



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

INTERNATIONAL DIVISION

MAY 26 1972

B-114898

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.

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.

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complete information on proposed projects will assist agencies responsible for monitoring zone activities to better carry out their responsibilities. In this connection, sufficient guidance has not been provided to zone operators by these agencies on the types of activities appropriate for location in a trade zone nor of the information needed to decide on applications.

In our discussions with Foreign Trade Zones Board officials, relating to your request, they stated that regulations would be amended to amplify information needed for timely decisions. Along these lines:

- the information the Bureau of Customs needs to determine product classification and applicable duty rate is shown in enclosure I, and
- some products with import restrictions administered by various Government agencies are shown in enclosure II. This data is also available to the public in a Bureau of Customs publication.

The success of the McAllen zone depends on the operator's ability to attract suitable tenants. In our May 1972 report to the Secretary of Commerce on the Foreign Trade Zones Program, we found that 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 use imported raw materials beset by tariffs, quotas, or other import restrictions. Several types of operations that would be suitable for expanding exports from trade zones were identified. (See enclosure III.)

Information on the five cases we looked into are summarized below.

#### Case 1

The Foreign Trade Zones Board recognized that E. I. du Pont de Nemours & Company is presently manufacturing hydrofluoric acid from Mexican fluorspar at a plant at La Porte, Texas, without any relationship to the trade zone. The Board believes that the establishment of a subzone status for this plant would not significantly benefit the public with increased employment, increased exports, or reduced imports. The Board, however, has delayed final decision until it receives confirmation from the McAllen trade zone that the du Pont Company will

transfer part of its hydrofluoric acid plant operation from La Porte to Mexico. We were told that the presentation of additional evidence showing anticipated public benefit would enhance the chances for obtaining approval.

Case 2

Industrial Textile Mills' proposal to manufacture industrial towels has been withdrawn and is academic at this stage. The proposal involved importing textiles in excess of established textile quotas and voluntary restrictions of textile exports to the United States. These import limitations are designed to protect the U.S. textile industry. Therefore, the proposed importation of textiles over these quotas and the agreed limits would negate their basic purpose.

Case 3

The proposal to process, package, and freeze fresh strawberries brought to the Trade Zone from Mexico was impeded when the Bureau of Customs ruled that strawberries imported without their stems are classified as prepared fruits and subject to higher import tariffs. We found that the Trade Zone manager's letter of March 7, 1973, asking for reexamination of the classification was not forwarded to the Bureau of Customs in Washington. Although regional Customs officials in Houston were asked by their local Customs office to act on this request, they assumed that the appeal had been sent to Washington. In response to our inquiry concerning this lack of communication, a Customs official in Houston told us that he would attend to this matter.

We were told that, to enhance Government responsiveness, appeals in the future should be based on new information, additional to that in the original proposal, such as the studies mentioned in the March 1973 letter or testimony of experts in the field of strawberry picking.

Case 4

A proposal to manufacture syrup for soft drinks from import of sugar over quota was denied. An Agriculture Department official informed us that this type syrup is considered as liquid sugar because it generally has less than 6 percent non-sugar solubles and must count against the sugar-quota in

accordance with the Sugar Act of 1948, as amended. If additional data could be presented to show that the soft drink syrup contains more than 6 percent soluble nonsugar solids, then an appeal for reclassification may be justified.

Case 5

The proposal for the final inspection of Korean-made suits, within the trade zone, before shipping to individual U.S. customers has been approved. Currently, it is the only project in operation within the zone.

We did not evaluate the appropriateness of the above decisions as we had little information other than that presented in the original proposals. Appeals are permitted on these decisions, and such resubmissions should be supported by adequate documentation to show that the decisions reached resulted from a misclassification or misunderstanding of the facts involved.

We hope the above data may be of assistance to you.

Sincerely yours,

Comptroller General  
of the United States

Enclosures - 3

Information Needed by Bureau of Customs  
to Determine the Classification and Rate  
of Duty on Specified Goods

- (1) A complete description of the goods. Send samples, sketches, diagrams, or other illustrative material when the goods cannot adequately be described in writing.
- (2) The method of manufacture or fabrication.
- (3) Specifications and analyses.
- (4) Quantities and costs of the component materials--with percentages if possible.
- (5) Information as to the:
  - (a) Commercial designation of the goods in the United States; and
  - (b) Chief use of the goods in the United States.

