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The USMCA Inflection Point: Plotting a Course for Free Trade Agreement Management - Which Way Will You Go?

BY GEORGE ZAHARATOS, ELIZABETH SHINGLER, AND ANDREW DOORNAERT

As the U.S. grapples with an international public health crisis and an overall economic slow-down, importers acutely feel the impact of supply chain disruptions, rising production costs, and wide- ranging tariffs. With this backdrop, the U.S.-Mexico-Canada Agreement (USMCA) entered into force on July 1, 2020. Replacing the North American Free Trade Agreement (NAFTA), the USMCA will require trade professionals to understand and apply detailed new rules and requirements, with possibly reduced resources, during a time when potential savings are paramount for economic recovery.

Nonetheless, where there's disruption and pressure, there may also be opportunity. USMCA's implementation in this challenging time highlights the need to reimagine how companies manage free trade programs. Importers are clearly at an inflection point—they can either continue to manage their trade programs as they have for NAFTA, or adopt new tools that will allow them to be creative problem solvers.

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Trade in Today's Environment

International trade in today's environment is not the same as it was 10, or even five, years ago. Business and regulatory changes have compelled trade professionals to adapt to a new environment in unexpected ways, whether it is managing the added risk from an increasing number of suppliers, or mitigating the impacts of trade-remedy tariffs, which are much higher than the normal trade relations duty rate. USMCA is only the latest entry on a growing list of complexities for importers that adds both potential opportunity and risk in global trade today.

USMCA was rolled-out during a period of economic flux—in June 2020, when U.S. unemployment was at 11.1% following the wide-spread economic shutdown. At the same time, trade costs were only increasing. In 2019 alone, duty collections by U.S. Customs and Border Protection (CBP) increased by 73% over the prior fiscal year (the CBP Trade and Travel Report for Fiscal Year 2019), meaning reduced profit margins for many companies. As a result, trade budgets and staffing were reduced in response to economic pressure, leaving small teams to manage historic changes in trade regulations. But even while grappling with these disruptions, USMCA implementation was not sidelined—NAFTA, its predecessor, was too big.

In 2018, the National Association of Manufacturers reported that of the $679 billion of manufactured goods exported from the U.S. to free trade agreement partners, NAFTA accounted for $500 billion. In 2019, Mexico was the U.S.'s top trading partner with $614 bil-

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lion in total trade, only slightly ahead of Canada, at $612 billion. China was in third place with $558 billion as reported by the Congressional Research Service. Further, the International Trade Commission has predicted that USMCA will create 176,000 new jobs and increase exports to Mexico by 6.7% and Canada by 4.8%. In the current economic climate, maximizing USMCA claims will be critical to duty management. However, like any trade program, compliance requirements must be met to claim the benefits. To compete and capitalize on this potential opportunity, importers need to be well-informed and thoughtful in identifying steps that can help reduce the compliance burden that comes with the benefits.

USMCA's Learning Curve

Although USMCA has only been in force a short time, we have noticed a few significant trends that can impact even the most sophisticated FTA program.

Not Enhancing USMCA Opportunities

As trade professionals know, replacing NAFTA with USMCA meant modifications to the existing rules of origin that will determine if a product qualifies for duty-free treatment. For many importers the transition caused concern about whether they would lose duty-saving benefits. Importers quickly began looking at their existing top imports by value to understand if they will qualify. However, as supply chains are shifting faster than ever, validating potential new opportunities to apply FTAs is as critical as determining whether existing product claims can continue.

This is particularly true for industries where USMCA simplified or expanded the opportunities for duty-free treatment, such as computer and electronic product manufacturing, which ranks as the seventh largest U.S. manufacturing industry, according to the publication *U.S.-Mexico-Canada Trade Agreement: Likely Impact on the U.S. Economy and on Specific Industry Sectors.* Electronics is a highly integrated industry with Mexico as a major manufacturing hub for these products. In fact, Mexico is one of the global leaders in production of flat-screen televisions and computers, most of which are exported to the U.S. By recognizing the deep integration of these supply chains, USMCA negotiators generally eased the qualification by reducing regional value content (RVC) requirements, converting tariff shift requirements, and making tariff shift rules easier to meet.

Another challenge is USMCA's mid-year implementation. This timing means that importers must assess how this will impact their current sourcing plans. Doing so requires developing a USMCA plan with clear goals, then assessing each project, and its components, in light of those goals. Not doing so increases the potential of proceeding with projects that may no longer be beneficial or could leave money on the table. While USMCA allows preferential duty treatment to be applied retroactively, it does not allow importers to reclaim the merchandise processing fee for post-entry claims. While on a per-entry basis the maximum payment is only $528, over time managing USMCA claims proactively at the time of entry can result in substantial savings. While this may be a legislative oversight that will be addressed in the future, developing a plan to analyze USMCA's entire potential impact on your company and then prioritizing next steps can result in a more complete duty-savings picture.

