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Reining in the Foreign Trade Zones Board: Making Foreign Trade Zone Decisions Reflect the Legislative Intent of the Foreign Trade Zones Act of 1934

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COMMENTS

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INTRODUCTION

Near Lake Calumet outside of Chicago, sugar from Guatemala arrives by barge. It is unloaded and soon stored on the grounds of a local candy manufacturer. This sugar is somewhat unique in that it is treated quite differently than other imported products. Unlike other products arriving from other countries, this sugar is not taxed as sugar. In fact, it is not even counted as being within United States territory. Instead, it is mixed with domestic ingredients such as dextrose and powdered milk and "enters" United States territory as an entirely different product. Thus, in lieu of paying at the imported tariff rate for sugar, the candy company pays at the lower rate for the candy product that emerges, much to the delight of those concerned with company profits.

The candy company can do this because it operates within a Foreign Trade Zone. The myriad of businesses using Foreign Trade Zones runs across the commercial spectrum, with good reason. Foreign Trade Zones offer substantial competitive advantages to those fortunate enough to operate inside them. In fact, these advantages

are so apparent, even the lay observer would recognize that *every* business which imports foreign components would want, and should be afforded, zone benefits. Those who have closely examined the Foreign Trade Zone system in the United States offer the same criticism. Many increasingly question the fairness and the usefulness of the Foreign Trade Zone.

The Foreign Trade Zone is an area inside United States territory which, for customs purposes, is considered outside of United States Customs territory. Various monetary and administrative benefits accrue to those who are allowed to operate within a foreign trade zone. Foreign Trade Zones were created in 1934 by the Foreign Trade Zones Act[1] to improve the domestic economy and stimulate foreign commerce. The Foreign Trade Zones Act also created the Foreign Trade Zones Board.[2] The Board is charged with the responsibility of setting up regulations surrounding Foreign Trade Zone creation and use.[3]

The relevance and prevalence of Foreign Trade Zones has grown dramatically in the last twenty years. The number has risen from 18 in 1973,[4] to 370 in 1990,[5] to 478 in 1995.[6] The value of merchandise handled by the Foreign Trade Zones increased from $161 million in 1973[7] to over $90 billion in 1991.[8] Over half of the 310 designated customs ports of entry in the United States have Foreign Trade Zones[9] and more than 2,200 businesses currently use them.[10]

The use and impact of the great number of Foreign Trade Zones now in existence not only contravenes the legislative intent of the Foreign Trade Zones Act of 1934, but, according to some, is nothing but an unfair competitive advantage for select corporations.[11] Others suggest that the use of Foreign Trade Zones may hurt the domestic economy more than they help it— and that those who approve zones have

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1 Foreign Trade Zones Act of 1934, Pub. L. No. 73-397, 48 Stat. 998, (codified as amended at 19 U.S.C. §§ 81a-81u (1988)).

2 19 U.S.C. § 81b(a) (1988 & Supp. 1993).

3 15 C.F.R. § 400 (1991).

4 GENERAL ACCOUNTING OFFICE, *Report to the Chairman, House Committee on Ways and Means: Foreign Trade Zone Growth Primarily Benefits Users Who Import for Domestic Commerce*, GAO REP. GGD-84-52, iii (Mar. 1984)(Hereinafter GAO REP.).

5 John J. Da Ponte, Jr., *Updated Rules for Foreign-Trade Zones Reflect Big Increase in Zone Activity*, BUS. AM., Nov. 4, 1991, at 9.

6 Telephone Interview with Camille Evans, Program Assistant, Foreign Trade Zones staff (May 25, 1995).

7 GAO REP., *supra* note 4, at iii.

8 FTZ Staff, *Foreign Trade Zones Information Summary*, Apr. 20, 1992, at 2.

9 *Id.* at 10.

10 *See* GAO REP., *supra* note 4, at 20.

11 *See infra* text accompanying notes 116-120.

no way of measuring its impact.[12] Most of the blame for these shortcomings has been placed on the Foreign Trade Zones Board. It has failed to ensure that the criteria for zone selection leads to results likely to be consistent with the legislative intent.

This comment addresses criticisms that the Foreign Trade Zones Board has inadequately adhered to the legislative intent of the Foreign Trade Zones Act of 1934. Part I examines the legislative history of the statute to discern a clear statement of its purpose and anticipated effects. It reveals that the universal intent among the drafters of the Foreign Trade Zones Act of 1934 was to provide a macro-economic stimulus by expanding the re-export industry. The expected impact of the legislation was a relocation of re-export operations to the United States, and a subsequent increase in domestic employment. The scope of Foreign Trade Zone activity, after legislative and regulatory amendments, evolved into something substantially larger and different than was originally foreseen. The greatest change came when the Foreign Trade Zones Board created the subzone. The subzone received all of the benefits of the general purpose zone, but could be created inside an existing facility. Thus, the subzone eliminated the need for start-up costs or substantial changes in a company's operation. Opportunities have since realized this facile route to tariff reduction, spawning the rapid growth in Foreign Trade Zone applications seen today.

Part II examines the actual effects of Foreign Trade Zone activity, including the benefits that the contemporary zone provides. These benefits revolve around the lessening of administrative and cash flow burdens. Ultimately, the benefits increase Foreign Trade Zone user efficiency, which enhances that user's competitive position in the market.

Part III summarizes criticisms of Foreign Trade Zones Board policy. These criticisms do not focus on zone benefits, but rather focus on the manner in which Foreign Trade Zone status is granted. The comment analyzes the Foreign Trade Zones Act of 1934[13] to delineate the parameters given to the Foreign Trade Zones Board by Congress. Also, the comment examines whether the Board exceeded these parameters when developing its approval scheme. The inquiry reveals the language of the statute is broad, requiring only that the Foreign Trade Zone serve a public benefit.

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[12] *See infra* text accompanying notes 105-115.

[13] 19 U.S.C. § 81a-81u (1988).

The most common criticisms of the Foreign Trade Zones Board center on the uncertainty surrounding whether Foreign Trade Zones provide this public benefit. The drafters intended the public benefit to manifest itself in the expansion of the re-export business and increased domestic employment. The Foreign Trade Zones Board instead interprets the public benefit criteria less stringently. It requires that a positive economic benefit be shown, though such a showing is not statistically possible. Part III concludes that the Foreign Trade Zones Board appears to be more influenced by pressure from private actors than by a consideration of what public benefits a Foreign Trade Zone can provide. Part IV lists Board responses to these criticisms.

Finally, Part V recommends specific actions to remedy the disparity between statutory intent and Foreign Trade Zone practices. It recommends that the application for Foreign Trade Zone status be confined to municipalities to shield the approval process from private coercion. It recommends that only local, as opposed to national, businesses be allowed to use the Foreign Trade Zone. It requires a showing that a net positive economic impact (e.g., employment or income growth) will likely result from a grant of a Foreign Trade Zone status or approval of a Foreign Trade Zone user. These recommendations will hopefully depoliticize the approval process, and fulfill the legislative intent that Foreign Trade Zone use serve a public benefit.

I. The Legislative History of the Foreign Trade Zone

The key in determining what role Foreign Trade Zones should play in the United States (or American) economy is to examine why they were established in the first place. This comment does this, and then follows their statutory evolution. It finds that the clear, dominant theme of Foreign Trade Zone legislation was that it was to enhance the United State's economic vitality.

