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Sugar Program: Issues Related to Imports of Sugar-Containing Products

Statement of
Brian P. Crowley, Senior Associate Director
Resources, Community and Economic Development Division

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Subcommittee on Cotton, Rice and Sugar of the Committee on Agriculture
House of Representatives

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to discuss our report being issued today entitled Sugar Program: Issues Related to Imports of Sugar-Containing Products (GAO/RCED-88-146). We did this work in response to a request by the Chairman and Ranking Minority Member that we review certain aspects of the U.S. sugar program to determine whether circumventions of the sugar quota system were taking place.

Specifically, we were asked to provide information on five issues that relate to U.S. sugar imports and administrative controls over these imports:

- -- the amount of sugar in sugar-containing product imports that displaces domestic sugar,
- -- the increase in such sugar imports from 1982, when the current sugar import quota system was put in place, to 1986,
- -- the amount of sugar in sugar-containing product imports that enters U.S. commerce from foreign trade zones (FTZs) (secured areas geographically inside the United States but legally outside Customs territory where companies are authorized to bring in merchandise to be stored, distributed, or used in manufacturing operations, and through ports of entry),
- -- whether the U.S. Customs Service's controls over sugar-containing product imports have been adequate to ensure compliance with Customs laws and regulations, and
- -- administrative options available to the President to limit the importation of sugar-containing products.

AUTHORIZED INFLOWS OF FOREIGN SUGAR

On the first issue, foreign sugar is authorized to enter the United States in three ways--(1) through the commodity import quota, (2) as nonquota commodity sugar imported under license for processing and subsequent reexport or for making polyhydric alcohol, a sweetener used in such products as toothpaste and dietetic foods, and (3) in sugar-containing products through ports of entry and FTZs. In 1986, 1.75 million tons of raw and refined sugar entered U.S. commerce via the commodity import quota and 550,000 tons of sugar entered through nonquota sugar programs. Statistics on the amount of sugar imported in sugar-containing products are inexact because industry formulas for those products are considered proprietary information, and the available data are not as credible as they are for commodity imports. However, on the basis of views and information provided by government and industry experts, we estimate that in 1986 from 265,000 tons to 307,000 tons of sugar may have displaced domestic sugar by entering the United States in sugar-containing products under 46 tariff categories.

INCREASES IN IMPORTS OF SUGAR-CONTAINING PRODUCTS FROM 1982 TO 1986

The amount of sugar in products imported under the 46 tariff categories more than doubled from 1982 to 1986. For some individual products, the increases were much greater. For example, imports of bulk sweetened chocolate bars and certain gelatin mixes increased more than tenfold from 1982 to 1986. Differences in product quotas and duties prescribed in the U.S. tariff schedules help explain the sharp increases, allowing resourceful businesses to "tailor" sugar-containing products to fit under different tariff categories.

In the case of sweetened chocolate bars, those weighing 10 pounds or more are exempt from duties while those weighing less than 10 pounds are subject to a 5 percent duty. Imports of sweetened chocolate bars weighing 10 pounds or more increased nearly 1,345 percent from 1982 to 1986, compared with a 25-percent decrease in bars weighing less than 10 pounds.

Although gelatin/sugar mixes frequently contain more than 90 percent sugar, they are eligible for a tariff category that is exempt from sugar quotas, and a lesser duty applies when the value of the gelatin is greater than the value of the sugar. From 1982 to 1986 gelatin/sugar mixes imported under the sugar quota-free category increased by 1,150 percent.

SUGAR IN PRODUCTS FROM FOREIGN TRADE ZONES

Blended products produced in FTZs and imported in 1986 contained about 40,000 tons of sugar, or about 13 to 15 percent of the sugar volume we estimated for products in the 46 tariff categories. The rest was in products imported through various ports of entry. The purpose of FTZs is to expedite and encourage U.S. participation in international trade and commerce that would otherwise occur in foreign countries. Blended products produced in a zone may be exported without incurring customs duties or may be entered into U.S. customs territory subject to appropriate quotas and upon payment of applicable duties.

Sugar-blending operations were first approved for FTZs in September 1983. In August 1984 USDA advised the FTZ Board that FTZ operations blending sugar for U.S. importation operations interfered with the domestic price support program. Because seven companies with ongoing or approved operations provided domestic employment and/or had already invested in equipment, and because the blending operations would otherwise occur in foreign countries, the FTZ Board gave the companies "grandfathered" approval for their operations in late 1984. At that time the FTZ Board set an annual limit of 55,950 tons of sugar in the products those firms produced for domestic consumption. As of May 1988, three of these companies were operating.

CONTROLS OVER SUGAR IMPORT OPERATIONS

Regarding the adequacy of Customs controls, we found that some FTZs Customs paperwork controls and enforcement efforts were not always sufficient to ensure compliance with Customs laws and regulations. The most serious problems involved one FTZ that has since discontinued operations and is currently the focus of a Customs criminal investigation. The situations we found illustrate that resourceful businesses will do all that is possible within the bounds of the law, and that some businesses may try to go beyond the law, in order to benefit from cheaper world-price sugar. After we discussed the following situations with Customs, it took action to correct the weaknesses in paperwork controls and enforcement procedures.