Developing an Efficient Approach to FTA Management

Many trade professionals with NAFTA experience have developed a solicitation and qualification process that meets their needs but can require significant attention and outside resources. In this new USMCA environment, however, what worked previously may now be a bottleneck. Even where the rules of origin were simplified, trade managers are finding that their teams are moving more slowly through the qualification process because they must build a knowledge repository. In one case, even though a company was using FTA-specific automation for the majority of their FTA qualifications, the remaining qualifications required manual data and document collection, necessitating more full time employee (FTE) hours. What evolved over time as a process with exceptions and work-arounds to manage NAFTA, is now a learning curve leading to delays and less time devoted to other activities—like modeling product qualification.

Companies are also seeking a more efficient way to manage their certificate of origins and other supporting documentation needed to reduce their compliance risks. Unlike NAFTA, there is no longer a prescribed form that must be completed. Although CBP has issued a template that may be used, suppliers are using their own forms that include the required USMCA data elements but create a challenge to their customers who are trying to receive UMSCA data in a uniform format. This is slowing the customer's ability to determine if their own products qualify for USMCA. Even with CBP's six-month period of flexibility, informal discussions with importers indicate there is still confusion about how to efficiently handle this process in the future.

Certain importers may lack confidence that suppliers have properly vetted the new rules of origin and will provide accurate information supporting USMCA qualification. As such, there is concern about bad information in, bad information out. To mitigate this, companies are dedicating more time educating their suppliers about how to apply the new UMSCA rules of origin. Additionally, while the U.S. applied a period of flexibility, Mexico did not. The divergence in how the U.S. and Mexico are applying various aspects of the USMCA requires companies to develop different standards based on the inbound country. Similarly, unforeseen challenges are arising, such as the exact language that must be included on certificates of origin. Some customs brokers in Mexico are stating that long-standing practices, like saying "various" for importers is no longer acceptable. This, among other uncertainties, forces the need for the trade group to investigate how each inbound country applies the new USMCA rules and develop processes to prevent delays that can disrupt production or damage customer relations.

In this environment where USMCA is not the only, or even biggest concern for many trade professionals, implementing a cohesive, streamlined process may be sidelined in light of other pressing concerns.

Understanding USMCA's New Requirements

With only a short time to assess the new requirements, trade professionals across industries are, in some cases, struggling to understand and apply USMCA's rules in a real-world context. One of these challenges is adjusting to the removal of the NAFTA preference override. Unlike NAFTA, a qualifying USMCA import may potentially have a country-of-

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origin marking that may not be U.S., Mexico, or Canada. Imported goods under NAFTA had to both (1) qualify under the NAFTA rules of origin, and (2) meet the NAFTA marking rules to be considered as originating in a NAFTA country. Where the marking rules were more stringent than the rules of origin, importers could claim the ''NAFTA preference override'' to allow a NAFTA country-of-origin marking. However, the USMCA's *Implementing Instructions* stipulate that under the USMCA, an import does not need to be marked as originating in Canada or Mexico to receive preferential treatment. While this change brings USMCA in line with modern FTAs, it can be confusing and a new process should be implemented to manage the requirements.

The USMCA rules to qualify vehicles and parts have been revised and broken out into a number of different categories. A new requirement requires certain vehicle assemblers to collect labor wage information from suppliers which has raised questions. For examples, certain workers are included in this formula while others are not. While ''high-wage transportation or related costs for shipping''—including ''drivers and loaders performing the transportation, logistics, or material handling of a part or component''—can be included in meeting labor requirements (according to the Federal Register Notice from the Department of Labor titled *High-Wage Components of the Labor Value Content Requirements Under the United States-Mexico-Canada Agreement Implementation Act)*, importers are finding that in practice it is not clear cut.

Understanding the new rules and implementing new procedures can result in real-time product slowdowns that impact bottom lines. Working through these challenges requires time—which may be in short-supply in many trade groups.

Choosing Your Trade Path

While this is not the first FTA that trade professionals have implemented for their companies, USMCA's complexity is unique. USMCA's sweeping implications come during a period of significant global pressure on supply chains and the global economy as a whole. Historically, the solution to many of these issues would be to dig into the agreement, learn its nuances, build upon an existing compliance program (i.e., NAFTA), train staff, and adjust their automation.

