

**Statement of Cathy Saucedo  
Director, Special Enforcement Division  
Trade Enforcement and Facilitation  
Office of Field Operations  
Department of Homeland Security  
U.S. Customs and Border Protection  
Senate Finance Committee  
U.S. Senate  
September 11, 2006**

Chairman Grassley, Ranking Member Baucus, and Members of the Committee, it is a privilege and an honor to appear before you today to discuss the operational impact and enforcement efforts of the North American Free Trade Agreement (NAFTA) by U.S. Customs and Border Protection (CBP) of the Department of Homeland Security.

I want to begin by expressing my gratitude to the Committee for the interest and support you provide as CBP continues to administer and enforce the NAFTA while facilitating the flow of legitimate trade that is so important to our nation's economy.

Your support has enabled CBP to make significant progress in implementing, administering and enforcing the NAFTA, as well as the many free trade agreements (FTA) that have entered into force. CBP looks forward to working with you to build on these successes.

**Background**

U.S. market opening initiatives took a significant step forward with the entry into force of the U.S.-Canada Free Trade Agreement in 1989. This FTA greatly liberalized trade between the U.S. and Canada. It was the first FTA that had specific rules of origin, which provided concrete, non-subjective methods for determining the origin of a good.

In 1994, the US-CFTA was superseded by the NAFTA. Implementation of this trilateral FTA with the United States' two largest trading partners not only led to a surge in U.S. exportations, but also resulted in a dramatic increase of importations from Mexico and Canada. The NAFTA improved upon the foundation of the US-CFTA by refining the specific rules of origin, adding more precise value concepts through a regional value content (RVC) methodology, and providing transparency requirements while continuing to facilitate trade. Since its implementation in 1994, the administration of the NAFTA has improved over the years, although CBP continues to experience operational challenges.

**NAFTA Successes**

The NAFTA provides for specific rules of origin to determine whether a good qualifies for preferential tariff treatment. The concept of product specific rules was first introduced in the US-CFTA, and sought to remove subjective interpretation of substantial transformation. The basis for these rules lies within the international nomenclature of the Harmonized Tariff Schedule (HTS), which contains a set of headings and subheadings that are internationally uniform and used by nearly all of our trading partners. The fact that these rules, known as tariff shift rules, use the common language of the HTS in the process of determining whether a good is originating provides for a streamlined application of the provisions of the NAFTA. The specificity of the tariff shift rules provides for an agreement that can be administered and enforced with greater ease than previous trade programs.

Moreover, there is flexibility within certain specific rules for industrial products in the form of a regional value content (RVC) test. This is an alternate method of determining eligibility for preference in the event the good does not meet the requirement of the tariff shift rule. The RVC requires that a certain percentage of the value of the good be attributable to materials produced in and processing that occurs within the territory of the U.S., Mexico or Canada.

Since the implementation of the NAFTA, there have been various trilateral agreements to modify or simplify certain specific tariff shift rules that were overly complex or did not reflect current sourcing patterns. The NAFTA parties have, to date, agreed on three separate sets of liberalized rules of origin. This was accomplished through established NAFTA working groups, which included consultation with industry and Congress in order to be consistent with current production realities. This process is ongoing, with another round of changes expected to be considered in 2007.

The NAFTA was the first FTA to address the concepts of transparency and facilitation within the context of implementation, administration, and enforcement of the agreement. CBP promoted transparency through the creation of a temporary NAFTA center manned by CBP NAFTA experts to assist the trading community as well as our field offices during the implementation phase and beyond. This NAFTA center provided operational support to all parties involved in NAFTA transactions, such as importers, exporters, Import Specialists and CBP Officers.

In the spirit of facilitation, the NAFTA negotiators ensured that the flow of trade was not disrupted or hindered by waiving the requirement of the presentation of the Certificate of Origin (CO) as a condition of release of the goods. Although CBP does not require the presentation of the CO as a condition of release of the goods, the CO must have been properly completed by the exporter and must be in the possession of the importer prior to making a claim for tariff preference under the NAFTA, and must be presented upon request by CBP. Canada has

adopted this same procedure while Mexico continues to require the presentation of a CO prior to release of the goods.

