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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Chairman Committee On Ways And Means House Of Representatives

Foreign Trade Zone Growth Primarily Benefits Users Who Import For Domestic Commerce

The Foreign Trade Zone Act of 1934, as amended, authorizes the establishment of designated geographic areas within the United States, called foreign trade zones, into which foreign goods may be brought without the payment of duties and with a minimum of the paperwork required by U.S. Customs. Such goods, which may be further processed in the zones, may be exported without incurring customs duties or may be entered into the customs territory of the United States upon payment of applicable duties.

GAO found that:

--growth in the number of zones and dollar value of business activity has been substantial and continuous over the past 10 years;

--zones were initially expected to primarily benefit the reexport and transshipment trade, but more than 80 percent of zone products are now entered into domestic commerce; and

--zones' impact on U.S. employment is inconclusive.

UNITED STATES GENERAL ACCOUNTING OFFICE

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

GENERAL GOVERNMENT
DIVISION

B-199500

The Honorable Dan Rostenkowski
Chairman, Committee on Ways
and Means
House of Representatives

Dear Mr. Chairman:

In response to your May 20, 1983, request, this report provides our assessment of foreign trade zone operations.

As arranged with your office, unrestricted distribution of this report will be made 3 days after the date of the report or at the time of public release of the report's contents by your office.

Sincerely yours,

W. J. Anderson

William J. Anderson
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE CHAIRMAN,
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

FOREIGN TRADE ZONE GROWTH PRIMARILY BENEFITS USERS WHO IMPORT FOR DOMESTIC COMMERCE

D I G E S T

The Foreign Trade Zone Act of 1934, as amended, authorizes the duty-free entry of imports with minimum customs paperwork into a designated geographic area within the United States, called a foreign trade zone. Such goods, which may be further processed in the zones, may then be exported without incurring customs duties or may be entered into the customs territory of the United States upon payment of applicable duties.

WHY THE REVIEW WAS MADE

At the request of the Chairman of the House Ways and Means Committee, GAO reviewed foreign trade zone operations and found that:

--growth in the number of zones and dollar value of business activity has been substantial and continuous over the past 10 years;

--zones were initially expected to primarily benefit the reexport and transshipment trade, but more than 80 percent of zone products are now entered into domestic commerce (see p. 3); and

--zones' impact on U.S. employment is inconclusive.

GAO did not obtain agency comments on this report.

FOREIGN TRADE ZONES-- WHAT ARE THEY AND HOW ARE THEY ADMINISTERED

A foreign trade zone is a fenced off or otherwise secured area within the United States that is located in or adjacent to a customs port of entry. It is operated by a public or private corporation upon approval by the Foreign Trade Zones Board. The United States is geographically divided into 310 ports of entry and each port is entitled to at least one zone. Foreign and domestic goods may enter a zone to be stored, distributed, combined with other foreign and domestic products, or used in manufacturing operations.

There are two types of zones--general purpose zones and subzones. General purpose zones are those specifically provided for in the act as being in or adjacent to ports of entry. They generally have multiple users and are primarily used for warehousing and distributing, although some assembling or small-scale manufacturing is occasionally done.

Subzones, on the other hand, are a type of special purpose zone first authorized in 1952 by regulation. They are technically part of, but physically removed from, a sponsoring general purpose zone and have a single user to whom the facilities located within the subzone belong. Also, unlike the general purpose zones, subzone users are engaged in large-scale manufacturing within the subzone boundaries. (See pp. 1 and 2.)

A foreign trade zone applicant may be a public or private corporation. Authority for approving zone applications is vested in the Foreign Trade Zones Board which administers the act. The Board is comprised of the Secretary of Commerce, who is the Chairman and Executive Officer of the Board, and the Secretaries of the Treasury and the Army. Upon the Board's approval, each zone is operated as a public utility. The zone grantee publishes a schedule of charges for the facilities and services applicable to all domestic businesses that wish to operate in the zone. The Customs Service has responsibility for the transfer of both foreign and domestic products into and out of a zone and for matters involving the collection of duties and taxes. The zone operator is obligated to reimburse Customs for the cost of such services.

DEVELOPMENT OF FOREIGN TRADE ZONES

The legislative history of the 1934 act shows that many supporters of foreign trade zones viewed them as mechanisms broadly designed to benefit many diverse sectors of domestic industry, including the maritime industry, domestic producers, and labor. The primary focus of the legislation's supporters was to increase the Nation's reexport and transshipment trade. This stemmed from the belief that the United States was not competitive with other countries in developing these markets during a time of world depression when the Nation's imports exceeded its exports. As such, under the trade zone concept, zones would be used to expedite foreign commerce and to increase domestic employment opportunities by facilitating and increasing exports, reexports, and transshipments through the Nation's port facilities. (See p. 3.)

In 1950, the act was amended to allow for manufacturing and exhibiting (displaying), which had been prohibited by the 1934 act. Legislative supporters believed that by broadening the scope of activity permitted within the zones, there would be increasing opportunities for U.S. businesses and labor to participate in world trade. Some supporters of the 1950 amendment also cited the benefits that would result from providing an American market for the products of nations being assisted by U.S. postwar economic recovery programs during a time when exports exceeded imports. (See pp. 5 and 6.)

GREATEST ZONE GROWTH HAS TAKEN PLACE IN PAST DECADE

In 1973 there were 13 general purpose zones and 5 subzones. By 1983, there were 87 approved general purpose zones and 30 subzones. The value of goods leaving the zones has soared from $161 million to $4.0 billion, with subzones producing more than 60 percent of the dollar value of zone business activity. (See pp. 9 and 11.)

The continuing growth in zone use is evident from the 29 applications pending Board approval. Furthermore, the dollar value of zone business activity is expected to continue to increase because as of November 1983, 21 of the 87 approved general purpose zones and 12 of the 30 approved subzones had not yet begun operations. (See p. 11.)

The potential for growth in the number of zones and dollar value of business activity is significant. As of December 1983, only 81 of the 310 U.S. ports of entry had a general purpose zone(s), and Board officials told us they receive more inquiries every day. (See p. 11.)

GROWTH ATTRIBUTABLE TO VARIOUS FACTORS

Notwithstanding the 1950 amendment to allow manufacturing in zones and the 1952 administrative authorization for subzones, there was not a dramatic increase in the number or uses of zones immediately following these developments. Rather, the significant increase appears to be attributable to a 1980 Treasury ruling that the dutiable value of finished products processed in the zone would only be the value attributable to the foreign components used. Furthermore, marketing of the zone concept by various trade associations and communities and changing economic factors also contributed to this increase. (See pp. 11 and 12.)

ZONES PROVIDE SUBSTANTIAL BENEFITS TO USERS

Zones provide competitive benefits to users that are not available to non-zone users. The primary benefits are simplified customs procedures, deferred payment of duties, duty reduction, and duty avoidance. There are also other benefits associated with zone use, such as increased security and deferral of taxes. The amount and types of users' benefits vary by zone activity (manufacturing versus non-manufacturing) as well as the ultimate disposition of a zone's output (whether that output enters domestic or foreign commerce). (See p. 16.)

The majority of products leaving zones are entering domestic commerce rather than being reexported to foreign commerce as visualized at the time the act was passed. Zone users that import are able to realize substantial duty savings that are not available to comparable businesses not operating in zones. (See pp. 19 and 20.)

CERTAIN INDUSTRIES OBJECT TO MANUFACTURING IN ZONES

Overall there has been little or no opposition to general purpose zones. However, some industries have expressed concerns to the Foreign Trade Zones Board about the dramatic growth in subzones and the manufacturing and assembling taking place in them. Specifically, opposition to the use of trade zones to produce certain products, for example, iron and steel, electronic components, bicycles, and textiles for clothing, has resulted in the Board limiting the use of trade zones for certain industries. However, there has been little or no opposition to the largest subzone user, the auto industry. (See pp. 20 to 22.)

OVERALL IMPACT OF FOREIGN TRADE ZONES ON EMPLOYMENT IS INCONCLUSIVE

The Foreign Trade Zone Act of 1934 sought to increase economic activity in the United States, including the stimulation of exports. As a consequence of the increased economic activity, the act also sought to increase employment in the United States.