A. Prior to the Foreign Trade Zones Act of 1934

The procedures governing the movement of products into United States customs territory prior to 1934 were inflexible and in many instances inefficient. It was especially burdensome on the re-export business. To "re-export" means to temporarily move a foreign product into a country for combination with other products and subsequent export. At the time, many ports around the world lacked adequate facilities for producing or combining products from different nations. Ports in the United States had the facilities, but were burdened by customs procedures which deterred their use.

The major procedural hurdle at the time was the wasteful "drawback" requirement. "Drawback" was the repayment, in whole or in part, of a customs duty assessed on goods imported into the United States and later exported.[14] Upon entry into customs territory, after the duty was paid, the good was taken to the business's location, manipulated or repackaged, then re-exported. The business would then apply for repayment of ninety-nine percent of the duty. Because the application process was so time consuming and confusing, many re-exporters would abandon their claim.[15] In the twelve years prior to the enactment of the Foreign Trade Zones Act of 1934, the amount of claims for repayment dropped by almost eighty percent.[16] Removal of the "drawback" requirement, it was thought, would attract re-exporters because it would improve a business's cash flow.

Drawbacks and other customs hurdles, combined with the depression, led to sharp drops in United States foreign trade. Re-exports decreased from over 147 million dollars worth of activity in 1920 to less than 63 million dollars in 1930.[17] New York Representative Cellar, author of the Foreign Trade Zones Act, saw the legislation as a necessary remedy to the problem of declining re-exports: ". . .[T]here is something wrong with our system. I firmly believe that a foreign trade zone would greatly encourage this reexport business."[18] The Foreign Trade Zone Act of 1934 was approved by Congress on May 29, 1934 by a near three-to-one margin.[19]

B. The Foreign Trade Zones Act of 1934

The Foreign Trade Zones Act of 1934 (the Act) established zones adjacent to or within United States Customs ports of entry which were considered outside of United States Territory for tariff liability purposes.[20] Goods within these zones were not subject to formal United States Customs requirements.[21]

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14 19 U.S.C. § 1313 (1988 & Supp. 1993).

15 78 CONG. REC. 9853 (1934).

16 *Id.* at 9854.

17 *Id.*

18 *Id.*

19 The House vote was 254 for, 95 against, with 80 not voting. *Id.* at 9859-60. There was no recorded Senate vote. *Id.* at 8477.

20 Pub. L. No. 73-397, 48 Stat. 998 (codified as amended at 19 U.S.C. § 81a-81u (1988)).

21 *See infra* text accompanying notes 80-94.

1. The Foreign Trade Zones Board

The Act created the Foreign Trade Zones Board (the Board) to oversee the authorization of Foreign Trade Zones (FTZs) to corporate applicants.[22] The Board consists of the Secretaries of Commerce, the Treasury, and the Army.[23] The Board has the authority to exclude from the FTZs ". . .any goods or process of treatment that, in its judgement, is detrimental to the public interest, health, or safety."[24]

2. The Purpose of The Foreign Trade Zone

FTZs were created to spur economic growth in a country staggered by depression.[25] The legislative history indicates that the purpose of the Act was to free United States foreign trade from the restrictions of customs duties, "not for domestic consumption, but for re-export to foreign markets and for conditioning or for combining with domestic products previous to export."[26]

The Act intended to accomplish this objective in three steps. First, it streamlined United States Customs procedures. Second, after the procedural impediments were removed, Congress believed that the United States, because of its modern facilities and strategic location, would become a major transhipment point in the world.[27] This, Congress hoped, would culminate in the third step: the promotion of job growth near United States Customs ports of entry.[28]

United States Customs procedures prior to the Act were not conducive to the re-export of goods. Any entity wishing to re-export goods through the United States would have to plod through cumbersome customs requirements. It would have to post bond with the Customs Service while the goods remained in United States territory. The goods were subject to strict surveillance, and their temporary import involved lengthy and expensive accounting reports. In addition, the goods had to meet United States health standards, even though they would never be consumed within United States borders. These and other customs requirements, it was thought, deterred potential entre-

22 19 U.S.C. § 81b(a) (1980).

23 *Id.*

24 19 U.S.C. § 81o(c) (1980).

25 78 CONG. REC., *supra* note 15, at 9852-59 (remarks of Representative Cellar).

26 S. REP. No. 905, 73d Cong., 2d Sess. 2 (1934).

27 78 CONG. REC., *supra* note 15, at 9852-53. The United States was thought to be ideally situated between Central and South America, the West Indies, and Canada, on one end and Europe, Asia and Africa on the other.

28 S. REP. No. 905, *supra* note 26, at 2-3.

preneurs from establishing transhipment centers within United States territory.[29]

C. Anticipated Effects of the Act

Drafters of the Act expected many rewards to emerge from its enactment. Among the anticipated benefits:

1) The encouragement of investment of American capital in new industries. (The Act, by creating FTZs, would engender new "reassembly" or "mixing" businesses).[30]

2) The employment of American labor in Foreign Trade Zones which would replace the work being done by foreigners overseas. (Assembly and transhipment businesses overseas would relocate to the United States).[31]

3) The development of American businesses in foreign markets and in foreign trade (by displaying goods within foreign trade zones, thereby increasing their exposure to foreign companies).[32]

4) The erection of distribution points in the United States for distribution of foreign merchandise throughout the world.[33]

5) The enhancement of the American merchant marine. (Increased transhipment would inevitably lead to greater use, and greater profits, for the merchant marine).[34]

The Act passed with broad support from the legislature as well as private interests, including trade organizations, the United States Chamber of Commerce and several port authorities.[35] The only opposition to the Act centered on concern that increased foreign competition would hurt domestic business.[36] It was because of this concern that both the manufacturing and the full exhibition of products within FTZs were prohibited.[37] With this concern addressed, the Act passed with only a few qualifications, the most noteworthy being the limitation of FTZ grants to corporate use. Preferential treatment was afforded to public corporations.[38]

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29 78 CONG. REC., *supra* note 15, at 9853-54.

30 S. REP. NO. 905, *supra* note 26, at 1.

31 S. REP. NO. 905, *supra* note 26, at 1.

32 S. REP. NO. 905, *supra* note 26, at 2.

33 S. REP. NO. 905, *supra* note 26, at 3.

34 S. REP. NO. 905, *supra* note 26, at 5.

35 78 CONG. REC., *supra* note 15, at 9852-53.

36 *See* GAO REP., *supra* note 4, at 5.

37 GAO Report, *supra* note 4, at 5.

38 Foreign Trade Zones in the United States, 15 C.F.R. § 400.21(b) (1994).

D. Actual Effects of the Act

After passage of the Act, FTZs in the United States bore little consequence on the international trade regime through the 1970's. By 1950, there were only five FTZs in operation.[39] Many attributed the dearth of popularity to the prohibitions against manufacturing and exhibition.[40] At the same time, foreign trade was rapidly expanding, and interest in inland ports increased because air commerce had made it easier to access those ports.[41]

E. The 1950 Boggs Amendment

Congress passed the Boggs Amendment to the Act in 1950 in response to the complaints of business leaders who believed American FTZs were neither comparable to, nor competitive with, FTZs of other countries.[42] Additionally, FTZ operators wished to take advantage of the anticipated boom in the European market as Europe attempted to return to the economic productivity level it maintained prior to World War II.[43] Another reason for drafting the Boggs Amendment was the ineffectiveness of the provision allowing "manipulation," but prohibiting "manufacturing."[44]

Examination of the purpose and expected outcome of the proposed legislation clearly delineates the boundaries of FTZ scope and impact. Subsequent Board regulation resulted in this intention being disregarded and contravened.