CBP continues to refine the application of the NAFTA and has introduced increased flexibility regarding the presentation of the CO. Initially, the CO had to be completed on an official CBP form as directed by the trilaterally negotiated Uniform Regulations. However, in July 2005, CBP began to allow the CO to be in any format as long as all the required data elements are present and the CO is in the possession of the importer and is signed by the exporter. CBP now allows for an alternate CO, which can be in any format and a computer generated CO, which requires pre-approval prior to use.

In the area of textiles and wearing apparel, CBP was instrumental in creating, and currently chairs, the Textile Enforcement Subgroup of the *ad hoc* NAFTA Working Group on Textiles and Apparel. Working with our NAFTA partners, CBP has consolidated verification efforts of NAFTA duty preference claims into a single trip, fashioned after our Textile Production Verification Team (TPVT) visits. These highly successful trips provide CBP a cost effective way to verify NAFTA claims, by allowing CBP personnel to personally inspect foreign factories making trade preference claims. The success of the TPVT style NAFTA verifications have prompted both Canada and Mexico to contemplate conducting similar verifications for their enforcement efforts.

In continued efforts towards the facilitation of trade, CBP has instituted the Free and Secure Trade (FAST) program along the borders of Canada and Mexico in 2002. FAST provides for expedited processing of participants' qualifying merchandise and allows for a harmonized clearance process for low-risk shipments. The FAST program is directly tied to other CBP supported programs to promote and enhance security and safety measures while enhancing economic prosperity, such as the Customs-Trade Partnership Against Terrorism (C-TPAT) program.

Additionally, the U.S., Canada and Mexico are actively engaged in the Security and Prosperity Partnership of North America (SPP), which was launched in March of 2005. This trilateral initiative is premised on mutually reinforcing security and economic prosperity through greater cooperation and information sharing among the three countries of North America while respecting the sovereignty and unique cultural and legal heritage of each country. As you can see there are various efforts and ambitious programs to continue to facilitate trade, increase security and build upon existing relationships.

### **NAFTA Challenges**

The NAFTA has been in effect for over twelve years and although the experience CBP has gained through implementing, administering and enforcing the first

multi-lateral FTA that the U.S. has entered into has been overwhelmingly positive, there have been some challenges posed by the Agreement.

NAFTA employs 2 sets of tariff rules to determine whether or not imported merchandise is eligible for a NAFTA benefit. First, there are permanent concise tariff shift rules used to determine whether or not the merchandise originates under NAFTA. Second, a temporary country of origin marking rules are used to determine which of the two NAFTA countries is the origin for duty purposes. For example if you have an imported good made in Canada with parts from China, Canada and Mexico, you would use the tariff shift rules to determine if the good was entitled to a NAFTA benefit. If it does, the marking rules determine the rate of duty (that from Canada or Mexico) would apply for those goods where Canada and Mexico have a different duty rate. This difference will disappear in 2008 when all NAFTA duties are eliminated for Mexico (duties for Canada were eliminated by 1998).

As previously mentioned, the provisions of NAFTA require a properly completed NAFTA Certificate of Origin, or "CO", be signed by the exporter and that the CO must be in the possession of the importer at the time a claim for preference is made. If the CO is not presented upon request, is not properly completed, or is not in the possession of the importer at the time the claim is made, the NAFTA requires that the claim be denied regardless of whether the good is in fact originating per the specific rules. This presents rigorous, paper intensive, recordkeeping requirements for the trading community and requires that claims be denied based solely on a paper document rather than the origin rules. We have remedied this provision in subsequent trade agreements.

As you might be able to deduce by the fact that the exporter is required to complete the CO, the NAFTA is an exporter focused agreement. Although the importer makes the claim and is responsible entity, the exporter has a critical role in a NAFTA transaction. The determination as to whether or not a good is originating is made by the exporter who may or may not fully understand the requirements to claim preferential treatment under NAFTA. CBP does have the ability to verify the origin of a good for which NAFTA preference is claimed through a verification to include a verification visit. However, there are several steps necessary prior to initiating verification, and these steps can interfere with the ability to accurately gauge the veracity of a party's preference claim. CBP must first obtain the CO from the importer, which must be completed according to the requirements. If a properly completed CO is received, CBP must then go beyond the CO in order to determine the origin of the good. This is conducted through the exporter, who is required to substantiate that the good meets the specific rules through additional supporting documentation, such as bills of materials, cost data, affidavits, and production information. A shortfall of the NAFTA is that the importer, who is ultimately responsible for the claim, is not an active participant in the verification process. Additionally, although CBP must

conduct verifications through the exporter, CBP has no jurisdiction over an entity in a foreign country.

