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NAFTZ

There Is A Reason For FTZs' Startling Growth: It Makes Good Business Sense

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THE remarkable growth of the foreign-trade zone program in the United States during the 1980s results from the desire of U.S. business to be more competitive internationally.

No federal financial subsidies are involved in an FTZ. The sole benefit is to treat a U.S. business for Customs duty purposes as if it were located in a foreign country. This market-driven device has had a significant impact on many industries in retaining U.S. production and employment as well as stimulating new activity.

The primary reason for this growth is the significant savings for U.S. business using FTZs to combat foreign competition and finished imports.

In 1980; there were 59 general purpose zones and nine subzones; dollar volume was $5.1 billion (34 percent domestic inputs) and 9,880 people were employed in zones. In 1988, the change is dramatic. There are currently 151 general purpose zones and 119 subzones with 73 pending applications. Dollar volume is estimated at $125 billion (78 percent domestic inputs), and 170,000 people are estimated to be currently employed in the zones. The primary reason for this growth is the significant economic savings for U.S. business using an FTZ in combatting foreign competition and imports of finished merchandise.

An analysis of the annual statistics of the FTZ Board provides some very interesting conclusions. While an initial view might be that FTZs stimulate imports, the statistics prove otherwise. The most significant increase in activity in FTZs in the 1980s has been the increase from 34 percent to 78 percent domestic input merchandise. In many of the subzone production operations, the vast majority of the merchandise is domestic. The FTZ is utilized for those foreign-sourced components or materials that are essential and, for business reasons, will be imported.

Unfortunately, the structure of the U.S. Customs law is such that in many instances these imported materials have a much higher Customs duty rate than the completed articles. In order to retain production in the U.S., FTZ status places these imported materials at the same Customs duty rate as merchandise fully produced in another country. The difference for the U.S. economy is the use of U.S. materials, labor and production facilities. A second interesting statistic is that the largest rate of growth is in domestic inputs, not foreign inputs, into FTZs. The balance of trade is positively impacted by such activity.

There is a correlation between the dramatic increase in foreign trade activity and the amendment to section 146.48(e) of the Customs Regulations in 1980. As general counsel of the NAFTZ, I structured and oversaw the

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effort to modify the Customs Regulation to clarify the appraisal of merchandise produced in FTZs. The amendment essentially removed the Customs duties applicable to labor, overhead and profit incurred within an FTZ.

This small modification made a dramatic change in the financial advantage of producing merchandise in an FTZ as compared to producing it overseas. Removing Customs duties owed on the labor, overhead and profit factor, be it overseas or in the U.S., can make a significant impact on corporate decisionmaking to produce merchandise in the U.S. This creates a significant savings not otherwise possible using any other Customs law.

An FTZ is an area that may be a single building, an industrial park or an existing company's production facility. For U.S. Customs duty purposes, it is not considered within the Customs territory of the U.S. Generally, merchandise admitted to an FTZ can be subject to a wide range of production activities. Unlike other so-called special Customs procedures, the FTZ user has the option of electing the most advantageous Customs duty rate on merchandise produced. In some instances, the most advantageous rate is that of the imported material. This unique choice, plus the nonpayment of Customs duties on labor, overhead and profit, waste and scrap, exports, inventory tax, cash flow, etc., may offer very significant savings. It is important to note, however, that the savings is no different than if the merchandise had been produced in another country. The essential point is that U.S.-based production is placed on a more equal footing with production in a-foreign country.

The Foreign-Trade Zones Act was passed by Congress in 1934 and amended in 1950 to allow manufacturing. The program was originally intended to create U.S. business opportunities similar to the free trade zones that successfully operated in Europe and the Middle East for centuries. The goal of the act was to contribute to the expansion of international trade by enhancing U.S. production and job opportunities. Some critics inaccurately suggest that zone activity was intended by Congress for primarily export activity. The facts do not support this conclusion.

The dramatic increase in the U.S. foreign-trade zone program has been for a reason—it makes good business sense. Any importer should consider the business advantages of FTZ use.

Section 3 of the Act, involving primarily the Customs impact, is clearly structured for import, transshipment and export. That is reflected by every Congressional committee report on hearings on the Act, which stated that its goal was tp stimulate the U.S. economy by import, transshipment and export. It was never intended by Congress that the Act be oriented only to transshipment and export. A similar reflection of Congressional intent can be found in hearings when the Act was expanded in the 1950s to authorize manufacturing and exhibition in FTZs. There has never been an attempt in Congress to restructure the Foreign-Trade Zones Act to not allow the importation of merchandise.

There are a number of other U.S. Customs procedures that individually provide some of the same benefits as FTZs, but to a lesser degree. There has not been the remarkable growth in the use of these other procedures as in the U.S. FTZ program in the 1980s. The primary reason is that each of these particular activities is far more restrictive than the use of FTZs and places U.S.-based production at a greater disadvantage.

The dramatic increase in activity in the U.S. foreign-trade zone program has been for a reason—it makes good business sense. Any importer of merchandise should seriously consider the business advantages of FTZ use. □