1. Manufacturing

The inclusion of the manufacturing provision in the Boggs Amendment was the result of both the FTZ operators' frustration with their inability to use a business within a zone to its optimal capacity, and the difficulty of defining "manipulation."[45] It was argued that permitting manufacturing within a zone would attract foreign business

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39 GAO REP., *supra* note 4, at 5.

40 GAO REP., *supra* note 4, at 5.

41 SENATE FIN. COMM., EXPANDING ACTIVITIES WITHIN FOREIGN TRADE ZONES, S. REP. NO. 1107, 81st Cong., 2d Sess. 2534 (1949); *See also, FTZs: Hearings on H.R. 6159 and H.R. 6160 Before the House of Representatives Committee on Ways and Means*, 80th Cong., 2d Sess. 10 (1948) (hereinafter *Hearings*).

42 *Hearings*, supra note 41, at 10; 93 CONG. REC. A3802 (1947) (remarks of Rep. Cellar). Foreign Trade Zones of other countries permitted manufacturing and exhibition within their zones.

43 *Hearings*, *supra* note 41, at 12-13.

44 *Hearings*, *supra* note 41, at 14-15.

45 94 CONG. REC. A2919, A2920 (1948) (remarks of Rep. Homer R. Jones).

interests then operating in other countries' FTZs — the same interests who avoided American FTZs because they lacked that capacity.[46] The expected increase in business activity would increase domestic employment levels.

Additionally, operators and regulators encountered difficulty when attempting to distinguish manipulation, which was permitted under the Act,[47] and manufacturing, which was not.[48] This determination was an uncertain, cumbersome, time-consuming process with great administrative costs.[49]

2. *Exhibition*

The addition of exhibition within FTZs was thought to be an opportunity for domestic and foreign businesses to present their goods to buyers from many countries in a central location.[50] Proponents argued that this provision would induce exhibitors showing their wares in the FTZs of other countries to relocate to American FTZs.[51]

3. *Anticipated Effect: Increased Re-exports and Employment*

The drafters of the Amendment explicitly defined how it was to affect activity within the FTZs, and how that in turn was to affect the domestic economy. Manufacturing was to be small scale; large manufacturing operations were not envisioned because of the scarcity of land and high expense of its rental.[52] Some doubted that manufacturing would even be advisable, suggesting, "[Manufacturing] could be engaged in profitably only if most materials used in the process come from, and the completed product is sent to foreign nations."[53] George Bell, the Associate Director of the Office of International Trade, added, "It is not contemplated that heavy industry or manufacturing activities would be undertaken in these zones.... On the other hand, many types of light industries would be attracted to the zones...."[54]

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46 *Hearings*, *supra* note 41, at 8.

47 Foreign Trade Zones Act of 1934, Pub. L. No. 73-397, 48 Stat. 998, § 3 (1934).

48 94 CONG. REC., *supra* note 45, at A2920.

49 *Hearings*, *supra* note 41, at 6.

50 *Hearings*, *supra* note 41, at 7.

51 93 CONG REC., *supra* note 42.

52 *Hearings*, *supra* note 41, at 25.

53 94 CONG. REC., *supra* note 45, at A2920.

54 *Hearings*, *supra* note 41, at 24. Mr. Bell later added that he could not envision Ford setting up an automobile factory within an FTZ because of the high costs. As of 1983, there were four automobile plants operating the FTZ subzone status, with four applications from other automobile manufacturers pending.

a. Re-exports

There was almost universal agreement among those debating the Boggs Amendment that its purpose was to enhance American foreign trade through an increase in re-exports.[55] New York Representative Ellsworth B. Buck, co-author of the legislation, said, "The value of allowing manufacture is attested to by the very considerable manufacturing for export markets normally undertaken in this country with imported materials."[56] A trade association testified in support of this view: "Since it seems obvious that practically all manufacturing done within a zone would be for re-export only, it would seem there is every reason for this provision and none against it."[57] Even the National Council of American Importers saw the Amendment as a tool for increasing re-exports.[58]

The legislative history also reflects an understanding that imports would increase due to the Boggs Amendment,[59] but only as a supplement to the anticipated export growth. Exhibition in zones would encourage the consumption of those goods coming from overseas and increase imports.[60] Additionally, American producers would be encouraged to purchase more foreign components for combination with domestic products in FTZs.[61] Imports would be beneficial to a certain extent: they would provide enough foreign companies the dollars to purchase American goods.[62]

b. Employment

Law makers were equally as clear on the impact they expected the addition of manufacturing and exhibition to have on the economy. The Boggs Amendment would increase both the number of zones and the utilization of existing FTZs.[63] Increased exports would result in increased production, which would spur employment.[64]

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55 S. REP. No. 1107, *supra* note 41, at 2534.

56 *Hearings*, *supra* note 41, at 8.

57 *Hearings*, *supra* note 41, at 67 (statement of the Pacific Northwest Trade Association).

58 *Hearings*, *supra* note 41, at 38.

59 *Hearings*, *supra* note 41, at 8.

60 94 CONG. REC., *supra* note 48.

61 *Hearings*, *supra* note 41, at 8.

62 *Hearings*, *supra* note 41, at 52.

63 *Hearings*, *supra* note 41, at 24 (remarks of George Bell, Associate Director, Office of International Trade).

64 *Hearings*, *supra* note 41, at 8. Co-author Buck added, "It will bring activities and employment. . .which the country does not now enjoy." *Hearings*, *supra* note 41, at 9. The emphasis of all the congressional testimony was on the creation of *new* jobs.

This benefit was not to be limited to local interests. The entire economy was expected to reap the rewards of FTZ activity.[65] As co-author Cellar indicated, "There are general provisions in the original act with reference to control that must be operated in the public interest. The economy of the Nation must be conserved."[66]

Some say the failure to specifically define this "public interest" qualification has disabled the Foreign Trade Zones Board from making consistent policy decisions.[67]

F. The 1952 Creation of Subzones

Though Congress's last action regarding FTZs came with the passage of the Boggs Amendment, the Foreign Trade Zones Board has subsequently changed the regulations several times. The most significant and controversial modification came in 1952, when the Board amended its regulations to authorize special-purpose subzones.[68] The modification order segregated zones into two categories: General Purpose Zones and Subzones. The function of each type of zone has not changed since the 1952 enactment.

1. The General Purpose Zone

The General Purpose Zone involves the leasing of portions of zone property by a municipal corporation to multiple private businesses:

> It is an isolated, enclosed and policed area, operated as a public utility, in or adjacent to a port of entry, furnished with facilities for lading, unlading, handling, storing, manipulating, manufacturing, and exhibiting goods, and for reshipping them by land, water, or air. Any foreign and domestic merchandise, except such as is prohibited by law or such as the Board may order to be excluded as detrimental to the public interest, health, or safety, may be brought into a zone without being subject to the customs laws of the United States governing the entry of goods or the payment of duties therein; and such merchandise permitted in a zone may be stored, exhibited, manufactured, mixed or manipulated in any manner, except as provided in the act and other applicable laws or regulations. The merchandise may be exported, destroyed or sent into customs territory from the zone, in the original package or otherwise. It is

65 94 CONG. REC., *supra* note 45, at A2921.