A verification can include a visit to the site of production in Canada or Mexico. This allows for an extension of CBP's enforcement capabilities, however, the NAFTA contains strict guidelines that must be adhered to, such as notification to the exporter 30 days prior to the visit, that impact effective enforcement capabilities. There is no flexibility with which to conduct strategic enforcement actions, as the exporter will have been provided with sufficient notice, allowing dishonest exporters and producers to make operational adjustments well in advance of the verification visit. This notice effectively allows those exporters and producers the opportunity to 'clean up their act.'

For NAFTA claims, the importer is the responsible entity for making the claim and paying any duties and potential penalties. However, it is the exporter who is required to support the claim during verification by CBP. Although the U.S., Canada, and Mexico have trilaterally discussed amending the restrictive verification visit procedures to allow for more flexibility, no agreement has been reached to date. Thus the exporter focused regime presents logistical and administrative burdens to importers, exporters as well as CBP.

An additional area that presents challenges involves textiles and wearing apparel. Twelve years after the implementation of the free trade agreement, the three NAFTA parties still have not agreed upon verification procedures for certain textile goods receiving preferential tariff treatment. A limited quantity of products of Canada and Mexico currently receive duty-free treatment up to specified quantities even though they do not meet the rule of origin or tariff shift requirements. These Mexican and Canadian goods receive benefits under Tariff Preference Levels as if they met the tariff shift rules. CBP continues to meet trilaterally with Mexican and Canadian government officials in an ongoing effort to resolve differences and agree upon verification procedures.

In addition to verifications, CBP has actively enforced the NAFTA through audits of the exporter to ensure claims for preference are valid. Mexican officials conduct comparable audits in the U.S. with different approaches resulting in dissimilar outcomes. During the audit process, CBP allows the Mexican exporter a reasonable amount of time to produce supporting documentation, often granting extensions due to the detailed requests for information. However, Mexican authorities do not allow U.S. exporters flexible timeframes for providing such documentation. If the U.S. exporter does not have every document requested by the Mexican authorities during the site visit, the Mexican government officials make the assumption that the goods do not qualify and claims for preference are denied without further opportunity for presentation of information. This different approach in audit operating procedures, results in a significant variance in compliance rates for claims made in Mexico and the U.S.

NAFTA provides for workgroups among the Parties to address these types of challenges and other concerns in the areas of administration, interpretation and enforcement. These workgroups successfully tackled many issues during the first few years. However, the Parties have not been able to make any progress on this particular issue to date.

### **The Framework For Post-NAFTA FTAs**

The NAFTA's concrete and transparent obligations for the importer, exporter, and government agencies have taught us a great deal regarding provisions that work well and those that require refinement. The NAFTA serves as a framework for the newer FTAs, furnishing some key provisions and concepts that allow for more effective enforcement and transparent administration. New FTAs also have the benefit of restructuring restrictive provisions, creating more flexibility without compromising enforcement.

The newer FTAs have shifted from an exporter focus to an importer focused regime, allowing the responsible party (the importer) to carry through its responsibility from the beginning of the transaction to the end. Additionally, the agreements eliminate the Certificate of Origin as a formal document by permitting the information to be presented in any format and by electronic means has also become less restrictive by allowing the importer, exporter, or the producer to complete the certificate while the importer maintains the ultimate obligation of supporting a claim.

CBP continues to promote the usage of the product specific rules and regional value content calculations modeled after the NAFTA, with modifications based on lessons we've learned and industry input. Regional value content calculations have been simplified by basing the equations on the value of materials and the appraised value of the good at the time of importation.

### **Conclusion**

Mr. Chairman, Members of the Subcommittee, I have briefly discussed the operational impact and enforcement efforts of the NAFTA that CBP has encountered over the past twelve years. The NAFTA has been monumental in the creation of a framework from which new FTAs are being modeled and shaped. We have gleaned the positive and effective provisions that allow for an enforceable and operationally sound agreement, and have also streamlined the more complicated concepts. We continue to maintain and administer the largest multi-lateral agreement the U.S. has entered into while retaining effective enforcement methods. CBP strives to improve upon the NAFTA through regulatory updates and hopes to resume tri-lateral discussions on pertinent issues. Thank you for this opportunity to testify. I will be happy to answer any of your questions.