leverage some of the new and existing free trade agreements (FTAs). These agreements reduce or eliminate import duties for goods that cross the borders of participating countries. The U.S. has a GSP (Global System of Preferences) program which allows duty-free entry of goods from specific developing countries.

The benefits of FTAs "do not come automatically," Berghofer cautions. "To qualify for any duty-preferential rate," she says, "there are specific rules of origin you have to comply with, and you have to have a certain value-added to the goods." Factors important to FTA qualification, she explains, are the location of production, where a component or ingredient is sourced, production processes and costs, and destination markets.

For example, says Berghofer, a U.S. company might source the raw materials for a particular product in the U.S., Japan, Germany and China; produce the product at facilities in Mexico, Colombia and Venezuela; and distribute the product in Ecuador, Costa Rica and Chile. To leverage FTAs to best advantage in such a case, she advises strategic sourcing managers to ask the following questions:

- How much duty is paid in each production and distribution country?
- How does the origin of the raw materials affect their FTA qualification in each production country?
- Will the finished products qualify for an FTA in each destination country?
- What processing will occur, and will it be enough to qualify the product in the distribution countries under FTA rules?

Once the potential savings areas are identified, says Berghofer, "you may want to ask yourself how you could change your sourcing or production policies to qualify" for certain FTAs. "Then," she adds, "you should develop purchasing procedures to build these factors into your sourcing decisions."

Benefits of switching

Shifting venues for sourcing or production can pay off handsomely. For example, duties for pharmaceutical imports into Latin American countries can range as high as 15%. But companies willing to change their purchasing and processing locales can reduce or eliminate these levies by taking advantage of one of the many bilateral FTAs

between Latin American nations, such as a pact between Mexico and Chile. Similarly, she adds, importers of pharmaceuticals into some Asian countries can be liable for duties up to 25%. But the ASEAN (Association of Southeast Asian Nations) Free Trade Agreement (AFTA) has reduced tariffs among its Southeast Asian members by up to 5% and will eliminate duties entirely by 2010. Moreover, China will join AFTA in 2010, and there is also talk of Australia, Japan and India joining the group. Therefore, Berghofer suggests that any company selling into the Asia-Pacific market might want to consider moving new or existing production units into present or future AFTA member countries.

Foreign Trade Zones (FTZs) are another tool chemical and pharmaceutical manufacturers can utilize to save money in procurement and production. Although physically inside a country, such zones are outside the country's customs territory. Companies operating in an FTZ can achieve a number of "significant benefits," says Berghofer. Among them:

- Increased cash flow. Duty payments in a U.S. FTZ can be deferred until goods leave the zone for a domestic destination.
- Elimination of duties in some cases. Items brought into a FTZ and exported from it are exempt from duty. Manufacturers who make products in a U.S. FTZ intended for a domestic destination may pay either the duty on the value of the imported raw materials or the duty for the finished materials, whichever rate is lower.
- Increased supply chain efficiency. Special rules allow supplies to be delivered directly to the FTZ with no customs inspection, or with expedited clearance. No matter how many deliveries are made over a week, only one weekly customs declaration needs to be filed for items leaving the FTZ.

FTZs "have become a hot issue for pharmaceutical companies," says Berghofer. The reason: Previous agreements between the U.S. and 16 of its trading partners to eliminate duties reciprocally on thousands of pharmaceutical products and chemical intermediates have not recently been updated due to stalled negotiations. As a result, many new active pharmaceutical ingredients (APIs) traded between the U.S. and the European Union remain subject to duties as high as 6.5%. The use of FTZs is one way to bypass such levies, Berghofer notes. This is possible, she says, because drug makers who use a U.S. FTZ to process imported APIs into finished products for sale in the U.S. do not have to pay duties on the ingredients that enter the zone and are not required, under existing laws, to pay duties on the finished products that leave the zone.

In order to use FTAs and FTZs in strategic sourcing it is necessary to constantly keep abreast of changes in the laws, calculate and recalculate costs and create the required documentation. In the past few years, some companies have begun marketing automated data management services that accomplish these tasks. One such firm is QuestaWeb, based in Westfield, N.J. Leon Turetsky, the company's CEO, says he sells his global trade and logistics management system to both strategic planners at large companies and to outside customs brokers that large companies often hire. Basically the system is an elaborate accounting module that can be continuously updated as rules and regulations change. (Another company, Vastera, of Dulles, Va., also offers trade management services and software.)

The QuestaWeb system can calculate the landed cost of imported goods, which includes the purchase price plus freight, duties and other charges. Another task it handles automatically is reconciliation. This is normally a labor-intensive calculation process. It is done by importers who are not sure of the NAFTA status of the goods they have brought into the country and have to pay fixed upfront duties on the goods to avoid delays. Later, the importers are required to file calculations to customs officials reconciling the difference between what they paid upfront and any refunds or additional duties that may be due. Product classifications, countries of origin, and specific FTA provisions must be cited in the calculations, which can be very complex. Generating and managing the reams of paperwork required for FTA qualification is another function of the QuestaWeb system.

Homeland security

Turetsky says users of his software get frequent updates of the latest regulations that affect international trade, including the ever-growing body of rules issued by the Dept. of Homeland Security. In fact, there are signs that homeland security issues—and the delays they can cause—are beginning to match tariffs as an object of concern for chemical importers. "The real danger to your supply chain these days isn't tariffs," says Rita Mihalek, logistics manager at Schott North America, an Elmsford, N.Y.-based maker of specialty glass and fiber-optic materials. "It's that your containers are stuck down at the terminal in New York [harbor] waiting for inspection" by radiation detection instruments.

Mihalek, who previously handled tariff issues for Ciba Specialty Chemicals, asserts that ways must be found to keep the country safe without forcing importers to incur costly holdups of their deliveries at seaports.

One solution, she says, would be a change in the law to allow importers of goods destined for the U.S. to file U.S. customs documents at selected overseas ports. She believes that it is "only a matter of time" before this practice, which is now forbidden, will be allowed.

In the meantime, U.S. terminals are congested with cargo ships waiting for security inspections. As a result, says Mihalek, "companies are looking for qualified people to manage security issues." While such individuals might not be able to circumvent inspections, she says, they could at least arrange for deliveries at ports with the fewest delays. In the end, she adds, that would contribute as much to the bottom line as any free-trade agreement.

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