



## **STAFF REPORT**

Improving the Temporary/Interim Manufacturing  
Procedure for Small and Medium-Sized Manufacturers

August 2006

## SUMMARY

In 2004, as part of the Department of Commerce's Manufacturing Initiative, the Foreign-Trade Zones (FTZ) Board approved a new procedure for rapid approval of applications for "temporary/interim manufacturing" (T/IM) authority in existing FTZ space based on similarity to prior approvals. In 2006, after practical experience showed the T/IM procedure to be less successful than envisioned in assisting small and medium-sized manufacturers in participating in the FTZ program, the FTZ Staff proposed a modification to allow greater flexibility in T/IM eligibility. Public comment on this modification has been uniformly positive, and the FTZ Staff recommends changing the T/IM procedure to allow for applications based on evidence of similarity to previous approvals.

## BACKGROUND

In October 2004, as part of the Department of Commerce's Manufacturing Initiative, the FTZ Board implemented a new procedure for T/IM authority in existing FTZ space<sup>1</sup>. The goal was a radical reduction in the time between application filing and approval so that U.S. manufacturers could react quickly to new opportunities for manufacturing under FTZ procedures. To accomplish this case-processing time reduction, the FTZ Board delegated to the Executive Secretary authority to approve T/IM cases in specific circumstances. This procedural change was designed to be particularly useful to small- and medium-size manufacturers (SMMs).

Eligibility for T/IM case processing was limited to non-complex, non-controversial circumstances. The FTZ Staff's May 2004 report, which delineated T/IM procedures, established a specific mechanism for determining T/IM eligibility. The FTZ staff would create a web-accessible database of non-controversial manufacturing approvals within the preceding five years – new applicants could then request T/IM authority if their specific components and finished products existed in the T/IM database. The database would be updated regularly as new regular FTZ (non-T/IM) manufacturing applications were approved, with cases older than five years automatically purged<sup>2</sup>.

Given the untested nature of the T/IM concept, the FTZ Staff created strict rules for the T/IM procedure. Specifically, eligibility for T/IM processing would require matching component and finished product combinations in the T/IM database with specificity at the level of six-digit HTSUS categories. The T/IM rules also limited a given applicant to twenty components, ten inverted tariffs, and five finished products (again defined with six-digit HTSUS specificity).

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<sup>1</sup> Although the focus of the T/IM proposal was the ability of small and medium-sized manufacturers to use general-purpose zone sites, existing FTZ space also includes approved subzones.

<sup>2</sup> The purging of older approvals from the T/IM database reflects the idea that – since duty rates, duty-rate relationships between components and finished products, and industry circumstances often evolve over time – cases older than five years may not be a good basis for determining what would be non-controversial in terms of new activity.

## Published Proposal

After more than eighteen months of experience in administering the T/IM procedure, the FTZ Board staff published a *Federal Register* notice<sup>3</sup> in April soliciting public comment on the possibility of improving T/IM by “modifying the T/IM procedure to define eligibility for application consideration on the basis of broader product and input categories than is currently the practice.”

The notice went on to make clear that a number of constraints – designed to ensure adequate review and minimize industry issues – would remain in place:

T/IM applicants would still be required to explain the specific activity which they seek to conduct under T/IM procedures, including the degree of similarity of requested products/inputs to already approved products/inputs in the T/IM database. Modification of the T/IM procedure would leave most current elements of T/IM practice in place, including limitation to non-complex, non-controversial proposals, the requirement for a 30-day public comment period on any T/IM proposal, the practice of consultation with appropriate industry experts within government, and the FTZ Board Executive Secretary's discretion to refer any T/IM case to the full FTZ Board.

The notice stated that “[a] particular benefit of modifying the T/IM procedure, as outlined above, could be to give manufacturers already operating in FTZs/subzones greater ability to react quickly to new challenges or opportunities.”

## Comments Received

In response to our Federal Register notice, we received submissions from the following five entities: the National Association of Foreign-Trade Zones (NAFTZ); Miller & Company, P.C.; the Jackson (Mississippi) Municipal Airport Authority; the Mississippi Coast Foreign-Trade Zone, Inc.; and the City of Mobile (Alabama). All of the submissions supported the T/IM procedure, in general, and modification of the FTZ Board’s practice to allow greater flexibility for T/IM requests.

