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Political and Policy Dimensions of Foreign Trade Zones: Expansion or the Beginning of the End?

Donald E. deKieffer

George W. Thompson

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*Donald E. deKieffer**

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* Partner, Pillsbury, Madison & Sutro, Washington, D.C.; J.D., Georgetown University School of Law (1971); B.A., University of Colorado (1968).

** Associate, Pettit & Martin, Washington, D.C.; J.D., Cornell University School of Law (1981); B.S., State University of New York (1978).

I. INTRODUCTION

Foreign Trade Zones ("zones") have been touted as an essential element in expanding United States foreign commerce since their authorization in 1934.[1] Over the last fifty years, structural changes[2] have expanded the scope of the zone program, permitting the explosive growth of zone utilization. This expansion has caused renewed scrutiny of the entire zone program by the public and private sectors. Both United States industry and labor interests have objected to using zones for the manufacturing of products that subsequently are imported at substantial savings in customs duty. Further, opponents of the present zone program claim that the rapid increase in the number of zones and the manufacturing operations conducted therein have "stolen" jobs from more traditional domestic manufacturing operations.[3] Proponents of zone expansion, including municipal and state authorities, argue that zone facilities attract industrial development to areas of the United States that otherwise might be outside of traditional international trade patterns.[4] Proponents claim that zone opera-

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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 (1982).

2. The 1934 Act was amended in 1950, in Pub. L. No. 81-566, 64 Stat. 246. *See infra* Section III.

In 1952, "special purpose subzones" were administratively authorized. 17 Fed. Reg. 5316 (1952) (current version at 15 C.F.R. § 400.304 (1985)). *See infra*, section IV.

In 1980, the Customs Service amended its regulations to exclude certain costs incurred in zone manufacturing operations from the dutiable value of subsequently imported zone-manufactured merchandise. 45 Fed. Reg. 17976 (1980) (amending 19 C.F.R. § 146). *See infra*, text accompanying notes 76-78.

3. *See* 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 INVESTIGATION NUMBER 332-165 UNDER SECTION 332(G) OF THE TARIFF ACT OF 1930 (19 U.S.C. § 1332(g)) (Feb. 1984). This report [hereinafter cited as USITC REPORT] analyzes the history and uses of Foreign Trade Zones, and presents the views of many groups interested in the zone program.

4. USITC Report, *supra* note 3, at 55-57; 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) 22 (Mar. 1984) [hereinafter cited as GAO REPORT]. Letter of Rep. Ronnie G. Flippo to the Foreign Trade Zones Board (May 17, 1983) (copy on file at Commerce Department Reading Room, Washington, D.C.).

tions have created a substantial number of jobs and have made domestic corporations more competitive.[5]

The debate over zones has transcended the relatively specialized legal questions of the past several years and now is becoming an important item in the overall political debate on United States international trade policy. The President and Congress, rather than the courts, are likely to resolve future conflicts among zone users, industry, labor, municipalities, and the Foreign Trade Zones Board.

In 1983 Congress requested that the International Trade Commission (ITC) and the General Accounting Office (GAO) investigate the zone program. The resulting agency reports[6] have helped to frame the issues in the upcoming political debate. Both of these reports present conclusions that implicitly criticize the current use of Foreign Trade Zones for product manufacturing, especially where operations are conducted in subzones.[7] The criticism is illustrated by the following excerpt from the ITC report:

> In view of the growth and nature of zone usage, the potential effects of zones on conditions of competition in U.S. markets, the Board's lack of guidance regarding the granting of zone privileges for manufacturing purposes, and the Board's proposed changes in FTZ regulations, it has been asserted that a review of the standards for the establishment, duration, and operations of zones (particularly where manufacturing is contemplated) should be undertaken.[8]

II. THE FOREIGN TRADE ZONES ACT OF 1934

The Foreign Trade Zones Act of 1934[9] provides for the establishment of a Foreign Trade Zones Board ("Board")[10] with au-

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5. USITC Report, *supra* note 3, at 44-47, 56-57; GAO REPORT, *supra* note 4, at 22-23; Comments on Proposed Foreign Trade Zones Board Regulations submitted by the Greater Kansas City Foreign Trade Zone, Inc. (May 27, 1983) (copy on file at Commerce Department Reading Room, Washington, D.C.).