In the current environment, this approach may actually work against certain companies by preventing the trade team from maximizing its strategic value. Trade professionals are now viewed as business partners with important skills—they can add value beyond the tactical and technical steps required for FTA compliance. Trade professionals have the expertise to anticipate the agility needed in today's supply chains including proactive FTA management and modeling. To maximize value for a company, trade professionals should consider a new FTA path that frees them from FTA management day-to-day needs. To enable success, this path should include, among other things, three guideposts: (1) technical knowledge and ability; (2) technology and automation; and (3) an efficient delivery model.

Investing in deep internal USMCA specialization assumes that a company can dedicate financial and personnel resources to a single issue. However, many trade compliance departments may be thinly staffed and under pressure to react quickly with 100% accuracy. Further, the fast pace of many multinationals means that the trade compliance function's role is expansive. Trade professionals may manage import and export compliance across a number of countries with different or competing regulations. We find that certain companies today increasingly leverage a variety of duty-savings measures with each playing a different role. Doing so can enhance potential duty savings and duty-elimination opportunities, but requires trade professionals to pivot between the various requirements, while addressing shipments that may be held by customs authorities.

Implementing automation to manage FTAs can be part of the answer. Technology generally reduces headcount while enhancing compliance, and for certain companies it can be a powerful tool to springboard them into a more mature trade compliance position. Yet there appears to be, in certain instances, an increasing reluctance to take on full-scale automation solutions. It can be difficult to justify large expenditures for resource-intensive projects during this period of economic uncertainty. Many importers are currently in a situation where they realize automating FTA management may be one of the only solutions to bring greater efficiencies but understand that this is a sensitive time to request budget for significant investments. Yet, automation allows CFOs, as well as supply chain and global purchasing leaders to model USMCA qualifications across multiple sourcing options to mitigate the potential impact of tariffs.

If using the old NAFTA process to manage USMCA is not the right answer, how should trade professionals proceed? One way may be through virtually supported managed services. As this industry has learned, it is no longer essential to have staff working together in an office. Virtual managed services (VMS) can achieve the overarching goals of USMCA specialization through day-to-day support and bring much needed automation as an embedded feature.

Virtual managed services combines the leading aspects of a trade compliance program—human knowledge with automated efficiency—to help capture operational and savings benefits. Using this model, dedicated off-site personnel help collect data and documentation to qualify imports for duty-free treatment under USMCA. This team drives the labor-intensive back-office functions that can bog staff down, including solicitation, qualification, and validation.

When integrating VMS into your trade compliance function, the following are some steps that can help accelerate a successful transition:

- Develop documented processes tailored to your company that help manage compliance risk and simultaneously enhance duty-savings;
- Strengthen communication and integration with your trade compliance function through regular updates, identification of continuous improvement areas and process enhancements, and compliance dashboards to monitor progress; and
- Develop a strong data-driven foundation to set-up an efficient and sustainable automation process.

When challenges arise it is typically because one of these three areas need development. Conducting an assessment of your processes, data, and communication plan in conjunction with the VMS team can help preempt these issues. Often, this can be conducted as part

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of a ''phase zero'' during which gaps are identified and mitigations are developed.

In essence, virtually supported managed services can help you expand the trade compliance function in an economically sound way. It also enables trade professionals to enjoy the benefits of automation without making the internal investment in implementing a system. In freeing internal resources through a virtual managed-services approach, trade professionals can reassess priorities as they are no longer responsible for meeting the heavy demands of an FTA program.

Who Can Help?

Identifying the right third party to work with can be key to a successful VMS implementation. The provider should be knowledgeable about USMCA and apply it through a technology-based approach. This means having the capabilities to validate whether additional product lines are eligible for USMCA or quantifying the potential benefits of other duty-savings programs. Further, the provider should be equipped to spot a potential compliance risk before it becomes a bigger issue that slows business.

Planning Your Next Steps

This is an exciting time during which companies have an opportunity to redefine their FTA management processes to help expand potential savings and mitigate trade compliance risk. Once the trade team's mission and strategic goals are identified, consider the following points to help assess your company's USMCA requirements:

- Are you declaring USMCA at the time of entry?
- How are your customers' USMCA information requests filled?
- Is your supply chain shifting away from China to the USMCA region, and are you ready to qualify them if so?
- What is USMCA's potential financial impact on your organization, including the potential savings and costs?
- What tools do you have to help implement an efficient USMCA program that mitigates the company's risk?

The answers to these questions can help frame how USMCA management will look for your organization.

Once your enterprise has decided to plot a new course, its focus should be on attaining a clear path to achieve, not just a smooth transition, but one that elevates trade compliance to a critical business-partner.

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