66 *Hearings*, *supra* note 41, at 18.

67 Donald E. deKieffer & George W. Thompson, *Political and Policy Dimensions of Foreign Trade Zones: Expansion or the Beginning of the End?*, 18 VAND. J. TRANSNAT'L L. 481, 491 (1985).

68 Foreign Trade Zones Board Order No. 29, 17 Fed. Reg. 5316 (1952) (codified at 15 C.F.R. § 400.304 (1988)).

subject to customs duties if sent into customs territory, but not if reshipped to foreign points.[69]

2. *Subzones and their Impact*

Special-purpose subzones can be established by a single corporation in an existing factory or facility. The subzone ". . .for one or more specialized purposes of storing, manipulating, manufacturing or exhibiting goods, may be authorized if the Board finds that existing or authorized zones will not serve adequately the convenience of commerce with respect to the proposed purposes."[70] The notable distinction between the general purpose zone and the subzone is that subzones can be applied for directly by an independent corporation. Before the amendment, zone privileges were granted to municipal corporations, who would lease areas out to corporations in certain areas. A business using a general purpose zone had to move to the location set aside by the municipality. With the subzone, however, corporations may receive zone privileges without having to move, build new facilities or hire new workers.

By the 1980s, subzones had completely changed the nature of FTZ usage. There were eighteen FTZs (thirteen general purpose zones and five subzones) in 1973.[71] By 1983, there were 117 FTZs (eighty-seven general purpose zones and thirty subzones).[72] By 1990, there were over 370 approved FTZs.[73]

3. *The Future of the Foreign Trade Zone*

The explosive rate of FTZ growth is unlikely to slow in the next few years. The Board has recently extended the area of permissible zone applications from thirty-five miles to sixty miles from the outer limits of a port of entry,[74] which should open the door for even more applicants.

While the Board has hailed the dramatic increase in FTZ usage as indicative of increased American economic potential,[75] critics have

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69 *Id.*

70 15 C.F.R. § 400.304 (1985).

71 GAO REP., *supra* note 4, at 9.

72 GAO REP., *supra* note 4, at 9.

73 BUS. AM., *supra* note 5, at 9.

74 15 C.F.R. § 400.21(b)(2)(i)(1993).

75 *See, e.g.*, John J. Da Ponte, Jr., *United States Foreign-Trade Zones: Adapting to Time and Space*, 5 MAR. LAW. 197, 203 (1980). Da Ponte, the Executive Secretary of the Board, stated, "Multinational firms manufacturing and marketing items of modern technology have a wider range of choices in the siting of plants and distribution centers. Whereas industries were once tied to certain locations, mobility and flexibility are now the rule."

suggested that FTZs may harm the very "public interest" which the Act's framers intended to promote.[76] By 1982, more than ninety percent of all FTZ manufacturing activity took place within subzones.[77] Imports, before considered to be only an ancillary benefit which would offset the trade imbalance brought on by the re-export boom, make up more than two-thirds of zone activity.[78] Additionally, foreign-owned corporations have increasingly used American FTZs to circumvent or diminish import duties, allowing them to price-position their products more favorably than their American competitors.[79]

Clearly, then, the use and effect of the FTZ has differed from the use and effect contemplated by Congress when drafting the FTZ legislation. However, before one may properly analyze whether this use controverts the congressional intent, an inquiry is needed into the benefits which accrue to FTZ users. An understanding of the advantages provided by the contemporary FTZ is necessary to an understanding of how it affects the public interest, and thus, to what extent it fulfills the intent of the Act's authors.

II. Contemporary FTZ Advantages

A. Inverted Tariffs

The first advantage a FTZ offers is the option of the inverted tariff. The inverted tariff permits a manufacturer to select the lower duty rate between the component and finished product. Often, imported components may be assigned higher tariff rates than the finished product. The inverted tariff allows the producer to select the lower rate.[80] Thus, if televisions are prescribed a lower duty than the plastic frames and electronics parts of which they consist, the manufacturer has the option of choosing the tariff rate on the television.

B. Deferred Duty Payment

The ability to defer duty payment is another benefit to FTZ status. Because the United States Customs Service collects duties only on products which enter United States Customs territory, the FTZ op-

76 *See, e.g.*, GAO Report, *supra* note 4; *see also*, deKieffer & Thompson, *supra* note 67.

77 United States International Trade Commission Publication 1496, *The Implications of Foreign Trade Zones for U.S. Industries and for Competitive Conditions Between U.S. and Foreign Firms*, Report to the Committee on Ways & Means, U.S. House of Representatives, on Investigations Number 332-165 Under Section 332(g) of the Tariff Act of 1930 (codified at 19 U.S.C. § 1332(g)) (Feb. 1984).

78 FTZ Staff, Foreign Trade Zones Information Summary, April 20, 1992, at 2.

79 deKieffer & Thompson, *supra* note 67, at 492-99.

80 15 C.F.R. § 400.1(c) (1991).

erator has the option of deferring payment until the product leaves the FTZ for customs territory.[81] Importers operating within the FTZ have the option of classifying its goods as "privileged" or "non-privileged." A product that is classified for duty liability purposes when it enters the FTZ is "privileged."[82] A product which defers duty payment until it leaves the FTZ and enters United States Customs territory is "non-privileged."[83]

C. Duty Avoidance

FTZ operators may also take advantage of duty avoidance. The United States Customs Service only collects duties on products which enter U.S. Customs territory. Items consumed within the FTZs in the manufacturing or processing of the emerging product are not required to pay duties.[84] Consider, for example, a television manufacturer who brings foreign television frames into a FTZ to combine them with domestic components. It may export the final product without paying any import duties. Both duty deferral and duty avoidance are attractive to FTZ operators because they improve their flexibility in controlling cash flow. By removing the requirement to pay temporary duties, FTZ status increases the level of cash on hand for the business.

D. Inventory Control

Another benefit comes by allowing the FTZ user to make necessary inventory adjustments. A producer may keep foreign merchandise within a FTZ until a purchase order is received. In high turnover industries, the ability to quickly respond to retailer and end user needs is a potent competitive advantage. To illustrate, assume demand for disposable lighters is especially high during the winter. A company who produces these lighters within a FTZ would be able to store them at the FTZ and distribute them to retail outlets according to need. Not only could the company improve cash flow by being able to select when to import the lighter, but it could also serve as a convenient, central location from which to distribute.

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81 *Id.*

82 19 C.F.R. § 146.21 (1985).

83 19 C.F.R. § 146.23 (1985).

84 15 C.F.R. § 400.1(c) (1991).

E. Exhibition Advantages

As mentioned earlier, an importer can exhibit its product within a FTZ.[85] This is done prior to the product's entrance into U.S. customs territory, thereby precluding import duties. Exhibition is attractive to prospective buyers, and can increase the number of buyers without increasing administrative or monetary barriers.

F. Local Tax Relief

Aside from national tariff relief, FTZ users can operate free from local ad valorem taxes.[86] The Trade and Tariff Act of 1984 exempts all foreign and domestically produced merchandise that enters a FTZ from all state and local ad valorem taxes.[87] This is a significant symbolic exemption. First, it removes the FTZ from local control and accountability. Second, it moves the FTZ towards national accountability. As will be discussed later, this goes against the original congressional intent that the FTZs have only a local effect.