The local and national aspects of zone-related employment are two very different phenomena. On the local level, GAO's work disclosed a variety of different outcomes ranging from no effect on current employment levels to gains in local employment. On the national level, however, it is inconclusive whether foreign trade zones result in increased U.S. employment over the long-term. The value of trade moving through zones is so small relative to the Gross National Product that it is impossible to measure the impact zones have on the U.S. economy.

Foreign trade zones do not necessarily increase employment if businesses operating in zones would still operate outside them. Zone benefits are only one of many factors that influence such business decisions. Further, the degree to which zones contribute to increasing employment, if at all, is affected by the level of activity conducted by zone users, and, whether any increase in activity is gained at the expense of domestic or foreign competitors. (See pp. 24 to 28.)

C o n t e n t s

ABBREVIATIONS

GAO General Accounting Office

GNP Gross National Product

CHAPTER 1

INTRODUCTION

The Foreign Trade Zone Act of 1934, as amended, authorizes the duty-free entry of imports with minimum customs paperwork into a designated geographic area within the United States, called a foreign trade zone. Such imports, which may be further processed in the zones, may then be exported without incurring customs duties or may be entered into the customs territory of the United States upon payment of applicable duties.

In the approximately 40 years following enactment of the foreign trade zone legislation, only 18 zones had been established. As of December 1983, however, this number had increased to 117. And, as of October 1983, there were 29 applications for zones pending. Because of the recent upsurge in zone use, the House Committee on Ways and Means asked us to conduct a fact-finding review of foreign trade zone operations (see app. I).

FOREIGN TRADE ZONES--WHAT THEY ARE

Foreign trade zones are fenced off or otherwise secured areas within the United States which have facilities for handling, storing, manufacturing, or exhibiting (displaying) goods. The United States is geographically divided into 310 ports of entry which comprise the U.S. Customs territory. Each customs port of entry is entitled to at least one foreign trade zone. When a port is located within the confines of more than one state, such a port is entitled to a zone in each state. Additional zones may be authorized within the boundaries of the port of entry if the existing or authorized zones do not meet the users' requirements.

Foreign and domestic goods may be brought into the zones to be stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic products, or used in a manufacturing operation. After the goods are processed in the zones, the products may be exported free of customs duties, or they may enter domestic commerce subject to laws and regulations concerning imports, including the payment of applicable duties.

There are two types of zones authorized--general purpose zones and subzones. General purpose zones are those specifically provided for in the act as being in or adjacent to ports of entry. They are usually warehouses primarily used for storing, repacking, and distributing although some assembling or small-scale manufacturing is occasionally done. Most general purpose zones have multiple users--businesses who rent space in the facilities. Subzones, on the other hand, are a type of special purpose zone first authorized in 1952 by regulation. They are technically part of, but physically removed from, a sponsoring general purpose zone.[1] Unlike the general purpose zones, each subzone has a single user to whom the facilities located within the subzone belong. Also unlike the general purpose zones, subzone users are engaged in large-scale manufacturing within the subzone boundaries.

ZONE AUTHORIZATION PROCESS

A foreign trade zone applicant--grantee--may be a public or private corporation. Authority for approving zone applications is vested in the Foreign Trade Zones Board by the act. The Board is comprised of the Secretary of Commerce, who is the Chairman and Executive Officer of the Board, the Secretary of the Treasury, and the Secretary of the Army. Each Secretary designates a representative to serve on a committee of alternates which performs all the duties of the Board except those specifically imposed by law on the members.

The Board's regulations require that a foreign trade zone application contain certain specific information such as a description of zone location and its boundaries, a detailed statement showing how the zone will be financed, and an economic survey showing the potential commerce and revenue to be derived from zone operations. Prior to its approval, each application is subject to an investigation by the Board's examiners which may include public hearings.

Under the act, the Board has the authority to deny an application or halt any zone operation it finds to be against the public interest. Since 1934, the Board has denied two applications, both of which were for subzones. In one case, the Board saw no evidence of a public benefit. The other application was denied because the activity could have been accommodated in the sponsoring general purpose zone. Operational restrictions were imposed in four cases. For instance, a proposal for a steel pipe subzone was approved for export manufacturing only.

Each zone is operated as a public utility. The zone grantee publishes a schedule of charges for the facilities and services applicable to all domestic businesses that wish to operate in the zone. The grantee must submit a yearly report of its activities to the Board. The Board, in turn, is required to submit a consolidated report to the Congress each year. The reports have been untimely, however. The most recent report,

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[1]For example, while it is within the geographic boundaries of the Honolulu, Hawaii, port of entry, an oil refinery subzone is located about 20 miles from the general purpose zone at the Honolulu Harbor.

for fiscal year 1981, presented information that was already 2 years old at the time of publication. The locations of authorized zones as of December 1983 are shown on the map on the following page.

The Customs' district director in whose district the zone(s) is located is the resident representative of the Board. Customs personnel monitor activities within each zone to ensure compliance with applicable laws and regulations. Customs has responsibility for the transfer of both foreign and domestic products into and out of a zone and for matters involving the collection of duties and taxes. The zone operator or grantee is obligated to reimburse Customs for the cost of such services.

DEVELOPMENT OF FOREIGN TRADE ZONES

The legislative history of the 1934 act shows that many supporters of foreign trade zones viewed them as mechanisms broadly designed to benefit many diverse sectors of American industry, including the maritime industry, domestic producers, and labor. The primary focus of the legislation's supporters was to increase the Nation's reexport and transshipment trade.[2] This stemmed from the belief that the United States was not competitive with other countries in developing these markets during a time of world depression when U.S. imports exceeded its exports. As such, under the trade zone concept, zones would be used to facilitate foreign commerce and to increase domestic employment opportunities by facilitating and increasing exports, reexports, and transshipments through the Nation's port facilities.

Efforts to encourage the reexport and transshipment of goods did not begin with foreign trade zone legislation. Earlier legislative efforts resulted in the establishment of bonded warehouses and the drawback system. Bonded warehouses can be used for the duty free entry and processing of goods intended solely for reexport. Under the drawback system,