6. *See* USITC REPORT, *supra* note 3.

7. *See, e.g.*, GAO REPORT, *supra* note 4, at 19-20; USITC REPORT, *supra* note 3, at vii. Subzones are discussed in Section IV, *infra*.

8. *See* USITC REPORT, *supra* note 3, at vii. The Commission issued the report pursuant to Section 332 of the Tariff Act of 1930, 19 U.S.C. § 1332(g) (1982).

9. Pub. L. No. 73-397, 48 Stat. 998, *codified as amended at* 19 U.S.C. § 81a-81u (1982).

10. 19 U.S.C. § 81a(b) (1982). The Board consists of the Secretaries of Com-

thority to grant to private and public corporations the privilege of establishing and operating zones in or adjacent to United States Customs ports of entry.[11] The zones are outside United States Customs territory for purposes of tariff liability.[12] Thus, goods entering Foreign Trade Zones are not subject to formal Customs requirements.[13]

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merce, the Treasury, and the Army. *Id.*

11. "The Board is authorized, subject to the conditions and restrictions of this chapter and of the rules and regulations made thereunder, upon application as hereinafter provided, to grant to corporations the privilege of establishing, operating, and maintaining foreign-trade zones in or adjacent to ports of entry under the jurisdiction of the United States." 19 U.S.C. § 81b(a) (1982).

Although the original act did not define the term "Foreign Trade Zone," zones were envisioned to be segregated areas, located in or near a Customs port of entry, which would be under Customs supervision.

The Foreign Trade Zones Board defines a zone as "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." 15 C.F.R. § 400.101 (1985); *see also* S. REP. No. 905, 73d Cong., 2d Sess. 2 (1934).

12. The zones, however, are subject to other laws concerning the public interest, health, and safety. S. REP. No. 905, *supra* note 11, at 2-3. The Act grants the board discretionary authority to oversee compliance with such non-Customs laws: "The Board may at any time order the exclusion from the zone of any goods or process of treatment that in its judgment is detrimental to the public interest, health, or safety." 19 U.S.C. § 81o(c) (1982).

13. "Foreign and domestic merchandise of every description, except such as is prohibited by law, may, without being subject to the customs laws of the United States, except as otherwise provided in this chapter, be brought into a zone . . . ." 19 U.S.C. § 81c (1982).

"Importation" means the arrival of merchandise within the Customs territory of the United States. 19 C.F.R. § 101.1(h) (1985). "Customs territory" is defined as "the territory of the United States in which the general tariff laws of the United States apply but which is not included in any zone." 19 C.F.R. § 146.1(c) (1985). Geographically, United States Customs territory "includes only the States, the District of Columbia, and Puerto Rico." Tariff Schedules of the United States, Annotated (TSUSA), 19 U.S.C. § 1202 (1982) (the Tariff Schedules are now published annually by the USITC); 19 C.F.R. § 146.1(c) (1985). Because a zone is not considered to be within United States Customs territory, merchandise that enters a zone is not imported for Customs purposes. As the Board states in its regulations, "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 customs entry of goods or the payment of duty thereon. . . . [The merchandise] is subject to customs duties if sent into Customs territory, but not if reshipped

In enacting this legislation, Congress sought to streamline international commerce procedures.[14] Corporations could use the

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to foreign points." 15 C.F.R. § 400.101 (1985). *See also* Hawaiian Independent Refinery v. United States, 460 F. Supp. 1249, 1251 (Cust. Ct. 1978) (for purposes of the customs entry of foreign merchandise and the payment of customs duties thereon, a foreign trade zone is not considered part of United States Customs territory).

14. "The proposal (Foreign Trade Zone establishment) does not introduce anything essentially new into our law. In fact, this is little more than the minimizing of the official limitations and costs involved in the formalities of entry into bonded warehouse and drawback now provided in the American tariff law." H.R. REP. 1521, 73d Cong., 2d Sess. at 3-4 (1934) [excerpt from a letter by Secretary of Commerce Daniel C. Roper].