G. Quota Leveraging

FTZ users who import may use the FTZs to leverage against temporary or permanent quotas set up by the United States. Because the FTZs are technically outside of United States Customs territory, such restrictions could not apply to products within the FTZ boundaries.[88] Thus, a prohibition against importing more than 10,000 items of Product X would not apply to the FTZ user. The FTZ user could stockpile as much of Product X as it needed, reaping those rewards which might accompany the accumulation. For example, the FTZ user could immediately flood the market with Product X once the quota was lifted.

H. Security Standards

FTZs offer another advantage to businesses because they require a high standard of security.[89] FTZs must be within fenced off areas and require close supervision. Since the operator must pay for zone

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85 15 C.F.R. § 400.1(c)(1991).

86 For a more complete treatment of this advantage, *see* Kenneth M. Horwitz & J. William McArthur, Jr., *Recent Developments Favor Use of Foreign Trade Zones as a Way to Avoid Local Taxes*, 63 J.TAX'N 172 (1985).

87 Trade and Tariff Act of 1984, Pub. L. No. 98-573, 98 Stat. 2948 (codified as amended at 18 U.S.C. § 925 (1988)).

88 15 C.F.R., § 400.1(c)(1991).

89 19 C.F.R. § 146 (1993).

use, she is essentially purchasing part of the added security, which is still attractive because it reduces the cost of insurance.

I. Administrative Relief

Re-exporters also benefit from the existence of FTZs. They are spared the administrative burdens of bringing products into United States Customs territory. They do not have to pay ordinary customs fees nor post an importer's bond. Importer's bonds are instruments which insure that the importer will comply with import regulations. The fee is at least $100,[90] and must be supported by a great deal of paperwork.[91] Removal of this requirement makes the FTZ user more efficient.

J. Non-Most Favored Nation Products Characterization

Another advantage lay in the treatment of Non-Most Favored Nation Product imports. Components imported from countries which lack Most Favored Nation status (and thus, whose goods are subject to a higher tariff rate) may be charged a lower tariff rate through the inverted tariff if the foreign product emerging from the FTZ has a different name, character and use than it had when it entered the FTZ.[92] This enhances the FTZ user's price position in the market.

K. Country of Origin Marking Requirements

Another advantage to FTZ status is that goods passing through a FTZ for re-export are not subject to United States Country of Origin marking requirements.[93] Imported items must be marked with the name of the ultimate purchaser in the United States, and the name of the country of origin. Additional procedures apply for containerized goods.[94] FTZ status removes these administrative hassles.

L. Ancillary Benefits

Other benefits spring from those already mentioned. Importers may inspect products for defects at the FTZ before sending them through customs, thus saving the cost of reshipping them to the port

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90 19 C.F.R. § 113.13(a) (1993).

91 19 C.F.R. § 113.62 (1993).

92 Customs Service Decision 79-41 *Foreign Trade Zones: Dutiability of Chemicals Manufactured From Components Imported From Communist Country*, 13 CUSTOMS BULL. 1056, 1057 (1978).

93 19 C.F.R. § 134 (1985).

94 19 C.F.R. § 134.11 (1993).

after the wholesaler/retailer rejects them. Additionally, the advantages of not having to strictly account for products being held or stored in FTZs alleviates the administrative burden that the same products would bear if they were in United States Customs territory.

The elimination of financial and administrative barriers is an advantage which runs through all of these benefits. Notably, these advantages serve the importer much more than the exporter. Critics of the Board and FTZ regulations have focused on this trend while making the argument that contemporary FTZs defy their original purpose which is to serve the public interest by stimulating the re-export business.

III. Criticisms of the Foreign Trade Zone

A. How Foreign Trade Zone Status is Granted

The explosive growth of FTZ usage is understandable, given the many advantages of operating within a FTZ. Yet, most criticisms of the FTZs do not center on the benefits which accrue to FTZ users. Rather, the critiques focus on the Board's method of determining when one may receive these benefits. It is clear that Congress created FTZs to stimulate the domestic economy.[95] However, instead of basing FTZ approval on the expected economic impact a business might have, the Board has clouded the criteria by basing approval on the vague notion of "public benefit." The result has been an approval process which seems much more directed by political pressure from private actors than by an independent consideration of what economically benefits the public. Congress created FTZs to stimulate the domestic transhipment and re-export industries, yet imports now dominate zone activity. To fully appreciate these criticisms, it is necessary to examine how FTZ status is gained. An analysis of the application process is in order.

The Board has the authority to approve FTZs and their users.[96] The language giving the Board this authority is broad, limiting approval only to "the conditions and restrictions of this chapter and the rules and regulations made thereunder."[97] Since the Board is responsible for writing these rules and regulations,[98] it creates its own limitations. The few Congressionally mandated restrictions are not very

95 *See supra* text accompanying notes 25-38.
96 19 U.S.C. § 81b(a) (1993).
97 *Id.*
98 19 U.S.C. § 81(i) (1993).

descriptive. Preference is to be given to public corporations.[99] Applications are to be denied where there is a state-municipality conflict of ownership.[100] There is little else in the statute which governs how FTZs are to be approved. The Board's power appears to be unchecked. Not only does it determine how FTZs are to be granted, but it regulates their operation as well. The only check is through external judicial proceedings, and courts have been extremely deferential when reviewing the scope of Board authority (because of the broadly written statute).[101]

The Board has promulgated its method of evaluating FTZ applications in 15 C.F.R. § 400.23 (1993). The Board centers its approval on the public interest criterion. The authorization of the FTZ must be consistent with public policy, United States Trade and Tariff law, must not interfere with trade negotiations and must not be the sole cause of imports into the United States.[102] If these threshold matters are satisfied, then the Board must "consider" the following factors when determining a public benefit:

(i) Overall employment impact;
(ii) Exports and re-exports;
(iii) Retention, creation of manufacturing activity.
(iv) Extent of value-added activity;
(v) Overall effect on import levels;
(vi) Extent of foreign competition;
(vii) Impact on domestic industry; and
(viii) Other relevant information relating to the public interest.[103]

These factors, manipulable because they are not quantified, must be "tak[en] into account" when determining if an FTZ grant would result in a significant public benefit. The applicant bears the "burden" of proving that, given these criteria, such a benefit would result.[104] These are the guidelines the Board is given when granting FTZ status, and the genesis of the sharp criticism it has encountered.

This broad issue of whether the public interest is being served by contemporary FTZs has been focused through three specific categories of questions:

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99 19 U.S.C. § 81b(c) (1993).

100 19 U.S.C. § 81b(d) (1993).

101 *See e.g., Armco Steel Corporation v. Stans,* 431 F.2d 779 (2d Cir. 1970); *Nissan Manufacturing Corp v. United States,* 693 F.Supp 1183 (Ct. Int'l Trade 1988); *Hawaiian Independent Refinery v. United States,* 460 F.Supp. 1249 (Cust. Ct. 1978).

102 15 C.F.R. § 400.31(b)(1) (1993).

103 15 C.F.R. § 400.23 (1993).

104 *Id.*

(1) Whether FTZs have a positive effect on domestic employment;

(2) Whether FTZ usage provides selective competitive advantages to fortunate grantees; and

(3) Whether the Board criteria for granting FTZs is too broad to effectively carry out the statutory guidelines set forth in 19 U.S.C. § 81 (1993).