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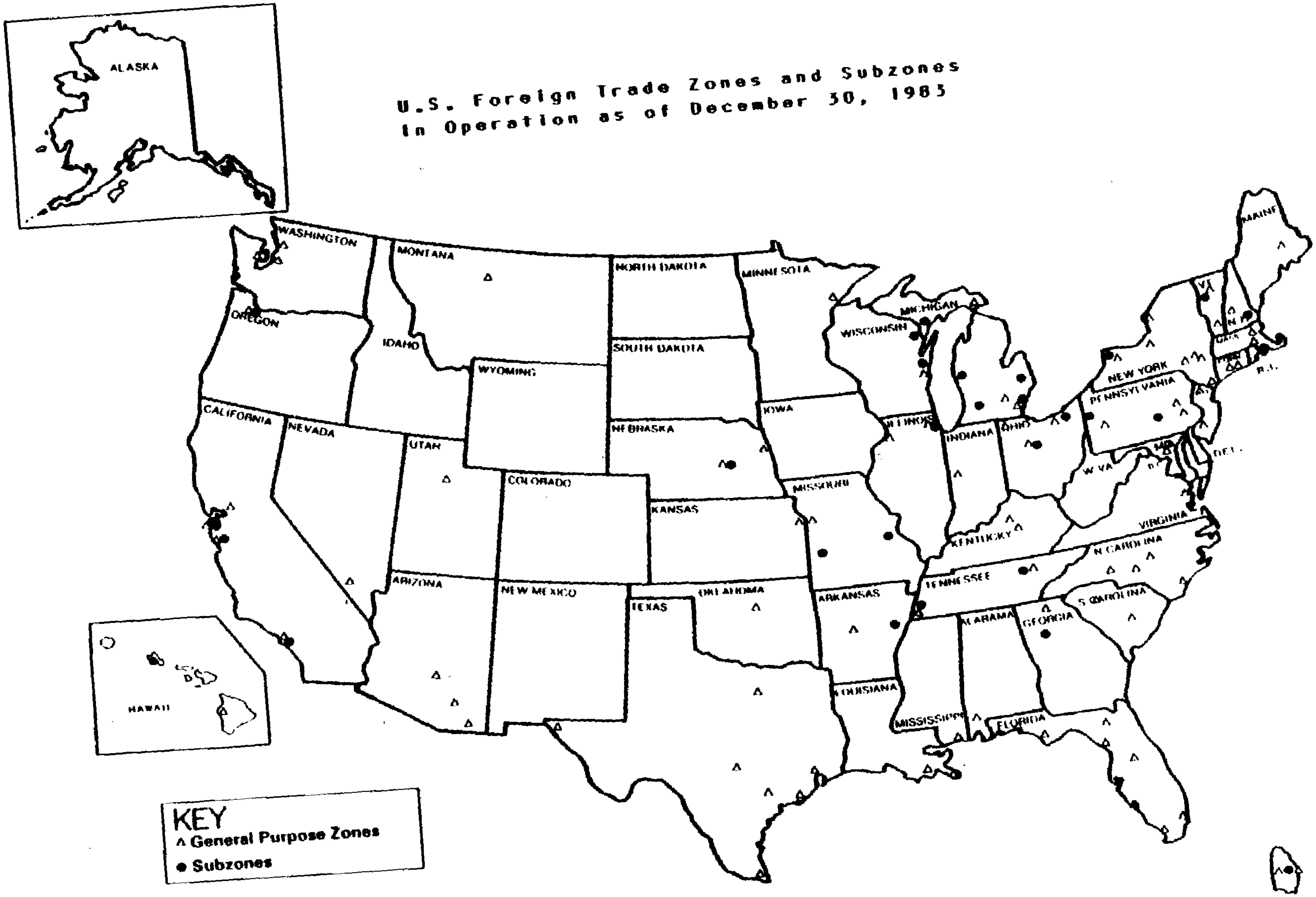
[2]Reexport refers to the temporary importation of goods for processing and their subsequent export. Transshipment refers to unloading goods coming from one foreign port and reloading them for shipment to a second foreign port.

U.S. Foreign Trade Zones and Subzones
In Operation as of December 30, 1983



99 percent of customs duties paid on imported goods are subsequently refunded if such goods are reexported. Some supporters of the 1934 act viewed the zones as a less complicated alternative to bonded warehouses and the drawback system which would make it easier to encourage the reexport and transshipment of goods.

Thus, foreign trade zones were not viewed as new policy, but as an improvement over existing devices. As stated in the Senate Report on the 1934 legislation:

> "The creation of devices such as the bonded warehouse and the drawback system indicates that it is not the policy of our Government to subject to our tariff laws those goods not destined for domestic use. However, in its attempt to free them from the operations of our tariff laws, the method adopted has proven burdensome and expensive, and has prevented the United States from building up a large transshipment commerce. The establishment of foreign-trade zones will liberate the transshipment trade from the burden and expense now imposed upon it, and will do much to assist in building up the United States as a transshipment center."

While the central theme cited by the zone's legislative supporters was the development of the Nation's reexport and transshipment trade, the 1934 act also provided for the treatment of zone products entering domestic commerce, subject to the laws and regulations governing imports. The legislative history reveals that the zones were intended to benefit many diverse sectors of American industry. However, even the legislation's supporters agreed that the benefits of the zones could not be forecasted and that policy with regard to the zones would develop and need to be reviewed as use materialized.

Congressional opposition to the foreign trade zones centered on whether the zone benefits would be outweighed by increased foreign competition with domestic businesses. This controversy was the motivation behind congressional supporters agreeing to prohibit manufacturing and exhibiting in zones under the 1934 act, although many of them thought that such activities would be desirable.

The restrictions against manufacturing and exhibiting within the zones proved to be difficult to administer. In the case of manufacturing, there were no guidelines as to what constituted a manufacturing operation. Similarly, exhibition was difficult to distinguish from the permissible activities of examination, inspection, and sampling. The fact that only five zones were operating by 1950 was attributed by some public and private sector officials to these restrictions.

The general purpose of the 1950 amendment was to make those refinements to the 1934 act needed to encourage the creation of additional zones and to broaden the scope of activity within the zones by permitting manufacturing and exhibiting. Difficulty in distinguishing between some permissible and prohibited activities under the 1934 act contributed to the passage of the 1950 amendment.

The primary focus of the amendment was to provide increased opportunities for American businesses and labor to participate in world trade. In addition to increasing the various components of the Nation's reexport trade, domestic businesses could use the zones to process imported raw materials, component parts, and other goods in combination with domestic goods in the manufacturing of products prior to export. Also, domestic goods which previously were exported to be combined with foreign goods before being sold in foreign commerce could now be placed in a zone and combined with imported goods, using U.S. labor instead of foreign labor, and then be exported free of duties.

Some supporters of the 1950 amendment focused on the zones in the context of world trade, citing the fact that U.S. exports exceeded imports. This contrasted with the economic environment of the 1934 act in which there was concern about the ability of the United States to compete in world trade during the world depression. These supporters pointed out that permitting manufacture for export in the zones would complement U.S. actions aimed at assisting countries rebuilding their economies after World War II by providing an export market for their raw materials.

OBJECTIVES, SCOPE, AND METHODOLOGY

We undertook our review at the request of the Chairman of the House Ways and Means Committee, who asked us to review the growth and operations of foreign trade zones. The Chairman asked us in particular to provide information on the following areas:

--the legislative history, administration, and operations of foreign trade zones;

--uses, growth, and benefits associated with foreign trade zones;

--the impact of foreign trade zones on employment; and

--safeguards in the foreign trade zones.

Because we briefed the Committee on the subject of safeguards in zones on January 30, 1984, we did not include it in our report.

In addressing the other areas of concern, we conducted an extensive examination of the general purpose zones and subzones in operation as of September 30, 1982.[3] Our review of the subzones encompassed 9 of the 10 in operation at the end of fiscal year 1982 and 4 of the 9 which became operational during fiscal year 1983, for a total of 13. Of these, we reviewed 11 in detail. The locations and types of operations represented were as follows:

Location	Activity
Claycomo, Missouri	Automobile assembly
Detroit, Michigan	Automobile assembly
Fenton, Missouri	Automobile assembly
Kenosha, Wisconsin	Automobile assembly
Lincoln, Nebraska	Motorcycle assembly
Manitowac, Wisconsin	Piston rings manufacturer
Marysville, Ohio	Automobile and motorcycle assembly
Romeo, Michigan	Tractor assembly
San Francisco, California	Apparel manufacturer
Smyrna, Tennessee	Truck manufacturer
Wayne, Michigan	Automobile manufacturer
Honolulu, Hawaii[a]	Oil refinery
New Stanton, Pennsylvania[a]	Automobile assembly

[a]Although we gathered statistical information on these subzones, we did not visit the facilities.

We also visited and reviewed the operations of 21 general purpose zones. In selecting these general purpose zones, we attempted to identify a cross section which would be representative of all zones in terms of the value of zone transactions, export/import orientation, and types of goods processed. Accordingly, the general purpose zones visited were located in: Battlecreek, Michigan; Boston, Massachusetts; Burlington, Vermont; Cincinnati, Ohio; Detroit, Michigan; Dorchester County, South Carolina; Granite City, Illinois; Kansas City, Kansas; Kansas City, Missouri; Lincoln, Nebraska; McAllen, Texas; Miami, Florida; Milwaukee, Wisconsin; Nashville, Tennessee; New Orleans, Louisiana; New York, New York; Oakland, California; Panama City, Florida; Port Everglades, Florida; San Francisco, California; and San Jose, California.

In conducting our review of the zones' operations, we interviewed the Executive Secretary of the Board, officials of the

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[3]When we initiated our review in July 1983, the fiscal year 1982 period reflected the most current information on foreign trade zones maintained by the Foreign Trade Zones Board.

Department of the Treasury, the Department of Commerce, and Customs; zone operators and users; industry executives; and officials of various trade associations. We also reviewed policies, regulations, and procedures applicable to foreign trade zones at Customs and Board headquarters in Washington, D.C., and at various Customs field offices and zones where we conducted our on-site visits.

