Cross-Border North American Supply Chain

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Cross-border trade is emerging as a key to United States supply chains as enterprises continue the shift from production capacity in Asia to North America. The story of how this focus on North America emerged is interesting and, when told concisely, surprising in its force and speed of change. From that perspective, we see how current cross-border practices, with their focus on the challenge of moving goods produced in Mexico northbound for consumption in the United States or Canada, can serve as a basic playbook for growth of the cross-border supply chain. This article explores those recent events driving production to North America and then surveys the common issues involved in this growing supply chain environment.

A Recent History of Cross-Border North American Supply Chains

North America is emerging as a powerful trading block due to the recent years of unprecedented efforts to steer away China trade. Today, it is reported that Mexico is, in fact, the largest trading partner with the United States, followed by Canada. China takes third place. Foreign investment into manufacturing capacity in Mexico is growing dramatically to accommodate this shift. Billions of dollars in investment are regularly reported by notable firms from the United States and elsewhere. These investments target capacity development as well as the infrastructure and multimodal investments required to accommodate distribution of parts and finished goods throughout the USMCA territory.

China's trading relationship with the United States has, of course, long carried unease. That distrust and its supply chain impact grew acute during the early years of the Trump administration. The Section 301 duties launched in four tranches between April 6, 2018 and May 17, 2019. The duties imposed an additional 7.5% to 25% on imports to the United States from China. A cumbersome exclusion process followed that provided relief to certain industries on a product-by-product basis. Still, the cost pressure of these tariff actions achieved the desired effect of forcing a reconsideration of China production. Our practice immediately began conversations with clients embarking upon sourcing tours to find adequate lawful manufacturing capacity outside of China. The early candidate countries were Vietnam, Cambodia, Canada, and Mexico. Most supply chain leaders predicted at least a five-year timeline before significant shifts could be completed.

The significance of 2018 from an international trade perspective continued with the renegotiation of 1994's North American Free Trade Agreement (NAFTA). The new US-Mexico-Canada Act (USMCA for those in the United States) was signed into law on Nov. 30, 2018. USMCA sought to improve upon NAFTA's free trade across the North American territories with new rules of origin that were favorable to certain industries and other modernization features. This strengthened a desirable solution for manufacturing capacity outside of China. However, it did not allow for gamesmanship, such as importing goods from China to Mexico and then entering into the United States duty-free following light assembly. U.S. Customs and Border Protection has carefully monitored and enforced evasion of Section 301 duties since their launch, whether through routing in Southeast Asia or North America.

Two years later, the onset of the global pandemic further strengthened the impetus for change. The World Health Organization declared a pandemic on March 11, 2020. Flight restrictions out of the United States were declared two days later, on March 13, 2020. Immediate production, transportation, and logistics capacity constraints were experienced in China. Steamship lines began “blank sailings” to manage availability of capacity, and trans-Pacific container rates increased tenfold. Traffic diverted into air cargo lanes, which offers fast service at a premium for relatively small and light products such as consumer goods. Rail traffic from China to Western Europe also carried unexpected capacity for a time. In the United States, port congestion was the key story with its delayed delivery of product and astronomical detention and demurrage fees for storage and use of containers. The pandemic did not officially end until May 5, 2023.

Four years after the first Section 301 list, the world was stunned by Russia's invasion of Ukraine on Feb. 24, 2022. The United States launched swift sanctions and related restrictions through the Treasury and Commerce Departments, as well as by Executive Order. Parallel efforts followed in the United Kingdom, European Union, and Japan. Transportation capacity of all modes restricted to, from, and through Russia. Western business investment shrunk as NATO expanded. Iran remained an antagonist to the United States and armed Russia (remember the so-called “Iran Deal” was decertified on May 8, 2018). At the same time, China tightened its relationship with neighboring Russia.