B. Employment Effects of the FTZ

The Framers of the Act and the Amendment clearly intended that zones have a positive effect on domestic employment.[105] The employment issue can be encapsulated in two questions; First, has FTZ use created *more* jobs; and second, if not, what is the likelihood that it has *diminished* domestic employment levels.

The General Accounting Office (GAO) examined the employment impact of FTZs at the request of Dan Rostankowski, the Chairman of the House of Representatives Ways & Means Committee.[106] The request was spurred by concern that FTZ growth was excessive, and that too much of FTZ activity centered on imports.[107] The GAO undertook two levels of analysis: local and national economic impact.[108] The GAO concluded that locally, FTZs had a varied effect on employment levels, and that it was too difficult to draw any definitive conclusions.[109] The report described one scenario where a car manufacturer which imported foreign components into a FTZ warned that if FTZ status were not available, it could not take advantage of the inverted tariff, and would be financially better off by importing the entire automobile.[110] The implication was that FTZ status was a contributing factor in the company's decision to continue manufacturing in the United States. Thus, the FTZ in this instance assisted in maintaining the local employment level.[111] Another example cited revealed an increase in employment when foreign car manufacturers set up assembly plants within FTZs. They attributed their decision to come to the United States and manufacture to favorable market conditions, among them the advantages of FTZ status. It was unclear that

105 *See supra* notes 20-30.

106 Letter from Dan Rostenkowski, Chairman, Committee on Ways & Means, House of Representatives, to William J. Anderson, Director, Government Accounting Office (May 20, 1983).

107 GAO REP., *supra* note 4, at 9. By 1982, imports made up 80% of all FTZ activity.

108 GAO REP., *supra* note 4, at 24.

109 *See* GAO REP., *supra* note 4, at 24-28.

110 GAO REP., *supra* note 4, at 25.

111 GAO REP., *supra* note 4, at 25.

but for FTZ status, the manufacturers would not have initiated operations in the United States.[112] This does not necessarily lead one to the conclusion that FTZs lead to greater employment levels.

One peculiar phenomenon in local FTZ impact was job relocation. Existing businesses could move their operations into a general purpose zone and receive the benefits of FTZ status without increasing the number of workers they employed.[113] Other firms could receive subzone status without moving, without hiring new employees, and, thus, without materially affecting local employment levels. While there may be an increase in the firm's sales (due to more competitive price positioning), any public benefit would probably be nominal. It is unclear, therefore, that FTZs, *especially* subzones, contribute in any way to local employment growth.

The GAO analysis was also inconclusive on whether FTZs provided any positive effect on national employment levels. The report stated, ". . .[W]hen 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."[114] In other words, the inflow of foreign capital will cause the dollar to appreciate against foreign currencies, which will lead to increased consumption of foreign goods and, subsequently, the loss of American firms' markets.

Since it is unclear that FTZs promote job growth, the next question is whether they *reduce* domestic employment. One scenario suggests that they may. If a domestic producer who makes automobiles wholly out of domestic parts can obtain subzone status, she may be inclined to purchase less expensive foreign parts as a substitute. The inverted tariff rate will make this possible. Thus, domestic components would no longer be consumed, thereby reducing domestic component consumption, and ultimately reducing domestic employment levels. One familiar with FTZ application procedures may argue that this scenario would not manifest because a subzone applicant must demonstrate that the proposed FTZ would be in the public interest. In reality, this argument fails. The public interest requirement is so ill-defined that it can easily be overcome.[115] Thus, it is quite possible that a FTZ which has a negative economic effect on domestic employment could receive Board approval.

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112 GAO REP., *supra* note 4, at 25.

113 GAO REP., *supra* note 4, at 24.

114 GAO REP., *supra* note 4, at 26.

115 *See infra* text accompanying notes 135-141.

It is clear then that FTZs might not only have a nominal positive impact, but may have a perversely *negative* impact on domestic employment levels. The GAO's examination of the employment impact of FTZs revealed too many variables to confirm the existence of either benefits or harms. It follows that any claim that a particular FTZ approval will result in a positive economic outcome is not statistically provable. If the Board took seriously the requirement that an applicant must prove that FTZ status will lead to a positive economic benefit, no FTZ would ever be granted. However, since FTZ status is granted, this suggests the Board does *not* take the positive economic requirement seriously.

C. FTZs As Selectively Unfair Competitive Advantages

A number of American industrial representatives have alleged that FTZs provide no material benefit to the public, but are merely advantageous to the user. The debates surrounding the Boggs Amendment acknowledged that there is an underlying unfairness to granting FTZ status to one company but not another. "If it is felt that there would be an undue advantage to a manufacturer there as against all the other manufacturers, they may seek to exclude them and not give them the privilege. . ."[116] One of the only opponents of the Boggs Amendment was a collective of oriental rug importers, who foresaw the dumping of rugs into FTZs on consignment, whereas existing dealers had fixed investments in purchasing operations overseas.[117] Recently, the domestic steel, electronic components, textile and bicycle industries have objected to FTZ use.[118] The electronic component producers charged that FTZs "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."[119]

Claims of unfairness can rest on the fact that not all businesses are eligible for FTZ status. General purpose zones are granted only to those communities within sixty miles of the port of entry.[120] Communities and businesses outside of this perimeter are immediately disqualified. Subzones are not limited to this area restriction. However, the discretionary authority of the Board to approve and deny sub-

116 *Hearings, supra* note 41, at 63.
117 *Hearings, supra* note 41, at 68.
118 GAO REP., *supra* note 4, at 20.
119 GAO REP., *supra* note 4, at 21.
120 15 C.F.R. § 400.21(b)(2)(i) (1991).

zones is so broad, and the criteria for zone approval so nebulous, that political and other pressures unrelated to the public interest could bring about one subzone's approval or denial. Thus, FTZs could be awarded, not to the business which would best serve the public interest, but to the business which has the most competent political operators.

D. FTZ Approval Criteria Too Broad, Board Discretion Too Great

19 U.S.C. § 81b(a) (1993) gives the Board authority, subject to the conditions and restrictions within the statute, to grant corporations zones in or adjacent to United States ports of entry. Each port of entry is entitled to at least one zone; additional zones are authorized only if existing zones will not adequately serve the convenience of commerce.[121] Preference is to be given to public corporations.[122] The statute also requires the applicant, when considering a FTZ application, to provide "such other information as the Board may require."[123]

The "public interest" criteria, which the Board so heavily relies upon, was initially intended to govern the re-entry of domestic products from a FTZ back into United States Customs territory. "Such articles may not be returned to customs territory for domestic consumption except when the Foreign Trade Zones Board deems such return to be in the public interest."[124] Additionally, the Board "may at any time order the exclusion from the zone of any goods or process of treatment that in its judgement is detrimental to the public interest, health, or safety."[125]

The plain language and legislative history of the statute clearly manifest the authors' desire that a return of domestic merchandise into United States Customs territory from a FTZ be an exception,[126] and should only be permitted if it is in the public interest. The regulations developed by the Board, however, hinge approval of the entire FTZ upon this requirement.[127] The public interest requirement lacks

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121 19 U.S.C. § 81f(a)(5) (1980).
122 19 U.S.C. § 81b(c) (1980).
123 19 U.S.C. § 81f(a)(5) (1993).
124 19 U.S.C. § 81(c) (1980).
125 19 U.S.C. § 81o(c) (1980).
126 *See supra* notes 21-23.
127 15 C.F.R. § 400.31 (1991). The Board virtually ignores the emphasis in § 81c that the import of domestic material from a FTZ was intended to be an exceptional circumstance, and that an affirmative showing that the activity was in the public interest was required before reimport was allowed. Instead, it relies on § 81o(c), which addresses what the Board may prohibit items detrimental to the public interest. It then makes the logical leap to infer that imports

the specificity to hold the Board to any consistent line of policy making. The Board has an enormous amount of discretion when deciding whether to grant an applicant zone status.