Proponents of the zone legislation anticipated that zones would be used primarily for warehousing and transshipment of products or for minor processing and subsequent exportation, thus encouraging transport activity and reducing administrative burdens connected with the use of bonded warehouses and the processing of drawback claims. *Foreign Trade Zones: Hearings on H.R. 3657 Before a Subcomm. of the House Ways and Means Comm.*, 73d Cong., 2d Sess. 4-16 (1934) (statement of Rep. Emanuel Celler).

Customs bonded warehouses are designated structures, authorized by the district director of Customs for the district in which the warehouse is located, into which imported merchandise may be placed for storage, repacking, resorting, cleaning, manipulation, or manufacture for exportation. 19 U.S.C. § 1555(a) (1982). The Customs Service provides for eight different classes of bonded warehouses; this class designation determines the activities that may be performed upon imported merchandise placed within a warehouse. 19 C.F.R. § 19.1(a) (1985). Imported merchandise may remain in a bonded warehouse for up to five years from its date of importation without payment of duties, after which it must be exported, entered for consumption (unless a manufacturing operation has been performed upon it), destroyed, or abandoned to the Federal Government. 19 U.S.C. §§ 1557, 1559 (1982). Dutiable merchandise may be entered for consumption upon payment of duties at the rate imposed upon such merchandise at its date of withdrawal. 19 U.S.C. § 1557(a) (1982).

Drawback is the refund or remission, in whole or in part, of a customs duty or other charge assessed or collected upon merchandise imported into the United States and subsequently exported. 19 U.S.C. § 1313 (1982); 19 C.F.R. § 191.2(a), (g) (1985). Following exportation, and assuming compliance with regulatory and record-keeping requirements, the Customs Service will refund as drawback ninety-nine percent of the duties that were paid upon importation of the merchandise. 19 U.S.C. § 1313(a) (1982). Drawback is available, for example, when imported duty-paid merchandise is exported in the same condition as when imported and has not been used in the United States ("same condition drawback"). 19 U.S.C. § 1313(j)(1) (1982). Drawback is also available when imported merchandise has been used in the manufacture, in the United States, of subsequently exported products. 19 U.S.C. § 1313(a) (1982). Also, imported duty-paid merchandise and domestic merchandise can be substituted for certain drawback

zones to warehouse or perform various minor operations on foreign goods before those goods were imported or reshipped abroad, thus avoiding Customs duty and paperwork requirements. The legislative history accompanying the Act stated that the Act's purpose was

> to encourage and expedite that part of [the] nation's foreign trade which [Congress] wish[ed] to free from the restrictions necessitated by Customs duties. In other words, [Congress desired] to foster the dealing in foreign goods that are imported not for domestic consumption but for re-export to foreign markets and for conditioning or for combining with domestic products previous to export.[15]

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purposes. Thus, drawback may be available upon the exportation of manufactured articles where fungible domestic and imported merchandise was used in manufacturing such articles ("substitution drawback"). Substitution drawback may be claimed even though none of the imported merchandise was actually used in manufacturing the exported articles. 19 U.S.C. § 1313(b) (1982). Pursuant to the Trade and Tariff Act of 1984, the principle of substitution has been extended to same condition drawback. Drawback may now be claimed where exported merchandise, whether imported or of domestic origin, is fungible with duty-paid imported merchandise, and the exported merchandise has not been used in the United States. Pub. L. No. 98-573, § 202, 98 Stat. 2973 (1984). *See infra* text accompanying notes 66-70 (discussion of the relative merits of Foreign Trade Zones, bonded warehouses and drawback).

The Congress had modest goals in mind when approving the zone concept and adopted a Tariff Commission report to the Chairman of the Commerce Committee in 1918, which defined a zone as:

> . . . an isolated, enclosed and policed area in or adjacent to a port of entry without resident population, furnished with the necessary facilities for lading and unlading, for supplying fuel and ship's stores, for storing goods and for reshipping them by land and water; an area within which goods may be landed, stored, mixed, blended, repacked, manufactured, and reshipped without payment of duties and without the intervention of customs officials. It is subject equally with adjacent regions to all the laws relating to public health, vessel inspection, postal service, labor conditions, immigration, and indeed, everything except the customs.