We analyzed the legislative history of the Foreign Trade Zone Act of 1934 and its 1950 amendment and traced the historical development of zones. We also reviewed documents pertaining to the establishment of zones, including applications, transcripts of public hearings for zones applications, the Board's annual reports to the Congress for fiscal years 1973 through 1981, and the zones' individual reports for fiscal year 1982. No fiscal year 1983 zone operating data was available at the time we completed our work in November 1983.

In addressing the impact of foreign trade zones on employment, we analyzed the employment effects both on the local and national levels. On the local level, use was made of a number of zone case examples. On the national level, use was made of generally accepted conclusions from the economic theory of international trade and finance. In an effort to substantiate our conclusions, we considered simulations of several large-scale macroeconometric models of the U.S. economy. However, the current value of trade moving through the zones is so small relative to Gross National Product (GNP)--$4.0 billion versus $3 trillion in 1982--that any analysis would be inconclusive.

Our review was conducted in accordance with generally accepted government auditing standards. We began our audit work in July 1983 and completed it in November 1983. Because of time constraints, the Committee requested we not obtain agency comments on this report.

CHAPTER 2

FOREIGN TRADE ZONES--GROWTH AND CONCERNS

Since 1973, the number of zones and the dollar value of their business activities have shown substantial and continuous growth. Prior to that, the few existing zones had little activity. Subzones, which are large-scale manufacturing operations, are responsible for more than 60 percent of zone activity. Furthermore, the continuing growth in the use of zones is evident from the numerous zone applications pending as well as the number of approved zones not yet operating. The increased use of zones appears to be attributable in part to the 1980 Treasury ruling that the dutiable value of finished products processed in the zone would only be the value attributable to the foreign components used. The increase can further be attributed to marketing of the zone concept by various trade associations and communities and changing economic factors.

The business activities in zones cover a broad spectrum and vary by type of zone. While zones were intended to benefit diverse sectors of American industry, and the 1934 act specifically provided for the treatment of imports entering domestic commerce from the zones, it was expected that zones would be used primarily for reexport and transshipment to promote foreign commerce. Instead, more than 80 percent of the products leaving zones in the past decade have entered domestic commerce, while the remainder have been exported.

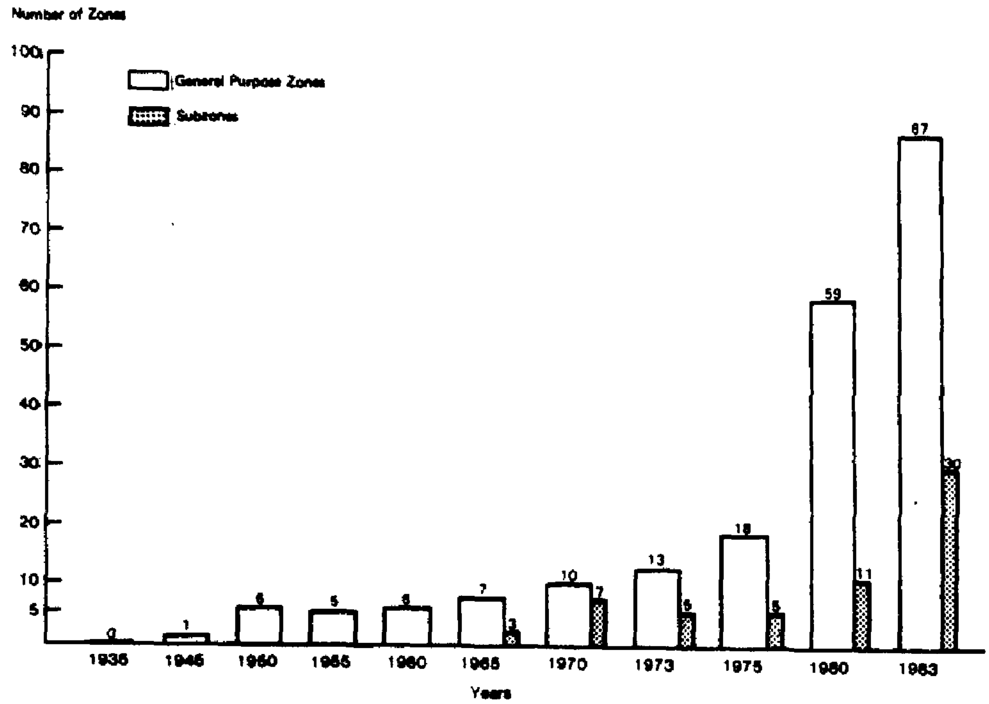
Zones offer substantial cost savings, simplified customs procedures, and other benefits to users. These benefits generally are not available to similar businesses operating outside the zones. Furthermore, these benefits go primarily to businesses that provide goods for domestic commerce, rather than for reexportation. Subzones enter higher percentages of goods into domestic commerce than general purpose zones.

So far we have seen little or no opposition to general purpose zones. However, four industries--iron and steel, electronic components, textiles, and bicycles--have opposed zone applications for manufacturing operations. Most manufacturing takes place in subzones. Automobile manufacturers, the largest users of subzones, view subzones favorably.

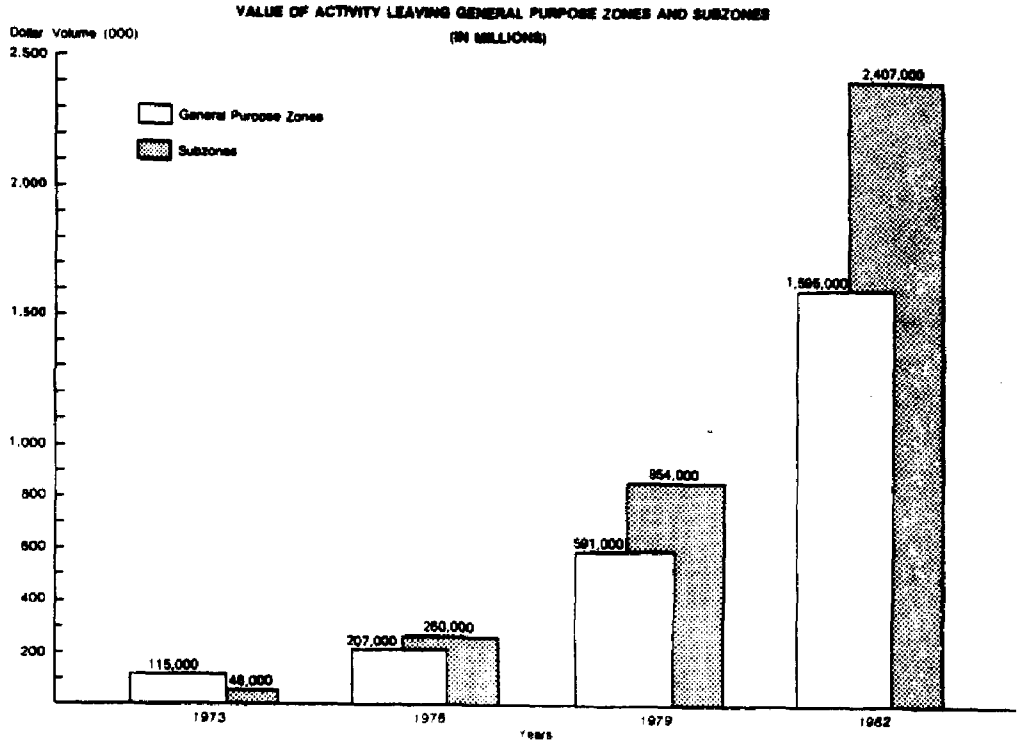
GREATEST GROWTH OF FOREIGN TRADE ZONES HAS TAKEN PLACE IN THE PAST DECADE

Statistics illustrate the significant growth in zones and the value of their activities. In 1973 there were 13 general purpose zones and 5 subzones. In 1983, there were 87 general purpose zones and 30 subzones, and the value of their activities has soared from $161 million to $4.0 billion. The following graphs show the significance of zone growth.