IV. Board Responses

While the Board has not attempted to directly answer the criticisms that FTZ activity may not help (and may even hurt) domestic employment and that FTZs offer unfair competitive advantages, it has extensively defended its adherence to the public interest criteria when evaluating FTZ applications.[128] The Board has responded to the charge that it has too much discretion by pointing out that it has not violated the power vested in it by the statute.[129] The courts have supported this position. In *Armco Steel Corporation v. Stans,*[130] a domestic steel producer challenged the Board's authority to grant a subzone where, among other things, "heavy" manufacturing was to take place. The Court rejected this contention, stating that the Foreign Trade Zones Act gave the Board "wide discretion to determine what activity may be pursued by trade zone manufacturers subject only to the legislative standard that a zone serve this country's interests in foreign trade. . ."[131] This ruling was backed up by other court decisions which established a deferential judicial posture towards Board decisions.[132]

The Board has used this "wide discretion" response as a blanket defense to criticisms regarding subzones. The charge that subzones serve an interest contrary to the public interest has been met with the response that although subzones are not structured to serve the public, their activity may have a public effect, and the Board has the broad discretion to determine whether that effect is in the public interest.[133] In other words, the FTZ is in the public interest because the Board says it is. The Board provides a final justification for its policies by stating that it has produced criteria sufficient for a determination of whether a proposed subzone or general purpose zone is within the public interest. This comment, like many others that have ex-

(including re-imports) are automatically allowed entry "unless detrimental to the public interest."

128 Foreign Trade Zones in the United States, 56 Fed. Reg. 50790-98 (1991).

129 *Id.* at 50793.

130 431 F.2d 779 (2d Cir. 1970).

131 *Id.* at 785.

132 693 F.Supp 1183 (Ct. Int'l Trade 1988); *Hawaiian Independent Refinery,* supra note 101.

133 Foreign Trade Zones Board Order No. 530, 56 Fed. Reg. 50793 (1991).

amined the statute,[134] does not contest that the language of the statute gives the Board such discretion. Rather, it seeks to remedy the incongruency between legislative intent and practice by tightening the statutory language.

This comment approaches this remedy by first responding to each of the Board's defenses to these criticisms. Finally, it will examine the language of 19 U.S.C. § 81 and suggest an alternative way to meet the legislative intent of the Act.

V. Conclusion: Critique and Recommendation

A. Board Defenses: Analysis and Response

1. Economic Benefit Undeterminable

The Board's claim that it can determine from the given standards whether an applicant for a FTZ will operate in the public interest overstates its capabilities. A significant factor in determining whether there is an public benefit is the positive employment impact a FTZ's operation would have.[135] Yet it has already been established that it is not possible to accurately assess the impact a FTZ has on either local or national employment levels.[136] The criteria for determining positive economic impact have no quantifiable amount attached to them. Thus, a Board motivated by political or private pressure could easily find a potential positive economic impact if it wanted to.

2. Limited Opportunity for Opposition in Approval Process

The application and approval process seems susceptible to one-sided pressure. Once the applicant has filed the necessary paperwork, the Board publishes a notice in the Federal Register.[137] Those wishing to contest a grant of zone status have sixty days within which to do so.[138] Only applicants for general purpose zones must hold public hearings in the community where the zones are being proposed; subzone applicants are not required to do so.[139] Thus, national competi-

134 *See, e.g.*, John J. Da Ponte, Jr., *United States Foreign Trade Zones: Adapting to Time and Space*, 5 Maritime Law. 197, 214 (1980) ("even absent such language, the legislative history suggests [that broad discretionary] authority is implicit"); Susan M. Spraul, Note, *Nissan Motor Manufacturing Corp. v. United States: An Update in Foreign Trade Zone Law*, 14 N.C. J. INT'L L. & COM. Reg. 483 (1989).

135 *See infra* text accompanying notes 55-59.

136 *See infra* text accompanying notes 101-110.

137 15 C.F.R. § 400.27(c)(2) (1993).

138 15 C.F.R. § 400.27(c)(2) (1993).

139 Telephone Interview, Camille Evans, Program Assistant, Foreign Trade Zones staff (May 25, 1995).

tors of local businesses seeking FTZ status, unless they regularly perused the Federal Register, would be entirely unaware that their competitor is seeking zone status and its advantages, and would be unable to contest the application. Furthermore, local opposition seems unlikely, since only a direct competitor would be hurt by the advantages FTZ status provides. Absent the protest of competitors, the only inertia in the decision of whether to approve or reject a FTZ would come from the private actor, who could, had he the resources, exert considerable political pressure on the Board to approve. This leaves the Board as the only real obstacle to a grant of zone status, and magnifies the import of those criteria the Board relies upon to approve zone status.

It appears, though, that these criteria are deficient. The GAO report lamented the lack of distinguishing criteria for FTZ approval: "Theoretically, almost every domestic business could qualify for zone status and thereby obtain the duty benefits on the goods they import."[140] This flies in the face of Representative Cellar's remarks before the Amendment was passed: "You could not have unlimited zones, widespread all over the country."[141]

3. Other Problems

The Board has offered no defense to the charge that FTZs provide unfair competitive advantages to those fortunate enough to obtain them. Nor has the Board responded to the allegation that it has too much authority, except to say that it has been granted that authority in the statute. This, however, misses the point. If the level of discretion afforded to the Board up to this point has led to a deluge of foreign components in the United States market, decreased American employment levels and unfair competitive advantages to select manufacturers, then there is something wrong with their decision-making process.

B. Recommendations to Make the Language of 19 U.S.C. § 81 (1993) Reflect the Legislative Intent

The Foreign Trade Zones Statute, 19 U.S.C. § 81a-u (1993), should be amended to more specifically reflect the intent of the drafting legislature. That is, the FTZ should increase domestic employment levels and encourage foreign trade. The following modifications

140 GAO REP., *supra* note 4, at 23.
141 *Hearings*, *supra* note 41, at 16.

are designed to restore the integrity of the FTZ system in two ways. First, they remove those components of Board discretion which can be tainted by pressure from private actors. Section 81b(a) takes the responsibility for promoting the zone away from private users and gives it to the municipality. Second, they increase the likelihood that a FTZ grant will result in economic growth. Proposed sections 81b(b) and 81f articulate a clearer standard for showing a FTZ will have a positive aggregate economic effect.

These changes are not all inclusive. There are several minor linguistic changes that will need to be made to the statute to reflect the broad, substantive modifications here specified. The changes will be highlighted in bold type.

SECTION: 19 U.S.C. § 81b(a)

SUBJECT: Board Authorization to Grant Zones

CURRENT LANGUAGE: The Board is authorized, subject to conditions and restrictions of this chapter . . . to grant to corporations the privilege of establishing, operating, and maintaining Foreign Trade Zones. . . .