The NAFTZ’s comments specifically supported broadening T/IM eligibility beyond the current limitations, stating:

We support the Board’s proposal to broaden the product and input categories considered in determining the T/IM application eligibility. In this regard, we believe that T/IM eligibility should be broader than the current six-digit HTSUS limit applied to the product and input categories.

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<sup>3</sup> 71 FR 23895-23896, April 25, 2006. The notice also solicited comments related to the concept of scope of authority for FTZ manufacturing. That subject, which is more complex than modification to T/IM procedures, will be the subject of future analysis by the FTZ Staff.

The NAFTAZ's comments also address an additional aspect of enhancing flexibility:

With respect to the finished products to be sold in the U.S. market, we recommend that the Board increase its limit of five (5) finished products and twenty (20) foreign status inputs as well as its limit of ten (10) inverted tariffs for T/IM authority. These limits can be increased to ten (10) finished products and thirty-five (35) foreign-status inputs as well as its limit of twenty (20) inverted tariffs.

Miller & Company addressed in detail the reasons why broader T/IM eligibility would be beneficial to U.S. manufacturers:

We have received a number of requests to analyze whether potential new activity that a company may attract to the United States qualifies for this T/IM treatment. The expedited time frame for approval (75 days) for T/IM is important as companies look for immediate financial results when making these decisions on new locations for production activity. Smaller and medium-sized companies must especially realize a return on their investment in establishing a zone manufacturing operation as quickly as possible.

Miller & Company concludes:

Additional latitude should be provided to allow a company to make a "substantially similar" argument as an input/finished product combination that may not exactly match the Foreign-Trade Zones Board database, but is clearly very similar to what has already been approved... The ability to quickly react to attract new activity to a United States facility that is competing with its sister facilities located overseas within the same company is extremely important.

The Jackson Municipal Airport Authority, the Mississippi Coast Foreign-Trade Zone, and the City of Mobile buttressed their support of broader T/IM eligibility with specific examples from local industries, including automotive, shipbuilding, and crop protection products, respectively.

## **ANALYSIS AND DISCUSSION**

During the nearly two years since the Board approved the T/IM procedure, we have been evaluating its implementation and are now able to assess the degree to which it has accomplished the goals that led to its creation. Since T/IM's 2004 introduction, we have received six T/IM applications. However, this represents a small fraction of the forty-three standard FTZ manufacturing/processing applications received during the same time period.<sup>4</sup> In addition, we have received a number of inquiries about the T/IM procedure from potential applicants whose

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<sup>4</sup> Of those forty-three cases, eighteen were for manufacturing/processing authority within existing FTZ space (general-purpose or subzone).

components or finished products were similar to those approved previously, but that did not constitute exact six-digit HTSUS matches.<sup>5</sup> On balance, the T/IM procedure has not been as successful as originally envisioned in allowing quick access to FTZ procedures for new program users (particularly SMMs).<sup>6</sup>

It appears that a key factor contributing to the limited success of the current T/IM procedure has been requiring exact six-digit HTSUS matches to prior approvals for any requested component-finished product combination. While this strict requirement has had the effect of avoiding controversy, its effect of limiting eligibility for rapid access to FTZ procedures must be considered in the context of the important role that FTZ procedures can play in allowing many U.S.-based manufacturing operations to remain internationally competitive. Further, as the limited number of T/IM applications received to date has shown, existing subzone and FTZ-manufacturing users also require a mechanism to be able to react quickly to new opportunities or challenges.

One additional consideration in evaluating the flexibility of the T/IM procedure is the degree to which it can serve as an inducement for U.S. manufacturers to choose to locate within FTZ space, thereby potentially increasing their ability to secure future production runs. A range of evidence suggests that many U.S. manufacturing plants face competitive situations which can change or evolve more quickly than ever before. There is also a growing role for companies that perform manufacturing on a contract basis – more and more U.S. companies appear to be opting for contract production arrangements rather than taking on additional commitments in terms of investment and employees. In many industries, this contract manufacturing is increasingly occurring abroad. A more flexible T/IM procedure can increase the extent to which it will be advantageous for many U.S. manufacturers – including those producing under contract arrangements – to locate in FTZ environments in order to give themselves the ability to quickly take advantage of FTZ procedures in future competitive situations.