NUMBER OF GENERAL PURPOSE ZONES AND SUBZONES



VALUE OF ACTIVITY LEAVING GENERAL PURPOSE ZONES AND SUBZONES (IN MILLIONS)



Goods that enter a zone are often stored and processed further before leaving the zone. Consequently, the value of goods entering and leaving a zone during any particular year is not always the same. To simplify our discussion of zone operations, we have used only the value of goods leaving a zone. The value of goods entering zones reflects a similar pattern and this information is contained in appendix II.

Subzones mainly responsible for overall growth in value of zone activity

In the 1973 to 1982 period, the subzone share of goods produced in the zones rose from 29 to 62 percent. And, the value of these products jumped fifty-fold, from $47 million to $2.4 billion. Meanwhile, general purpose zone value of business activity increased twelve-fold, from $114 million to $1.5 billion.

Growth expected to continue

The potential for growth in the number of zones and value of activity is enormous. As we pointed out earlier, each of America's 310 ports of entry is entitled to at least one general purpose zone and an unrestricted number of subzones. As of December 1983, 81 of the 310 ports of entry had a general purpose zone, and Board officials told us they receive more inquiries every day.

The continuing growth in zone use is evident from the 29 applications pending Board approval. Furthermore, the value of zone activity will continue to increase because as of November 1983, 21 of the 87 approved general purpose zones and 12 of the 30 approved subzones had not yet begun operations. When these zones become operational, they will substantially increase the value of zone business activity.

Several factors responsible for increased zone activity

Notwithstanding the 1950 amendment to allow manufacturing in zones and the 1952 administrative authorization for subzones, there was not a dramatic increase in the number or uses of zones immediately following these developments. Rather, the significant increase appears to be attributable to a 1980 Treasury ruling that the dutiable value of finished products processed in the zone would only be the value attributable to the foreign components used. Furthermore, marketing of the zone concept by various trade associations and communities and changing economic factors have also contributed to the increase.

Neither the 1950 amendment to allow manufacturing nor the Board ruling to authorize subzones had an immediate impact on the proliferation of zones. The recent growth in the value of zone activity is largely attributable to large-scale manufacturing being done in subzones. This growth appears to have resulted from subsequent administrative actions and changing economic factors.

The Department of the Treasury and Customs have made two valuation decisions that made it more attractive to manufacture in subzones. First, Treasury Decision 80-87, effective April 21, 1980, deleted value added (consisting of a percentage of the value of the processing and/or manufacturing costs, overhead, and profit) in the foreign trade zone from the dutiable value of the finished product for duty assessment purposes. Second, in June 1982 Customs modified an earlier position on Treasury Decision 80-87 and also excluded brokerage and insurance fees and transportation costs from the dutiable value of a finished product.[1]

These changes made only the value of foreign components dutiable. Thus, the changes lowered the dutiable value of zone-processed products, and, consequently the duty paid on them. Representatives of the five leading U.S. automakers told us they would not operate in subzones without Treasury Decision 80-87 because paying duty on the value added would have negated the benefit of the duty reduction obtained from operating in a zone.

The growth of zones and subzones can also be attributed to the marketing being done by the National Association of Foreign Trade Zones, the Motor Vehicle Manufacturing Association, grantees, and communities. This marketing has increased public awareness of the benefits of zones.

Domestic auto industry officials told us that changing economic conditions plus foreign and domestic competition led them to greatly change their product lines and import more auto parts. The auto industry's use of subzones to obtain lower duty rates and to defer such duties made it economically feasible to increase imported components and raw materials.

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[1]Before these decisions, the dutiable value included: merchandise cost at the foreign port; brokerage and insurance fees; transportation costs; and a percentage of value added in the zone.

The domestic auto industry started making smaller, more gas efficient cars to meet the demands of American consumers. According to auto industry officials, however, their plants were not equipped to make four cylinder engines and front wheel drive trains for economy cars. Considering the investment capital and lead time needed to manufacture these parts, they decided to import them instead. Consequently, they decided to buy engines and drive trains from foreign firms and to assemble them with domestic parts in U.S. subzones. Subzone status and benefits make domestic manufacturers more competitive with their foreign counterparts. According to U.S. auto industry officials, they would still import parts if zones did not exist but added costs would render them less competitive.

In summary, domestic auto industry officials told us that the industry is operating in subzones because of the cost savings. Auto industry officials told us that by operating in zones, they can reduce production costs by $20 a car. They said this dollar savings is very significant to the industry in view of the large number of cars they produce.

GENERAL PURPOSE ZONES AND SUBZONES: MULTIPLE AND SINGLE USERS AND DIFFERENT USES

General purpose zones have multiple users and are primarily used for warehousing, distributing, and other activities. Subzones, on the other hand, are single use manufacturing and/or assembling operations. Zone-processed goods primarily enter domestic commerce.

General purpose zones have multiple users; subzones have single users

There is a sharp contrast between subzones and general purpose zones when it comes to number of users. For example, each subzone had only one user during 1982. General purpose zones, on the other hand, tend to have multiple users. The following table shows the range of users in general purpose zones for 1982.

Range of users	Number of zones
1 to 5	16
6 to 10	7
11 to 15	1
16 to 20	1
21 to 40	5
41 to 75	2
76 to 100	3
101 to 150	2
151 to 200	3

In 1982 only four general purpose zones had a single user. For example, the Burlington, Vermont, general purpose zone is used by a single major manufacturer. Also, some users do not occupy the zone on a full-time basis; they only use it as needed. The Brooklyn, New York, zone, for example, reported 168 users in 1982, but only 14 occupied permanent space in the zone. The New Orleans zone reported 196 users in 1982, but only 12 occupied zone facilities on a continuous basis. The Miami zone reported 150 users in 1982, 110 of whom use it on a full-time basis.

General purpose zones have a wide range of business activities

General purpose zones are utilized primarily as warehousing and distributing facilities. Some of the most common activities carried out in the facilities are packing and unpacking, labeling, inspecting goods, inventorying goods, and destroying inferior products. Zone operators in 1982 reported that 27 percent (11) of the zones also had small-scale manufacturing taking place in general purpose zones. This was up from approximately 15 percent in 1981. An example of small-scale manufacturing is the cutting of wool material into cloth tie pieces. Other products of small-scale manufacturing are bridles, blinds, wire, and plastic.

The range of activities within a specific general purpose zone also varies greatly. For example, the Brooklyn, New York, Foreign Trade Zone has virtually every type of activity discussed above, including small-scale manufacturing. In comparison, the Louisville Foreign Trade Zone is used solely as a warehousing facility. Most general purpose zones had multiple activities during 1982 as the following table illustrates.

Activity	Number of zones indicating activity[a]
Warehousing	41
Packing and repacking	23
Examining and inspecting	23
Labeling	14
Destroying inferior goods	12
Manufacturing (small-scale)	11
Assembling	10
Cutting goods	6
Repairing	3
Exhibiting	4
Sorting	3

[a]Based on information contained in the 41 annual reports available for fiscal year 1982.

Subzones are used for manufacturing and/or assembly operations as well as the storage of components and finished products. The major goods being produced in subzones are automobiles, trucks, motorcycles, tractors, women's garments, and refined oil. The following table shows products manufactured in the 10 active subzones during fiscal year 1982.

Product	Number of subzones[a]
Automobiles	4
Motorcycles	2
Trucks	2
Tractors	1
Women's garments	1
Refined oil	1
Steel pipe	1

[a]Some subzones produce more than one product.

In addition to the 10 active subzones in 1982, there were 8 subzones that became operational in 1983. These eight subzones are used as follows: six to assemble automobiles, one to produce TV's and microwave ovens, and one to produce automotive electronic components. Also, there were 13 subzone applications pending as of December 1983--4 automobile, 3 textile, and 1 each sugar, chemical, gasket, forklift, steel pipe, and shipbuilding.

Most zone products enter domestic commerce

The majority of zone-processed products enter domestic commerce for consumption--82 percent ($2.7 billion) in fiscal year 1982. The percentage is higher for subzones--89 percent ($2.1 billion)--and lower for general purpose zones--64 percent ($578 million). As shown in the following table, this balance between exports and imports--the products that enter domestic commerce--from general purpose zones and subzones has remained at a relatively constant percentage over the 10-year period of rapid zone growth.