MODIFICATION: The Board is authorized, subject to conditions and restrictions of this chapter . . . to grant to **municipalities** the privilege of establishing, operating, and maintaining Foreign Trade Zones. . . . **Municipalities will seek approval for each corporation, or other business entity, who wishes to operate within the zone. The Board will approve zone operation on a case by case basis, subject to the criteria specified in this chapter.**

COMMENT: The amendment removes the private company from a petition for FTZ status. This will decrease the politicization of the FTZ approval process, for municipalities are much more likely than the particular corporation to prudently weigh whether a corporation is serving a public benefit. Moreover, a municipality will be less likely to expend huge resources campaigning for particular operator approval. This precludes the powerful corporation from directly lobbying the Board. While the powerful corporation could still lobby the municipality, it would not have direct access to the Board, as it now does. Nor could powerful corporations directly lobby the Board to quash the applications of competitors, as they may do now. This shield should lead to greater Board objectivity, and will likely make its decision more reflective of the public economic interest.

SECTION: 19 U.S.C. § 81b(b)

SUBJECT: Number of Zones per Port of Entry

CURRENT LANGUAGE: Each port of entry shall be entitled to at least one zone. . . . Zones in addition to those which a port of entry is entitled shall be authorized only if the Board finds that existing or authorized zones will not adequately serve the convenience of commerce.

MODIFICATION: Each port of entry shall be entitled to at least one zone. . . . Zones in addition to those which a port of entry is entitled shall be authorized only if the Board finds **a substantial likelihood** that **an additional zone would lead to a net increase in regional economic activity, as defined by increased employment levels or income.**

COMMENT: The "convenience of commerce" standard for determining the necessity of an additional FTZ does not comport with the intent that FTZs serve a public benefit. FTZs are inherently convenient because they remove procedural and financial barriers. The "substantial likelihood of net economic activity increase" reflects the legislative intent, yet allows the Board some degree of flexibility. It is the standard which will be used throughout the remainder of the amended statute.

SECTION: 19 U.S.C. § 81f

SUBJECT: Application for Establishment of Zone; Expansion of Zone

CURRENT LANGUAGE:

(a) Each application shall state in detail—

(1) The location and qualifications of the area in which is proposed to establish a zone, showing [physical compatibility for zone use and expansion];

(2) the facilities and appurtenances which it is proposed to provide and the preliminary plans and estimate of the cost thereof, and the existing facilities and appurtenances which it is proposed to utilize;

(3) the time within which the applicant proposes to commence and complete the construction of the zone and facilities and appurtenances;

(4) the methods proposed to finance the undertaking;

(5) other such information as the Board may require.

(b) The Board may upon its own initiative or upon request permit the amendment of the application. Any expansion of the area of an established zone shall be made and approved in the same manner as an original application.

MODIFICATION:

Title: Application for establishment of a zone; **Criteria for approval of zone users.**

a) Each **zone** application shall state in detail—

[19 U.S.C. § 81f(a)(1-4) will remain the same.]

(5) the anticipated use of the zone, including a list of pending or potential users;

(6) Such other information as the Board may require.

b) Each user application will contain the following:

(1) A showing by each applicant that;

(i) the business activity is physically suitable for this particular zone;

(ii) the business activity will particularly benefit from zone status;

(iii) the business activity is an intra-state entity, with no subsidiary or branch offices outside the state;

(iv) the business activity shows a substantial likelihood that its use of the zone would lead to a net increase in regional economic activity, as defined by increased employment levels or income.

(2) a showing by the business entity that it has the financial resources to operate within a zone.

(3) a statement by the municipality that the business activity's use of the zone will not give the business activity a competitive advantage unavailable to a competitor in the same geographic and product markets.

(4) such other information as the Board may require.

COMMENT: The amendment breaks up the application process into two steps. The municipality must first apply for the FTZ. Then, the municipality must submit applications for each user.

Section (1)(i) is self-explanatory.

Section (1)(ii) is intended to preclude zone use from business activities who will only realize marginal benefits from zone status. For example, a business whose product is composed of 5% foreign components and who only exports 2% of its product would not be as likely to benefit from FTZ use as the business which has 50% foreign components and exports 40% of its product.

Section (1)(iii) is intended to limit the size of the FTZ user. This is responsive to the criticism that certain national manufacturers gain unfair price advantages over other national manufacturers through

FTZ use. By limiting FTZ users to intra-state operators, the adverse impact on those businesses outside of FTZ range is lessened. This would prevent a firm's location from turning into an artificial competitive advantage. This is simply a suggestion. There may be alternative means of limiting the size of the FTZ which more directly address the problem of unfair competition.

Section (1)(iv) is intended to give the Board a more definitive guideline when determining the central issue of FTZ user approval—whether a public benefit will result. As discussed earlier, the one consensually agreed upon public benefit was the increase in domestic employment. The question the Board would ask here is: "How many new jobs will this business create by using a FTZ?" or "How much net income growth will result from this business' use of the FTZ?" Without showing that there is a substantial likelihood that these results will occur, the application will fail. This is an improvement over existing criteria because each business activity is responsible for making this showing. Thus, the evidence is much more verifiable than is an analysis of aggregate employment activity. A mere shift in business activity from one site to another would be an insufficient showing under this criterion.

Finally, Section (3), requiring a statement by the sponsoring municipality that the opportunity for FTZ status is equally available, is designed to preclude one local business from gaining an unfair competitive advantage over another business. The municipality operating the FTZ must provide equal access to its facilities.

C. Expected Impact of Proposed Amendments

These amendments should remedy the approval process and use of FTZs in three ways. First, the approval process will be insulated from direct lobbying by private, powerful corporations. Currently, an application for FTZ status is susceptible to public challenge. A small manufacturer who competes in the same product market as a national competitor could be overwhelmed by the competitor's challenge to its FTZ application. It would likely be unable to match the resources and political clout of its powerful challenger. Because the standards for approval are easy to manipulate, if the Board has been heavily pressured by the powerful lobby it could easily claim an alternative reason for denying the application. Under the amendments, municipalities would bear the brunt of such lobbying efforts, but would still be responsible for producing hard data to the Board to meet the new criteria.

Second, the amendments should eliminate the negative effects of the subzone while retaining the positive ones. No longer will businesses be able to apply for zones. However, a showing of a positive economic benefit, as measured by net or income growth, would allow a city to establish a subzone. Thus, the advantages that the geographic flexibility of the subzones provided could still be had.

Finally, the amendments would restore the credibility of Board decisions by forcing the Board to comply with relatively clear standards. The removal of direct political pressure on the Board, and the requirement of an affirmative showing of a public economic benefit will serve notice to all future applicants that decisions are made with some level of objectivity. These amendments would restore this confidence in the Board by tying the Board to the broad objectives that the drafters of the Act intended.

D. Final Considerations

Finally, the concept of the foreign trade zone should be reconsidered. In a world economy with significant trade barriers (e.g., tariffs and administrative burdens), the advantages of a FTZ are significant and attractive. However, in our emerging world economy, where trade barriers are being lowered or removed, the FTZ begins to lose its appeal. Inverted tariffs will lose their significance when all duties are near the same level. In addition, the nominal cost savings of duty deferral in a country with low tariff rates would be unimportant to the importer, who would likely consider application and payment for a FTZ to be an unnecessary administrative hassle. Legislators should consider the necessity of such an instrument in a trade environment that appears to be outgrowing it. To retain any protectionist device will undoubtedly benefit the few fortunate enough to qualify for it. Yet ultimately, the consequences of such protectionism fall squarely on the shoulders of the domestic consumer.