The subsequent years under the Biden administration involved further policy- and sectoral-based restrictions on China trade. For example, the Uyghur Forced Labor Prevention Act (UFLPA) was signed into law with an effective date of June 21, 2022. The Act sought to relieve forced labor and persecution of a Muslim minority peoples in China by providing U.S. Customs and Border Protection with broad discretion to prevent importing goods into the United States without proof of the absence of forced labor. This placed significant strain on certain supply chains, particularly in fashion and consumer retail. As another example, the CHIPS Act was signed into law on Aug. 9, 2022, which sought, in part, to correct a trade imbalance where 75% of semiconductor production occurred in Asia and only 10% occurred in the United States. The effort to drive domestic production had, at its core, a clear national security focus. Priority sectors for the administration were nanotechnology, clean energy, quantum computing, and artificial intelligence. The Commerce Department announced additional restrictions for that semiconductor traffic on Oct. 13, 2022.

Many of the early forces driving this present business environment were and remain focused on protectionist, political, and national security interests. This is made clear by the jargon used in industry and the press, particularly with respect to capacity in China. Reshoring traditionally referred to the return of manufacturing capacity to the United States from abroad, typically China. Relatedly, nearshoring referred to the transition of manufacturing capacity to regions in greater proximity to the United States. Friendshoring has since emerged as a reference to use of manufacturing capacity in countries with strong diplomatic and commercial ties to the United States. Now, with China squarely at the center of discussions, the term decoupling has grown in favor to suggest a systemic departure of production from China. Even more recently, the term derisking became fashionable as a reference to rationalizing China production risk within a global supply chain.

Cross-Border North American Supply Chain Issues and Practices

It is no surprise that many considerations must be addressed when building out a safe, compliant, productive supply chain outside of China. There are nonetheless distinct operational challenges that have been overcome for years in North American production. Our examination of those core items, their simple legal basis, and the day-to-day approach is helpful in recognizing the range of practical solutions as supply chain operations grow only more complex. Six key issues and practices that we frequently encounter in today's cross-border supply chains are explained below: (1) supply chain security, (2) customs classification compliance, (3) customs cabotage compliance, (4) immigration compliance, (5) cargo loss and damage, and (6) traffic operations.

Supply Chain Security – National security considerations for the integrity of cross-border supply chains are a common point of consideration. Many cross-border enterprises have gained perceived benefits from participating in U.S. Customs' Customs-Trade Partnership Against Terrorism ("C-TPAT"). The program was officially part of the Safe Port Act of 2006, although in practice, it dates to the terrorist attacks on Sept. 11, 2001. C-TPAT offers participants a relationship with U.S. Customs for strengthening their supply chains in return for purported expedited and priority processing as goods enter the country. Participation is limited to companies that meet certain minimum security requirements, and on-site validations by CBP Supply Chain Security Specialists are required. The program is tiered at three levels so that a participant can conceivably increase its security over the course of time. In practice, C-TPAT membership allows the trade community to recognize those suppliers and service providers impacting supply chain security and who meet the minimum requirements along a dedicated focus to strengthening security. It is, therefore, common to see C-TPAT as a threshold requirement to participate in certain supply chains. Mexico offers an analogous program referred to as the OEA (formerly NEEC), and Canada similarly offers a PIP program.

Customs Classification Compliance – From the earliest stages of production in Mexico, the legal compliance challenge for domestic importers often begins with confirming origin and duty treatment under the USMCA. Rules of origin are presented in a clear hierarchy for most items. The common means of achieving origin within a USMCA territory remains a "tariff shift" as was the case under NAFTA. If a tariff shift does not occur, or if the express rules do not otherwise confer origin within the territory, then a foreign item from outside the territory may remain foreign and subject to duties. This is arising more frequently with the increase in China inputs used in Mexico production, which may retain China origin and, therefore, application of the Section 301 duties.