Reclassification Can Legally Avoid Quotas of Sugar-Containing Product Import Categories

During the course of our work we found that a manufacturer in one FTZ was able to reclassify, with Customs approval, its sugar-containing product to a nonquota tariff classification with a lower duty rate by adding a very small percentage of flavoring ingredient to the product when the product was in the FTZ. The flavoring was previously added after the product left the FTZ. Customs ruled that the flavored mix constituted a new and different product, exempt from duty. The example illustrates the ease with which a resourceful business can tailor a product to meet the most advantageous duty and quota classification. Customs approved the change after the manufacturer threatened to move its FTZ operations to another country, thereby eliminating U.S. jobs.

Quantity of Sugar Entering Foreign Trade Zone Was Not Always Accounted For

We also noted instances in which Customs did not enforce controls over sugar entering FTZs. Sugar entering the United States at ports of entry and destined for FTZs is sealed by Customs inspectors and transported to the zones under in-bond status. Technically, this means that the sugar is not imported into the United States until it is placed into domestic commerce in the form of sugar-containing products made in the FTZ. At the FTZ the seal is to be broken by a Customs employee, or with Customs authorization, by the FTZ operator (the entity that operates the zone).

During a visit to one FTZ, we noted that the seal on a 132 ton shipment of sugar had been broken by the user (the sugar-blending company) rather than by the FTZ operator and that the shipment was unloaded into the trade zone without the knowledge or approval of Customs district officials or the FTZ operator. If the quantity of sugar shipped into the FTZ is not accounted for upon arrival in the zone, sugar could be diverted before it reaches the FTZ, or a greater amount of sugar could be received in the FTZ than shown on the shipping documents. Either case would allow the user to dispose of commodity sugar in U.S. commerce without the sugar being charged against the applicable quota. In addition, contraband could be sealed in the shipments. After we brought this matter to the attention of Customs district officials, the district notified the FTZ operator that the delivery practice was contrary to Customs regulations and that future shipments would require prior Customs approval. Customs issued a directive on May 31, 1988, reiterating its position to all regional offices.

Unauthorized Sugar Has Been Diverted Into U.S. Commerce

In another case, a sugar-blending company had brought significant amounts of sugar into an FTZ. Available documents showed that in an apparent attempt to circumvent its FTZ Board allocation, the company had blended the sugar with gelatin, exported the gelatin/sugar blend, brought a like amount of the same blend back into the zone (under a different company name), and then sold the blend to a U.S. food company. According to Customs regulations, shipping merchandise abroad with the intention of returning it to the United States to circumvent provisions of the tariff schedule (including sugar quotas) or to secure a benefit accruing to imported merchandise is not considered to be an exportation and therefore is not allowed.

We estimate that this company blended as much as 1,500 tons of foreign sugar with gelatin, exported it to Canada, repurchased and reimported it, and then sold the product within U.S. commerce in 1986 in excess of the FTZ Board allocation. By January 1988 the sugar-blending company had discontinued operations, and Customs had begun investigating it for possible criminal violations. As of May 1988, the matter was still under investigation, but Customs had already taken action to help prevent further repetitions of this activity. Customs' May 1988 directive requires that such exportations be charged against the FTZ Board allocation in the same manner as products that enter U.S. commerce. FTZ Board officials told us that the Board would not allow the company to resume operations pending the outcome of the Customs investigation.

Sugar in Blended Products May Have Originated in Country Subject to Import Restrictions

In at least one FTZ some sugar had been received from Canada that had been grown in South Africa, which is subject to a U.S. embargo. The Comprehensive Anti-Apartheid Act of 1986 prohibits the U.S. entry of agricultural products, including sugar, from South Africa. The 1986 act also prohibits the U.S. import of derivatives of sanctioned products or any product suitable for human consumption. However, in November 1986 Customs approved the entry of 20 lots, or an estimated 440 tons, of South African-grown, Canadian-refined sugar into one FTZ. Customs' position at the time was that sugar refined in Canada was substantially transformed and not subject to South African sanctions. Customs reversed its position in late 1987. Customs' May 1988 directive further clarifies Customs' position that refining raw sugar does not substantially transform it nor change its country of origin.

ADMINISTRATIVE OPTIONS FOR LIMITING SUGAR-CONTAINING PRODUCT IMPORTS

Customs has taken some actions to improve its administration of FTZ Board sugar allocations and other enforcement mandates of the U.S. sugar program. Monitoring the implementation of these improvement actions could help ensure the proper entry of sugar-containing products. Other options, which are available to the President to limit sugar-containing product imports include the following:

- Extending import restrictions, via import quotas or fees, to additional sugar-containing products. Such an action should include a comprehensive analysis of all sugar-containing products that carefully describes the products to avoid new loopholes being created.

-- Submit a legislative proposal to rewrite tariff schedule descriptions so that existing loopholes can be closed while avoiding the creation of new loopholes.

In either option consideration must be given to whether any changes comply with existing trade agreements.

That concludes my statement. We would be glad to respond to your questions.