Year	Subzone products Imported	Subzone products Exported	General purpose zone products Imported	General purpose zone products Exported	Total Imported	Total Exported
	(percent)					
1982	89	11[a]	64	36[b]	82	18
1981	90	10[a]	62	38[b]	82	18
1980	93	7	59	41	83	17
1979	95	5	69	31	86	14
1978	91	9	68	32	81	19
1977	95	5	78	22	86	14
1976	94	6	80	20	88	12
1975	96	4	77	23	88	12
1974	93	7	80	20	86	14
1973	80	20	89	11	86	14

[a]The major exports were oil and automobiles.

[b]The Miami, Florida, and Brooklyn, New York, general purpose zones account for more than 60 percent of all goods exported.

ZONES PROVIDE SUBSTANTIAL BENEFITS TO USERS, PARTICULARLY THOSE WHO IMPORT FOR DOMESTIC COMMERCE

The primary benefits to zone users are simplified customs procedures, duty deferral, duty reduction, and duty avoidance. There are also other benefits associated with zone use, such as increased security, deferral of taxes, etc. The amount and types of users' benefits vary by zone activity (that is, manufacturing versus non-manufacturing) as well as the ultimate disposition of the zones' output (that is, whether it enters domestic or foreign commerce). The greatest benefits of zone operations usually accrue to subzone users who manufacture or assemble products and enter the finished products into domestic commerce. And while total zone benefits may be quite substantial for some users, such benefits may only be marginal for others.

Simplified custom procedures

The Foreign Trade Zone Act provided for simplified customs procedures with a minimum of paperwork. Several users cited the ease of expediting shipments because of simplified procedures as a primary benefit, especially since time is a key element in shipping. Another zone user told us that paperwork can now be done by his company which enables him to save the $1,000 a month he previously paid in customs broker's fees.

Duty deferral

General purpose zone and subzone users gain a significant cash flow benefit because they do not have to pay the applicable duty on imported raw materials and components until these materials enter domestic commerce. In comparison, non-zone users have 10 days to pay the applicable duty on imports. The deferral of duty can provide considerable cash flow savings when goods ultimately enter domestic commerce as shown by the following examples:

--During a 6-month period, a company brought foreign components with a value of $23.5 million into a zone. These components were used to manufacture product X. The company did not have to pay the duty on the foreign components until product X entered domestic commerce.

--In fiscal year 1983 a company brought foreign components with a combined value of $55.6 million into a zone. These components were utilized to manufacture product Y. The company did not have to pay the duty on the foreign components until product Y entered domestic commerce.

--A particular shipment of eight cases of Z was received in a zone on July 15, 1983. On the same date, six of these cases with a value of $11,883 were entered into Customs territory and assessed at a duty rate of 20 percent, or $2,377. No duty was paid on the remaining two cases with a value of $6,131 until they were removed from the zone 1 month later. As a result, the $1,226 duty was deferred until the two cases entered domestic commerce.

--A company was able to defer about $3 million in duty on manufacturing equipment used in a zone until the first finished product was completed.

Duty reduction

Manufacturers in general purpose zones or subzones gain a significant cash benefit by being able to effectively choose between two duty rates when they import foreign goods into a zone and subsequently send a finished product containing the foreign goods into domestic commerce. Duty reduction is possible when an inverted tariff exists; that is, the duty rates for components or raw materials are higher than the duty rate for the finished product. Section 3 of the Foreign Trade Zone Act provides that zone users may elect when foreign goods are imported into the zone to have duties assessed at the rate applicable to their condition at that time. Those duties then are paid if the foreign goods are sent into domestic commerce regardless of their condition and what rate would be applicable at the time the goods leave the zone.

If this election is not made and foreign goods are sent into domestic commerce, duties are assessed at the rate applicable to the condition of the product leaving the zone and not of the goods which originally were imported. This allows the user to have the lowest duty rate. In contrast, non-zone users must pay the duty on imported components and raw materials at the duty rates applicable to their condition when they enter the United States.

Manufacturers in zones choose the duty rate for the finished product when the duty rate on components or raw materials is higher. This can save subzone users substantial duty as shown by the following examples:

--A company saved more than $2,000,000 in 1 year by taking advantage of the inverted tariff on its product. By having the goods classified in the condition they leave the zone, the company paid a duty rate of 2.8 percent on the finished product rather than an average rate of 3.9 percent on the 37 foreign components used in producing the product. This company told us that planned production increases could increase duty savings to about $3.3 million.

--A company in 1981 and 1982 saved $707,000 and $716,000, respectively, by having the goods classified in the condition they left the zone. As a result, the company paid the finished product duty rate of 5 percent on foreign components instead of an average rate of 6 percent.

--A company estimated that duty reduction and duty deferral in 1984 will save them about $5 million. By selecting the finished product rate, they will pay 2.8 percent versus the 3.6 percent average rate on foreign components.

--A company brings coil steel into the zone and presses it into body stampings. The stampings are then moved to a part of the plant that is not designated part of the zone. At that time, the company pays a duty rate of 3.6 percent on the stampings. The stampings are then reentered into the zone as domestic merchandise. If the company paid duty on the coil steel as it came into the zone, the rate would have been 8.5 percent.

Duty avoidance

Businesses located in general purpose zones and subzones gain a significant cash benefit because they are able to avoid duty that non-zone businesses have to pay. Zone users do not have to pay duty on waste material from manufacturing, items destroyed in the zone, and goods that never enter domestic commerce. Also, they do not have to pay duty on goods produced in the zone which never leave the zone. For example, oil that is consumed in the refining process is not dutiable since it does not leave the zone. In contrast, a non-zone oil refinery would have to pay duty on all oil it imports into domestic commerce. The ability to avoid duties can mean substantial savings to zone users. The following examples indicate the type of duty avoidance taking place:

--A subzone refinery during 1981 to 1982 did not pay duty on $101 million worth of oil that was consumed in the production of oil.

--A general purpose zone user has been able to lower manufacturing costs by destroying substandard electrical components in the zone and thus avoiding the duty.

--Other zone users told us that they use subzones to avoid duty on defective goods and scrap parts but no dollar values were available.

Other benefits

General purpose zone and subzone users realize secondary benefits, including lower insurance costs, deferral of certain taxes, increased security, and better control of quota-restricted items.

Since zones are usually fenced off or otherwise secured, zone users may incur lower insurance costs. Also, zone users that import may defer certain taxes by operating in zones. For example, internal revenue taxes, if applicable, are deferred until goods enter domestic commerce. Zone users are better able to meet import quotas by operating in foreign trade zones. The Foreign Trade Zone Act allows merchandise of every description, including quota-restricted merchandise, to be imported into foreign trade zones unless otherwise restricted by law. Therefore, an importer may ship quota-restricted merchandise into a foreign trade zone in unlimited amounts for storage before entering into domestic commerce in amounts that meet the quota limitations.

Users who import for domestic commerce maximize zone benefits

As provided in the Foreign Trade Zone Act, foreign merchandise may be admitted duty free to a foreign trade zone for storage or further processing, and reexported without incurring custom duties. The majority of products leaving zones are entering domestic commerce, however, rather than being reexported to foreign commerce as visualized at the time the act was passed. Zone users that import are able to take advantage of most, if not all, zone benefits mentioned above. These benefits are not available to comparable businesses that operate outside of a foreign trade zone. Examples of these benefits are illustrated by the following.

--Duties can be avoided or reduced on imports of raw materials, such as steel, textiles and oil; components, such as automobile and tractor parts; and other merchandise.

--Zone users can realize cash flow savings by deferring customs duties and taxes.

--The quota restrictions on sugar can be avoided by using sugar to produce another product not restricted by quota, and then entering the transformed, quota-free merchandise into domestic commerce.

--Duty can be avoided on damaged and defective products, scrap, shrinkage, and fuel consumed in the zone.

