096549

261.01

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

INTERNATIONAL DIVISION

MAY 26 1972

72-0556

6

B-114898

LM096549

Dear Mr. Secretary:

The General Accounting Office has made a review of the Foreign Trade Zones program. We looked into the program's contribution to U. S. export expansion efforts and sought to identify ways to increase exports through foreign trade zones.

We reviewed activities at four authorized zones--Honolulu, New York, New Orleans, and Seattle. We met with zone operators, zone users, local businessmen, and Federal, State and local officials. Although we were not able to conclusively demonstrate that this program can significantly increase exports, we believe our observations would be useful in your continuing efforts to identify new ways to expand exports.

RESULTS OF REVIEW

As presently operated, foreign trade zones are contributing minimally in expanding U.S. exports. We found that foreign trade zones are being used primarily for accommodating import trade, and have had only limited effect in stimulating exports, reexports, and transshipments. There are two basic reasons for the lack of export orientation: first, legislation contains restrictions which hamper introduction of potentially viable export industries within and without the zones; and second, the export potential of existing and new zones has not been fully exploited.

Legislation proposed in October 1971 (S. 2754) by the Subcommittee on Foreign Commerce and Tourism, Senate Committee on Commerce, if passed, will remove a major impediment identified by our review. The Foreign Trade Zones Board may wish to consider proposing further relaxation of the act to extend zone privileges to firms located outside the existing zones.

S2305

P.1785

In conjunction with the above, new approaches, uniquely different from current operations, must be tried if foreign trade zones are to contribute significantly to expanding U.S. exports.

These and other matters are discussed in the sections that follow.

~~701135~~ 096549

BACKGROUND

Foreign Trade Zones are administered by the Foreign Trade Zones Board and authorized by the Foreign Trade Zones Act (19 U.S.C. 81), enacted on June 18, 1934, as amended. The objective of the Foreign Trade Zones program is to promote foreign commerce and transshipment. The Senate Commerce Committee in its report on the bill to establish the foreign trade zones described the purpose of foreign trade zones as follows:

> "To encourage and expedite that part of a nation's foreign trade which its government wishes to free from restrictions necessitated by the customs duties. In other words, it aims to foster the dealing in foreign goods that are imported, not for domestic consumption, but for conditioning, or for combining with domestic products previous to export."

As long as the merchandise remains in a zone or is transshipped or reexported to another country, no customs duties are applied. Duties are collected only if the merchandise is released into the domestic market.

The movement of goods illustrates the import orientation of foreign trade zones. As shown in the table below, over 80 percent of all goods received in the zones eventually end up in the domestic economy.

MOVEMENT OF MERCHANDISE IN
AND OUT OF ZONES
FISCAL YEARS 1966 TO 1970

	Dollars	Percent
Received		
From U.S. customs territory	$ 95,245,000	20.1
From foreign countries	377,613,000	79.9
Total	$472,858,000	100.0
Forwarded		
To U.S. customs territory	$372,111,000	80.4
To foreign countries	90,674,000	19.6
	$462,785,000	100.0

EXPORT POTENTIAL OF ZONES

Although export expansion through the Foreign Trade Zones program has been disappointing under current legislation and organization, the concept underlying the program may still represent opportunities to expand exports.

The principal reasons that limited exports are generated through zone activities appear to relate to several constraining factors, including the (1) imposition of customs duties on manufacturing equipment and supplies, (2) restrictions on where the zones can be located, and (3) lack of promotional effort on the part of zone operators and the Department of Commerce in seeking potential export users.

Future success of this program is dependent on favorable legislation complemented by an aggressive program to encourage and develop export manufacturing activities within and without the existing foreign trade zones. These matters are expanded on below.

Restrictions Hinder New Export Activities

We found indications that if some of the current restrictions were removed, then additional firms might be encouraged to manufacture goods for export that could not otherwise be manufactured without the advantages offered by a zone. For example, we found:

Waiver of duties and taxes

The State of Hawaii wanted to establish a special purpose subzone to process sugar cane waste (bagasse) into pulp for export. State officials said that creation of a customs-free subzone in Hawaii could result in about [illegible] jobs and annual exports of about [illegible] tons of pulp product valued at about $13 million annually. State officials emphasized that the economic feasibility of the project is dependent on waiver of import duties and taxes on foreign machinery, material, and fuel to be used in the proposed subzone. We reported this matter to the then Secretary Stans in a letter dated April 15, 1971 (B-114858).

We are advised that the Foreign Trade Zones Board General Counsel is of the opinion that duty free status does not apply to capital equipment.

This situation was recognized by the Subcommittee on Foreign Commerce and Tourism, Senate Committee on Commerce, which submitted a bill (S. 2754) to amend the Foreign Trade Zones Act so that:

> "The Secretary of the Treasury, through the Bureau of Customs, is authorized to approve the duty-free entry of (1) machinery and materials to be used solely in the manufacture or production of goods in a zone or subzone, if such goods are not subsequently entered into the customs territory of the United States, and (2) fuel and

materials consumed solely in the manufacture or production of such goods, in the same manner and subject to the same limitations as foreign merchandise, may be brought into such zone or subzone without being subject to the customs laws of the United States under section 3 of this act."