Some Products with Import Restrictions  
Administered by Various Government Agencies

<u>Product</u>	<u>Office/Agency</u>	<u>Function/Authority</u>
Oil and gas	Office of Oil and Gas Department of Interior Washington, D. C. 20240	Licensing and Quotas
Watches and watch movements from insular possessions	Office of Import Programs Bureau of Resources and Trade Assistance Department of Commerce Washington, D. C. 20230	Licensing and Quotas
Sugar and products con- taining sugar	Sugar Quota Group Policy and Program Appraisal Division Agricultural Stabilization and Conservation Service Department of Agriculture Washington, D. C. 20250	Quota
Certain dairy products	Import Branch Foreign Agricultural Service Department of Agriculture Washington, D. C. 20250	Licensing and Quotas
Cotton, textiles	Interagency Textile Administrative Committee Department of Commerce Washington, D. C. 20230	International Agreement
Narcotics, marijuana, dangerous drugs	Bureau of Narcotics and Dangerous Drugs Department of Justice Washington, D. C. 20530	Regulations
Arms, ammunition, explosives and implements of war	Alcohol, Tobacco and Fire- arms Division Internal Revenue Service Washington, D. C. 20224	Licensing

<u>Product</u>	<u>Office/Agency</u>	<u>Function/Authority</u>
Gold and silver bullion, coins, articles	Domestic Gold and Silver Operations Department of the Treasury Washington, D. C. 20220	Gold Regulations
Articles from Mainland China, North Korea, North Viet Nam, Cuba, and Rhodesia	Foreign Assets Control Department of the Treasury Washington, D. C. 20220	Foreign Assets Control Regulations
Foods, beverages, drugs cosmetics, dangerous caustic and corrosive substances	Food and Drug Administration Department of Health, Education and Welfare Washington, D. C. 20204	Federal Food Drugs and Cosmetic Act
Fur, wool, textile fiber products	Federal Trade Commission Washington, D. C. 20580	Fur Products Labeling Act Flammable Fabrics Act Textile Fiber Products Identification Act Wool Products Labeling Act
Wild or game animals or products therefrom	Bureau of Sport Fisheries and Wildlife Department of Interior Washington, D. C. 20240  Public Health Service Department of Health, Education and Welfare Washington, D. C. 20201	Endangered Species Act Migratory Bird Treaty Act
Cats, dogs, monkeys, and other pets	Foreign Quarantine Program National Communicable Disease Center Atlanta, Georgia 30333	Foreign Quarantine Regulations
Meat, meat food products	Animal Health Division Department of Agriculture Federal Center Building Hyattsville, Maryland 20782	Agricultural Regulations

<u>Product</u>	<u>Office/Agency</u>	<u>Function/Authority</u>
Fruits, vegetables	Fruit and Vegetable Division Consumer and Marketing Service Department of Agriculture Washington, D. C. 20250	7 U.S.C. 608 (e) Part 1060, 7CFR also Federal Seed Act of 1939
Plants, plant products	Plant Quarantine Division Plant Importation Branch Department of Agriculture 209 River Street Hoboken, New Jersey 07030	7 U.S.C. 608 (e) Part 1060, 7CFR
Radioisotopes, uranium, thorium, plutonium, nuclear reactors	Atomic Energy Commission Washington, D. C. 20545	Atomic Energy Commission Regulations
Automobiles, automotive equipment	Office of Standards Enforcement National Highway Traffic Safety Administration Department of Transportation Washington, D. C. 20590	National Traffic & Motor Vehicle Safety Act
	Mobile Source Pollution Control Program Environmental Protection Agency Willow Run Airport Ypsilanti, Michigan 48197	Pollution Control
Televisions	Bureau of Radiological Health Division of Electronic Products 12720 Twinbrook Parkway Rockville, Maryland 20852	Radiation Control for Health and Safety Act for 1968
Insecticides, fungicides, herbicides, rodenticides	Pesticides Regulation Division Environmental Protection Agency Washington, D. C. 20460	Insecticide, Fungicide and Rodenticide Act of 1947

Source: "Exporting to the United States," A Bureau of Customs publication.





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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 transhipped 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

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

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 225 jobs and annual exports of about 91,000 tons of pulp product valued at about \$13 million annually. These 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-114898).

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 processes 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 screened 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 reexport of the finished product was an important consideration in establishing foreign trade zones.

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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 X 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 transhipped 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  
Chairman, Foreign Trade Zones Board