CERTAIN INDUSTRIES OBJECT TO MANUFACTURING IN ZONES

Overall there has been little or no opposition to general purpose zones. However, certain industries have expressed concern about the dramatic growth in subzones and the manufacturing and assembling taking place in zones. These industries believe that the manufacturing and assembling is not in the public interest, encourages importation, and gives zone users a competitive advantage over non-users.

Four industries currently have argued against manufacturing or assembly in foreign trade zones. These include the iron and steel industry, the electronic components industry, the textiles industry, and the bicycle industry. However, there has been little or no opposition to the largest subzone users, the auto industry. The automotive parts industry and the autoworkers union have not voiced opposition to date because they believe that the subzones are currently helping them and that general purpose zone operations do not affect them.

The iron and steel industry has opposed at least three zone applications that would entail various types of steel manufacturing. The textile, electronic components, and bicycle industries have all voiced similar opposition to specific zone applications. Their comments, as expressed to the Foreign Trade Zone Board, are summarized below.

--The Iron and Steel Institute stated in a position paper that the net economic effect of granting foreign trade zone applications that allow manufacturing would be negative to the United States as well as domestic steel producers. As a result, domestic steel producers continue to oppose foreign trade zone applications for steel related manufacturing operations which attempt to use this program in a manner not consistent with public interest and the intent of the Congress. Specifically, the Institute stated that inverted tariffs represent a significant economic incentive to import raw materials. Thus, production and employment by domestic companies would be reduced, offsetting production and employment created in the zones and, therefore, not creating a net increase in U.S. production or jobs. Also, duty saved under zone status would likely allow the zone producer to increase his market share, which would presumably result in increased production and employment by the firm in the zone, but would be offset by losses in domestic production and employment.

--The component group of the Electronic Industry Association in a statement letter to the Foreign Trade Zones Board claimed that subzones no longer promote exports but stimulate imports. The group also stated that its objection to foreign trade zones is that they provide special privileges which, when combined with the inverted tariff, enable certain companies to gain an unfair competitive advantage over their counterparts who are not located in foreign trade zones.

--The Committee to Preserve American Color Television in a paper to the Foreign Trade Zone Board said that one company's application for a subzone to manufacture televisions and microwave ovens is inconsistent with U.S. economic policy and unfair trade practice laws and is therefore contrary to the public interest and the application should be denied. The Committee opposed the application for the following reasons: (1) it will allow circumvention of the outstanding dumping finding--the practice of exporting goods at unfair prices--on television receivers, (2) it will allow the company to reduce its duty from 15 to 5 percent because of the inverted tariff, (3) it will create a net job loss to the United States, and (4) it will harm the fragile health of the U.S. television industry.

--The American Textile Manufacturers Association told us it is opposed to manufacturing taking place in zones and that subzones divert the intent of foreign trade zones. The Association said that the zone seeker wants foreign trade zone status to reduce duty because the duty is higher on wool than the finished product, suits. It also told us that the foreign trade zones will clearly be used to import products into domestic commerce and this will hurt the textile industry.

In several instances, applications for zone status have been withdrawn because of opposition voiced by these industries. In others, the opposition caused the Board to place restrictions on the operations of a zone. For example, a zone TV manufacturer is not allowed to take advantage of the inverted tariff on TV's and picture tubes. The duty on TV's is 5 percent, and the duty on pictures tubes is 15 percent.

Auto subzones currently not opposed

To date there has been little or no opposition to the manufacturing of automobiles in subzones. Affected parties told us that the benefits of continued operation of final assembly plants and the continued purchase of many U.S. made components offset the negative impact of reduced employment related to a small percent of components. Auto industry officials told us that those most heavily affected are the employees who make U.S. components which compete with foreign made components used in the zones. For example, Chrysler's use of a Japanese engine in its K-Car results in fewer jobs at the Chrysler engine plant. However, a United Automobile Workers Union official told us that the union has not objected because of continued, and perhaps increased, employment of workers at the Chrysler K-Car assembly plant.

In one case, automotive management officials told us that they were seriously considering closing down specific assembly plants because of unprofitable company operations. However, according to auto industry officials, subzone use in conjunction with other economic package benefits has allowed substantial cost savings and, therefore, has enabled them to effectively compete with foreign automobile producers. In addition, domestic distributors told us that they have not objected to zone usage by the auto industry. Likewise, the National Automotive Parts Association told us that it is not affected by zone use because its membership is only involved with distributors of automobile replacement parts.

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The proponents of the Foreign Trade Zone Act of 1934 and its 1950 amendment believed that foreign trade zones would expedite foreign commerce by facilitating and increasing the reexport and transshipment market in the United States. They also anticipated that zone operations would develop over time, and they have. The growth, however, has not been to the benefit of the reexport and transshipment market as initially envisioned. Rather, the primary beneficiaries of zone operations have been the businesses that ultimately enter zone products into domestic commerce.

Zones provide substantial cost savings, simplified customs procedures, and other competitive benefits to users that are not otherwise available to non-zone users. Automobile industry officials in particular emphasized the importance of zone benefits in keeping U.S. automobiles competitive with foreign imports.

Overall, we found very little opposition to zones, except for certain manufacturing operations. Four industries have expressed serious concerns about manufacturing operations and the associated benefits and competitive advantages gained by zone users, particularly those operating in subzones. However, the major user of subzones--the auto industry--has encountered little or no resistance to manufacturing cars in subzones to date.

The value of zone-produced merchandise has grown substantially over the past 10 years and the potential for continued zone growth is significant. Theoretically, almost every domestic business could qualify for zone status and thereby obtain the duty benefits on the goods they import.

CHAPTER 3

IMPACT OF FOREIGN TRADE ZONES

ON EMPLOYMENT

Among the stated objectives of the Foreign Trade Zone Act of 1934 was to increase economic activity in the United States, including the stimulation of exports. As a consequence of increased economic activity, the act also sought to increase employment in the United States. It was assumed that the increased employment brought about by the foreign trade zones would result in a net addition to overall employment in the United States. To assess this assumption, we attempted to determine employment effects within a general purpose zone or subzone and overall employment effects within the United States. Even though our evidence shows that in some cases employment has increased within a zone, it is inconclusive that total U.S. employment has risen.

The local and national aspects of zone-related employment are two very different phenomena. In order to put these issues in proper perspective, we discuss them separately. In our discussion of local effects, we use specific cases from our audit work to illustrate our points. In the case of national effects, we rely on generally accepted conclusions from the economic theory of international trade and finance.

LOCAL EMPLOYMENT EFFECTS ARE MIXED

Consider first the local aspects of zone-related employment. Does the creation of a general purpose zone or subzone increase employment in the local area? Our audit work disclosed a variety of different outcomes ranging from maintaining current employment levels to increasing local employment levels. In some cases, there is no effect on local employment. For example, in one instance, after the creation of a zone, a firm moved its operation from one area of a city to the area where the zone was located. No new jobs were created in this city or local area. Only the actual place or location of employment changed.

Our other local employment examples are a little more complicated. When imported component parts are brought into a zone and combined with domestic components to produce a finished product for domestic commerce, the applicable duty rate is the lower of the rates for the foreign components or the finished product. Because the duty rates for foreign component parts and the completed products embodying those components are different in numerous cases, especially for automobiles, the interaction of the zone legislation and tariff schedules can produce a variety of local employment effects. The examples that follow are drawn from the automobile industry, a major user of subzones.

As an example in which the interaction worked to maintain local employment levels, consider the decision by American Motors to import foreign components for final automobile assembly in the United States. American Motors officials told us that without the zone legislation it would have been more costly for them to import foreign components from their French partner for assembly and sale in the United States. Because of the inverted U.S. tariff schedule, it would have been to American Motors' advantage to import completely constructed vehicles and large job losses would have been the consequence. Because of the zone legislation, however, the foreign components can be imported at the same duty rate as assembled vehicles. Hence, the ability to avail itself of the zone benefits was one factor in American Motors' decision to import the foreign components, instead of finished vehicles, thus saving local jobs or maintaining employment at its assembly plants.