With regard to the specific, practical changes to be made to the T/IM procedure, the starting point is the concept of greater flexibility than the current requirement of an exact match with the T/IM database for each six-digit HTSUS component-finished product combination. At the same time, the entire T/IM concept is premised upon similarity to prior FTZ Board approvals. Therefore, any enhanced flexibility for T/IM should involve the FTZ Staff creating a mechanism where applicants can frame their T/IM requests by presenting arguments as to why their proposed activity is similar to previously approved activity (as detailed in the T/IM database). To that end,

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<sup>5</sup> In such cases, the fact that FTZ procedures are not available quickly generally ends the potential users' evaluation of the FTZ program as a mechanism for enhancing their U.S. facilities' international competitiveness.

<sup>6</sup> Of the six T/IM applications to date, two were from companies already operating their own subzones (they used T/IM to expand their authorized scopes for FTZ manufacturing), while another of the applications was from a large petrochemical company.

the FTZ Staff should work with Import Administration’s information-technology staff to create a user-friendly mechanism for applicants to find either components or finished products at a four-digit HTSUS level within the T/IM database. After finding a given component (or finished-product) category at the four-digit HTSUS level, the database should then display the approved components (or finished products) at the six-digit HTSUS level. The applicants could present their arguments as to the similarity<sup>7</sup> of their proposed activity to the previously approved activity in the database.

One other aspect raised through the comment process is the number of components and finished products that can be considered through a T/IM application. The initial T/IM implementation was very conservative in approach, involving a limit of twenty components, ten inverted tariffs, and five finished products. In practice, the limitation to ten inverted tariffs generally has actually limited companies to ten dutiable components. Given the arguments presented for some greater flexibility on this issue and the fact that T/IM has not functioned as originally envisioned, it is reasonable to simplify the T/IM approach to focus on the number of components and finished products, as well as consider a modest increase in the numbers allowed for those items. The current numbers of components and finished products have posed no analytical problems for the FTZ Staff on the cases processed to date. As such, an increase to thirty components and ten finished products<sup>8</sup> should be manageable<sup>9</sup> and further enhance the usefulness of the T/IM procedure for U.S. manufacturers that need to react quickly to new opportunities.

Finally, one aspect of T/IM that arose in 2004 and which is a factor for consideration now is whether or when T/IM should be codified in the FTZ Board’s regulations. During the 2004 evaluation of the possibility of creating the T/IM procedure, the FTZ Board agreed that, “[w]hile it may ultimately prove desirable for the FTZ Board to codify the delegation of T/IM approval authority through regulations, implementation of the T/IM delegation should be given time to evolve through practical experience before the FTZ Board seeks to codify it.” The wisdom of that approach has been confirmed by the fact that, if T/IM’s procedural aspects had been codified as originally conceived, the FTZ Board would already need to consider changing regulations which – at this point – would be less than two years old. In this context, it continues to seem most reasonable to make any revisions to T/IM practice and then allow at least two years of experience with administering the revised T/IM procedure before considering codifying T/IM procedure through regulatory changes.

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<sup>7</sup> Similarity could potentially be expressed in terms of duty rates, uses, production situation, competitors, etc. Guidelines for the implementation of a revised T/IM procedure could clarify criteria for arguing similarity.

<sup>8</sup> Components and finished products would continue to be defined at the six-digit HTSUS level.

<sup>9</sup> Based on experience, the limitations on numbers of components and finished products should be adequate without the complication (and potential confusion) of an additional limitation on the number of inverted tariffs.

## RECOMMENDATIONS

For the reasons delineated above, the FTZ Staff recommends modifying the current T/IM procedure to allow for requests on products and components similar (but not necessarily identical) to previous approvals. This would entail a potential applicant using the existing T/IM database to find previously approved finished products and component combinations similar<sup>10</sup> to what the applicant would be seeking authority to manufacture. The applicant could then explain the degree to which the proposed components and inputs are similar.

The FTZ Staff also recommends allowing a modestly expanded number of finished products and components for a given T/IM application: thirty components and ten finished products. The Board's Executive Secretary would have discretion to develop guidelines for these T/IM applications to implement the framework for revisions to T/IM outlined above. The FTZ Staff further recommends allowing at least two years of experience in administering the revised T/IM procedure before considering codifying any of the T/IM practice in regulations. Finally, aspects of T/IM practice (limitations, conditions, restrictions, etc.) not specifically recommended for modification in the published proposal or this report would remain unchanged, including the requirement that the FTZ Board staff notify the Board members (or their delegates) of all approvals of T/IM authority on a quarterly basis.

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<sup>10</sup> This similarity would need to involve at least a four-digit (heading) or greater level of HTSUS commonality.