Customs Cabotage Compliance – Another legal challenge within the jurisdiction of U.S. Customs is the need for cabotage compliance in northbound traffic. The United States restricts point-to-point movements within its territory by foreign-based carriers. A foreign carrier may only service international traffic. An analogous restriction exists within Canada. This means that northbound traffic by a long-haul carrier must only involve international cargoes, except in limited (and difficult to prove) circumstances involving domestic traffic incidental to the immediately prior or subsequent international engagement. In practice, efficiencies are lost due to this restriction, such as the ability to reposition empty shipping containers or trailers by a foreign motor carrier. Failure to observe this requirement can delay shipments due to customs enforcement and may yield sizeable civil penalties for the carrier based upon the value of goods or equipment that entered the country.

Immigration Compliance – Immigration remains a longstanding issue for supply chains across North America. The question is whether (and how) one may staff with foreign personnel while remaining in compliance with the rules under U.S. Immigration and Customs Enforcement jurisdiction. The ever-present labor shortage in certain sectors of our supply chain make immigration compliance even more acute. The basic options for cross-border work are to obtain B-1/B-2 visas for temporary work in the United States or to obtain a permanent resident visa (so-called "Green Cards"). The permanent immigration options typically require a showing of need by the respective industry as part of a process that can take 12-24 months to complete. Unique impacts on cross-border supply chain include the need to consider the immigration status of drivers hauling northbound cargoes. Similar to cabotage, a foreign driver must observe the terms of its visa, which will often prohibit handling point-to-point domestic traffic. This adds a layer of complexity to routing cross-border shipments and increases the risk of civil and criminal penalties, as well as supply chain interruption.

Cargo Loss and Damage – An increasing concern as cross-border traffic grows is the delta between cargo liability regimes in the United States versus those in Mexico. Carrier liability for cargo loss in the United States is determined by the full actual loss, damage, or harm suffered based upon cargo value at the place of destination. This is often limited under contract to obtain favorable service rates. Even a limited liability for cargo loss will yield a higher recovery in the United States than in Mexico, where the recovery is based on prevailing local wage. As a result, it is common among mature cross-border supply chains for the cargo owner to obtain first-party insurance covering loss or damage to the goods. Those insurance tools often take the form of a Shipper's Interest or Inland Marine policy. The added advantage is that the policy will respond to the shipper as insured in the event of loss rather than the carrier's policy, which covers its liability only and is therefore subject to available defenses under the law.

Traffic Operations – Finally, three dominant operating models exist for managing northbound traffic out of Mexico. The first is to cross-dock in a border zone. Under this model, a Mexico-based motor carrier will load a shipment at the plant in Mexico and haul to the United States border zone. The shipment will be unloaded at a cross-dock facility designed for the seamless unloading of one trailer and loading of the shipment in another or building multiple new shipments by

combining inbound product for outbound loads. Then, a United States-based motor carrier will hook its tractor to the trailer and haul into the United States for delivery, or even into Canada (sometimes under bond to eliminate the need for customs entry). The second model is to perform a drop trailer operation in the border zone. This is similar to cross-docking in the sense that a Mexico-based carrier interchanges with a United States-based carrier, except the goods are not unloaded. The trailer is simply unhooked from the tractor before the second carrier hooks for the northward haul. The third model is for a motor carrier to complete the entire movement from a plant in Mexico through to delivery in the United States. This is less frequent at the southern border, because only approximately 60 Mexico-based motor carriers have received approval from the Department of Transportation to complete those long-haul moves.

The Complex Future of Cross-Border Supply Chains

The "shoring" impact on supply chains is only in its earliest stages despite the many years and driving factors under which the current trading environment formed. We in North America can be certain in two things as we look ahead. Supply chain management as a discipline will only grow more valuable to the C-Suite alongside growth in the significance of production and consumption within the USMCA territory. These trends carry the need for technical expertise in the subject so that supply chains may be designed and built, risks assessed and mitigated, and business operations flawlessly executed under greater commercial speed, supply chain risk, and regulatory scrutiny than in the past. Fortunately, for an experienced practitioner, the tactical toolbox available for managing risk in northbound cross-border supply chains is well-stocked with known issues and proven practical solutions. In many ways, the future for cross-border North American traffic is an exercise in scaling and improving upon operational, risk management, and legal best practices that already exist.