As an example in which the interaction worked to create new local employment, consider the decision by Volkswagen and Honda to set up assembly facilities in the United States. Company officials advised us that many factors relating to market conditions and economic incentives, among them receiving zone status, led them to consider assembly in the United States. However, both companies said that the major reasons for locating in the United States were related to market factors and not economic incentives. Economic incentives offered by many states were considered to be a factor involved in where to locate their operations within the United States, but these were not a dominant factor, since labor rates, transportation costs, and access to raw materials had a much greater effect on operating costs. But, without the zone benefits it would have been more costly for each firm to assemble vehicles. To the extent that zone benefits were one of many factors in getting each firm to set up assembly facilities, one can conclude that the interaction worked to increase local employment.

Thus, our examples indicate that the availability of operating in a zone may be a factor in determining local employment levels. However, because of the variety of possible outcomes, generalizations about those employment levels appear unwarranted.

Aside from the direct employment effects of foreign trade zones, there may also be indirect local effects on employment. We have no evidence bearing on the magnitude of these effects. Nevertheless, some of their dimensions may be worth noting.

To the extent that the firms' zone benefits increase sales, they may have to employ more clerical and administrative personnel, and employment in the local communities may increase because of the larger payrolls being spent there. On the other hand, increased sales by these firms may be at the expense of non-zone firms with the result that these non-zone firms' sales, employment, and indirect employment arising therefrom will be adversely affected. The net effect these events have on employment cannot be precisely measured.

Our discussion of the case studies of the employment effects of foreign trade zones does not address the long run local employment consequences that might result from the absence of foreign trade zone legislation. Any attempt to assess whether, in the absence of the legislation, U.S. firms marketing relatively higher priced goods might suffer losses in market share and, ultimately, employment, would be highly speculative.

INCREASED NATIONAL EMPLOYMENT UNCERTAIN

Our local examples have indicated that the employment effects of foreign trade zones are mixed. However, it is uncertain whether, and to what extent, foreign trade zones contribute to a net addition to total U.S. employment, even if local employment is increased either by increasing exports (imports) or by reducing imports. This uncertainity exists because, when addressing national employment effects, consideration must be given to the effect that any zone-induced activities have on international capital flows, the balance of payments, and the exchange rate of the dollar for other currencies.

To understand how these factors alter conclusions drawn from a consideration of local employment effects, consider the case where the use of foreign trade zones contributes to the substitution of domestic production for imports (the Volkswagen and Honda examples) with a consequent rise in local employment.

Initially, when these two companies bring to the United States the financial wherewithal to begin construction, the dollar tends to appreciate as the inflow of foreign capital increases the demand for dollars. This enhanced exchange value of the dollar for other currencies encourages Americans to buy from abroad (U.S. imports rise) and discourages foreigners from buying here (U.S. exports fall). As a result, while jobs are created in those industries engaged to construct and equip Honda and Volkswagen plants, they are lost in U.S. industries that export goods and produce import substitutes.

Later, as the Volkswagen and Honda plants begin to produce their import substitutes, U.S. spending on imports will fall. As fewer U.S. dollars flow overseas, the price of the dollar is bid up--the dollar appreciates. This again creates a hardship for U.S. exporters and those Americans producing import substitutes. Thus, while jobs are created in the Honda and Volkswagen operations and surrounding environs where these payrolls are spent, they are lost elsewhere in the economy where exports and other import substitutes are produced.

Finally, in a still later stage, as the Volkswagen and Honda operations become profitable, their foreign owners may wish to repatriate some of their profits. When they do, the increased supply of dollars on the foreign exchange market will drive down the value of the dollar which will in turn encourage U.S. exports and discourage imports (or encourage the production of domestic import substitutes). While employment can be stimulated in some U.S. industries, it may be lost in those industries from which Honda and Volkswagen would have purchased had their profits remained in the United States and been invested in their domestic operations.

In each stage noted above, jobs were gained and lost. There is no presumption that the two precisely offset each other in the short run. In fact, this is unlikely to occur, as the use of labor relative to capital is different in industries producing exports and import substitutes.[1] In an effort to see in which direction the employment effects were likely to go, we contemplated some simulations using large-scale econometric models. However, the amount of commerce currently moving through foreign trade zones is so small relative to GNP that it would be a fruitless exercise to measure its effects on such macroeconomic variables as price levels, interest rates, and total employment.

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Discussing the job-creating potential of zones is far from easy and is certain to evoke some controversy. The critical issue for analysis is whether the benefits gained from using zones lead to a net increase in domestic employment. The local and national aspects of zone-related employment are two very different phenomena. On the local level, our work disclosed a variety of different outcomes ranging from no effect on current employment levels to gains in local employment. On the national level, however, it is inconclusive whether foreign trade zones result in increased U.S. employment over the long-term. Currently, the value of trade moving through zones is so small that it is not possible to measure the impact zones have on the U.S. economy.

Equally important is the fact that foreign trade zones do not necessarily increase employment if businesses operating in a zone would still operate outside the zone. Zone benefits are

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[1]This conclusion does not depend on the specific example selected above. We could have chosen one in which the predominant effect of the zone was to increase exports or even imports. The adjustment involving the balance of payments and the exchange value of the dollar would have produced similar conclusions.

only one of many factors that influence such business decisions. Further, the degree to which zones contribute to increased employment, if at all, is affected by the level of activity conducted by zone users and whether any increase in activity is gained at the expense of domestic or foreign competitors.

6

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

May 20, 1983

Honorable Charles A. Bowsher
Comptroller General of the United States
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Bowsher:

As you may know, the creation and operation of foreign trade zones and their implications for U.S. trade policy has been a concern of the Congress since the enactment of the Foreign Trade Zones Act in 1934. Recently, increasing public concern over the proper role of foreign trade zones (FTZ) in the U.S. economy has been expressed to the Committee on Ways and Means by such diverse interests as the importing community, municipal governments and domestic manufacturing industries. The Committee would appreciate the assistance of the General Accounting Office in analyzing these operations and assessing their implications for the American economy.

Use of FTZ's has grown dramatically in the past decade. In fact, the Department of Commerce reports that the number of ports of entry with zone projects has grown from 10 to 75 during the past decade, and the value of goods entering zones and subzones has increased from just over $100 million to over $3 billion, about 50% of which involves manufacturing activity. Further, about 33% of the goods currently entering zones is of domestic origin and 30% of the goods shipped from zones are exported. Many proposals for manufacturing in zones for the domestic market have been opposed by competing domestic industries.

These statistics demonstrate not only the rapid growth in trade zones, but also their impact on international trade and investment. In view of these data, the Committee is concerned about whether the Congressional intent of the 1934 Act is being carried out: namely, to promote economic development, stimulate exports, increase employment, and improve the competitive posture of U.S. located firms in world markets.

Honorable Charles A. Bowsher
May 20, 1983
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Accordingly, the Committee requests that the GAO conduct a fact-finding investigation into the implications of foreign trade zones for U.S. industries and for competitive conditions between U.S. and foreign firms. We would also appreciate a review of the effects on revenue collection, employment, and the economy in general, caused by the establishment of zones. It would be helpful to the Committee if the following issues could be examined:

- Current administration and operation (FTZ Board, U.S. Customs Service);
- Trends in FTZ usage (growth, volume, and types of storage);
- Benefits associated with FTZ's (tariff exemptions, employment generated, etc.);
- Major manufacturing industries utilizing FTZ's and the nature of operations used (with emphasis on special purpose subzones);
- U.S. industry concerns regarding FTZ's (increased imports, foreign content of "domestic" products, quota and tariff evasion, etc.) and their recommendations for modification;
- Safeguards in FTZ system.

It is recommended that you consult with the Foreign Trade Zone Board and the U.S. Customs Service in the conduct of this study; their cooperation will be encouraged by this Committee. We would appreciate receiving your report not later than February 15, 1984.

Thank you for your early consideration of this request.

Sincerely yours,

Dan Rostenkowski
Chairman

DR/FCPn

VALUE OF GOODS ENTERING
FOREIGN TRADE ZONES

Year	Amount (millions)
1982	$3,360
1981	2,999
1980	2,594
1979	1,520
1978	806
1977	663
1976	507
1975	323
1974	205
1973	144

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