Another situation similar to the above was reported by the manager of the Puerto Rico zone. At the time of our review, the zone was considering a proposal by an Italian firm to construct and operate a refinery there. Their proposal was for a $300 million plant investment capable of refining 350,000 barrels a day and employing 3,000 people. The manager was unaware that customs duties would be imposed on the plant, equipment, and operating supplies; he believed that imposition of customs duties would have fatal consequences on this proposal.

Location requirement

The Foreign Trade Zones Act requires that zones be located in or adjacent to a customs port of entry. This location requirement has limited the accessibility of firms to zone opportunities and facilities and particularly affects significant manufacturing efforts. Firms at considerable distance from the zones would normally not be interested. The need to establish new plants and facilities instead of utilizing existing plants and facilities is a consideration that undoubtedly makes a critical difference in whether or not a firm elects to operate under the benefits accorded by zones. It seems reasonable to conclude that many firms might be induced to consider new export programs if they were not required to relocate.

Concerning the question of whether extension of zone privileges to existing manufacturing facilities might adversely affect present U. S. suppliers, both Commerce and U. S. Tariff Commission officials indicated that this would not be a problem since applications are reviewed by the Foreign Trade Zones Board. Their review would assure that these activities would not disrupt present domestic consumption patterns.

Regarding the feasibility of controlling the benefits from extending trade zone privileges to firms outside the confines of present zones, a Commerce official felt that experience with an on-going procedure indicates this would not be a problem. For example, under the "drawback" procedure, duty is paid when foreign materials are imported but the duty thereon is rebated when the finished products are later exported. Extending the benefits of trade zone privileges to manufacturers outside the zones would likely benefit many more small and medium sized firms which find it impractical to relocate in customs port areas. We noted that the cost of carrying the duty payment over an extended period between use of the materials and subsequent re-export of the finished product was an important consideration in establishing foreign trade zones.

Another important consideration in extending the zone privileges to those activities located outside the present zones is the limited physical capacity of existing zones to accommodate an influx of new operations.

Needed: New Approaches

The export potential of foreign trade zones was indicated in a study entitled, "U.S. Foreign Trade Zones and U.S. Export Development," prepared by the Bureau of International Commerce (BIC), in August 1969. The study group concluded that the foreign trade zones export activities had not been extensive and that they were unable to develop any formal analysis that would provide a sound forecasting basis for estimating foreign trade zone export potential. Nevertheless, the group also concluded that the export potential for the zones had not been fully exploited, even in the known presence of competitive trade procedures. They maintained that the zones offer certain advantages for the export of U.S. goods, technology, and labor, and that these advantages are particularly applicable to export-oriented products which utilize imported raw materials beset by tariffs, quotas, or other import restrictions.

The study group, despite the limited time available for the study, was able to identify a few specific instances that represent potential for export activity in the zones. For example:

—Consumers of wire mill and brass mill products could utilize the zone concept to reduce production costs for such export items as air conditioners and electrical equipment.

—The United States fishing tackle industry could increase exports through a greater use of zones for incorporating foreign and domestic components into fishing tackle for export.

—Use could be made of an area such as Puerto Rico for zone purposes to obtain low labor costs, as well as saving on transportation costs.

The group thought that given additional time, further areas of export promotion through foreign trade zones could be identified. In addition, if certain of the recommendations made in the study were adopted it was felt that these changes might open further avenues of exploration which might result in increases in United States' exports through the use of foreign trade zones.

We met with Commerce officials to learn of developments subsequent to the 1969 study. We were advised that no further action had been taken on the study recommendations. These officials believe that the potential for increasing exports through foreign trade zones merits further study. They were of the opinion that this potential would be greatly enhanced if certain restrictions were removed, especially the requirement that firms locate in existing foreign trade zones.

CONCLUSIONS AND SUGGESTIONS

Foreign trade zones, as now operated, do not provide the means to significantly increase U.S. exports. Although our study did not identify many specific new approaches to exporting under foreign trade zones regulations, our observations together with BIC's study indicate that there is unexplored potential for increasing exports through zones.

The export potential of zones will be greatly enhanced if the legislation proposed by the Senate Subcommittee on Foreign Commerce and Tourism is passed. Regarding the restriction that firms locate in or adjacent to a customs port of entry, the Board may wish to consult with the Subcommittee staff to expand the interpretation of a "subzone" (contained in Title I of S. 2754) to include inland facilities. Also, if other new and innovative approaches were considered, such as aggressively searching for new export processing firms and zone locations; and reactivating export activities that were not fully developed; these actions would likely uncover a number of latent opportunities.

In view of our downward trending trade balance, we believe there is a need for reevaluating foreign trade zones operations with a view to identifying new ways to increase their export orientation. The study previously conducted by the Bureau of International Commerce could be used as a starting point. An expanded study should seek to identify industries and companies that can benefit from (1) exemption from import duties on foreign machinery, materials, and fuel to be used in manufacturing products for export, and (2) exemption from import duties on merchandise to be transshipped or reexported. Such a study should not be limited to operations within existing zones in customs ports of entry.

If warranted by the study results, the Department of Commerce should initiate a promotional program to encourage selected industries and companies to avail themselves of a more responsive foreign trade zones program.

We would appreciate your comments.

Sincerely yours,

Charles D. Hylander

Oye V. Stovall
Director

* The Honorable Peter G. Peterson
Secretary of Commerce 14
Chairman, Foreign Trade Zones Board

~~D-1140~~
D. 1249