



095581

1.50.0

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

7-270

6
34

INTERNATIONAL DIVISION

APR 15 1971

B-11/398



LM095581

Dear Mr. Stans:

The General Accounting Office (GAO) recently undertook a review of Foreign-Trade Zones activities administered by the Foreign-Trade Zones Board. During the course of this study, which is still in progress, we came upon a situation which we bring to your attention as Chairman of the Foreign Trade Zones Board. The situation in question involves imposition of customs duty on imported merchandise used in some manufacturing operations, under the jurisdiction of the Secretary of Treasury, a member of your board. D.1249

The Situation

The State of Hawaii wants to establish a special purpose subzone to process sugar cane waste (bagasse) into pulp for export to Japan. Bagasse is in great abundance in Hawaii and of little value to the local economy. Disposal by ocean dumping or burning has become a serious problem because of pollution considerations. State officials submit that creation of a customs-free subzone could result in some 225 jobs and annual exportation of about 91,000 tons of pulp product valued at about \$13 million annually. These officials emphasize, however, that the economic feasibility of the project is dependent on waiver of import duties and taxes on foreign origin machinery, material, and fuel to be used in the proposed subzone.

Bureau of Customs officials have stated that duties and taxes are applicable to all foreign machinery, material, and fuel to be consumed in the proposed subzone. Thus, it now appears that the project may be abandoned with resultant loss of economic and balance of payments benefits to the United States.

The Issues

The Bureau of Customs position is based on a precedent established in 1953 and consistently applied since that time. The general principle involved is that all foreign merchandise is subject to duty unless specifically exempted. The Bureau points out that the Foreign-Trade Zones Act, as amended (19 U.S.C. 81a-81u), is silent with respect to the status

70677 095581

(1) of merchandise used in manufacturing operations, and, had the Congress intended that such merchandise be admitted duty free, the statute would have so provided. The Bureau also noted that Senate Report No. 1107, September 26, 1949, of the Senate Committee on Finance (covering the amendment in 1950 that permitted manufacturing in zones) set forth that the amendment would not authorize consumption of imported merchandise in a zone, but would authorize its exportation or destruction without the payment of the liquidated duties and determined taxes thereon. 54100

It is our understanding that the Foreign-Trade Zones Act was enacted to provide a means by which business firms, unencumbered by customs regulations, might compete in world markets while maintaining their base of production on U.S. soil; the objective of this concession being to reap the benefits of American value added in the final product. The Senate Commerce Committee in its report on the bill to establish zones commented that it was not the policy of the Government to charge duty on goods not destined for domestic use. The effect of the Bureau's ruling in the Hawaiian project, however, imposes duty charges on goods destined entirely for export and not intended for domestic consumption. 52

The Considerations

The favorable U.S. balance of trade which has historically provided the surplus that stabilizes the U.S. balance of payments position, has dropped sharply and the United States has recognized the need to move aggressively to improve its export position. Our review of the Foreign-Trade Zones was with a view to increasing the effectiveness of United States efforts to expand exports.

Based on our work in this area to date, we believe there may be potential for utilizing foreign trade zones as a means of increasing our ability to expand exports. Discussions with zone operators indicate that the exercise of judgment by the Board on the waiver of duty on a case-by-case basis was desirable and could likely pave the way to a wide range of industrial activities which heretofore have not been sufficiently attractive for potential manufacturers. While the GAO has not fully validated the benefits to be derived from any propositions for duty-free entry of foreign merchandise, we think there is merit to reevaluating this question. At the same time, we are mindful that duty-free entry of foreign merchandise for use in the zones would result in loss of revenues.

The GAO does not propose that the Bureau rescind its established rule of imposing duty on foreign source merchandise brought into foreign trade zones and used in the manufacturing process. The GAO does, however, submit that considerable benefits might accrue to the United States if the Bureau were to adopt a policy for allowing waiver

of custom duties on a selective basis. We believe that Foreign Trade Zone officials should be given the task of recommending a desirable course of action. If, in the judgment of these officials, a waiver of duty is essential for the successful operation of a venture in the trade zone, then their submission, properly documented, for waiver of duty should be considered by the Bureau. The law is worded in such a manner that, we believe, a strong case may be made for waiving the duty on foreign equipment, material and supplies to be used in foreign trade zone manufacturing processes. This interpretation is especially appropriate in the instant case where the potential loss of economic benefits seemingly outweighs the loss of revenue from waiver of customs duty. Information available to us indicates that the proposed manufacturing facility in the foreign trade zone will be abandoned because of the unfavorable ruling on duties rendered by Customs.

In economic terms, this means the loss of 225 jobs with personal income of about \$1.5 million a year, the value assigned to the expense which would have been converted into a marketable product valued at \$13 million annually, and accessorial benefits accruing from continuation of a manufacturing process. A further adverse effect is the cost of disposing of a troublesome waste material.

The Alternatives

The GAO believes that the Bureau of Customs has the authority to decide on the dutiability of merchandise brought into foreign trade zones. We think that Congress intended that Customs oversee the operations of foreign trade zones to assure that a fair assessment is made on foreign origin goods that are destined for consumption in the domestic economy. In furtherance of this responsibility, however, we submit that export-oriented operations with potential for overall economic and balance of payments benefits, need to be encouraged rather than discouraged. In line with other export expansion programs presently advocated by Commerce, it seems that proposals aimed primarily at the export market should receive special consideration.

It appears that the Foreign-Trade Zones Board has the authority to establish rules and regulations for operations of zones, including the protection of revenues, subject to the approval of the Secretary of the Treasury. Accordingly, GAO believes the assessment of duties on those items of foreign origin used in the manufacture of a product to be consumed domestically is appropriate but that an administrative determination on a case-by-case basis would be more appropriate for those items of foreign origin used in the manufacture of a product destined for export. In this manner, GAO believes recognition could be given to congressional desires to increase exports and, at the same time, ensure that appropriate duties are collected on merchandise consumed domestically.

The remaining alternative is to continue to assess duties without regard to whether or not the manufactured product is exported. This alternative, however, would continue to be a deterrent to undertaking some otherwise economically viable projects which might contribute to export expansion efforts.

Suggestion

3
/ The GAO suggests that the Board explore this question with the Department of Treasury with a view to reevaluating the precedent established on the dutiable nature of foreign merchandise used in the manufacture of products in a foreign trade zone. We suggest that this question be viewed from the standpoint of potential gain in economic benefits to the United States as compared with the potential loss of customs duty in each case. 38

We would appreciate your comments.

Sincerely yours,


Oye V. Stovall
Director

2 The Honorable Maurice H. Stans
Chairman, Foreign Trade Zones Board p 1249
Department of Commerce 74