S. REP. No. 905, *supra* note 11, at 2-3.

15. S. REP. No. 905, *supra* note 11, at 2-3. The legislation's chief sponsor, Representative Emanuel Celler, emphasized the following as the potential role of zones in increasing United States exports:

> The following table shows a steady decline in our reexport trade: . . . . Here, again, there is indicated that there is something wrong with our system. I firmly believe that a foreign trade zone would greatly encourage this reexport business. A free port has nothing to do with free trade.
>
> . . . .
>
> Foreign trade in New York dropped 75% in value and 50% in volume since 1929. This drop is typical of ports throughout the country. We must

The expected growth in "re-exports" was a major impetus behind the Act.[16] Proponents also foresaw increased imports as a secondary benefit of the zone program.[17]

Because of congressional concern that manufacturing within the zones might adversely affect United States industry, the 1934 Act expressly prohibited zone manufacturing.[18] The Act's proponents emphasized the role that zones would play in reducing the financial and administrative burdens placed upon importers and re-exporters of merchandise. As the Senate report accompanying the Act stated:

> [I]t 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 operation 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 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.[19]

This passage, and the legislative history generally, show the relatively modest goals that the Act's sponsors envisioned for the zone program.

Zones met their proponents' expectations, and for many years served primarily as transshipment centers for foreign-origin merchandise. Because of the proscription on zone manufacturing prior to 1950, however, the importance of zones in United States

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do something to fill this void. Encouragement of transshipments will help. Establishment of foreign trade zones will induce greater transshipments between two foreign countries by way of ports of the United States.

78 CONG. REC. 9852, 9854 (1934). *See also* Rep. Celler's extended discussion. *Id.* at 9852-59.

16. *See* 78 CONG. REC. at 9858 (1934) (statement of Rep. Celler).

17. "Foreign and domestic merchandise of every description, except such as is prohibited by law, may, without being subject to the customs laws of the United States, except as otherwise provided in this act, be brought into a zone and may not be manufactured or exhibited in such zone . . . ." Pub. L. No. 73-397, § 3, 48 Stat. 998, 999 (1934); *see also* S. REP. No. 905, *supra* note 11. The Act permitted only "manipulation" in zone operations. 78 CONG. REC. 9762, 9766 (statement of Sen. McCormack).

18. Pub. L. No. 73-397, § 3, 48 Stat. 998, 999; S. REP. No. 905, *supra* note 11, at 2.

19. S. REP. No. 905, *supra* note 11, at 3.

international trade remained small.[20]

III. The Boggs Amendment: Authorization of Manufacturing in Zones

The substantial expansion in United States international trade following World War II prompted Congress to amend the Foreign Trade Zones Act (via the "Boggs Amendment") in 1950 to permit manufacturing in zones.[21] Representative Celler stated the purpose of the amendment:

> In and of itself, the value of allowing manufacture is attested by the very considerable manufacturing for export markets normally undertaken in this country with imported materials. The long history of the drawback privilege is a partial reflection of this section of foreign commerce. . . . By extending the Celler Foreign Trade Zones Act to permit manufacturing in foreign trade zones, this important segment of our economy will be enabled to benefit from expanded foreign opportunities and to meet competition from other world areas.[22]

Although the Boggs Amendment neither placed any express restrictions on the type of zone manufacturing nor restricted importations of zone-manufactured products, its legislative history suggests that Congress may have intended to impose certain limitations on zone manufacturing. The ambiguity has provided the ITC, GAO, and other contemporary critics of the zone program support for their argument that further restrictions should be placed on zone manufacturing operations.

For example, a Senate report indicates that Congress may have envisioned zone manufacturing operations to benefit primarily reexported goods, rather than imports:

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20. USITC Report, *supra* note 3, at 1-2; GAO Report, *supra* note 4, at 5.

21. "Foreign and domestic merchandise of every description, except such as is prohibited by law, may, without being subject to the customs laws of the United States, except as otherwise provided in this Act, be brought into a zone and may be . . . exhibited . . . or be manufactured . . . ." Pub. L. No. 81-566, 64 Stat. 246 (1950). The 1950 amendment was identical to amendments proposed in 1948 by Reps. Buck and Celler. *See* H.R. 6159 and H.R. 6160, Bills to Amend Section 3 of the Act of June 18, 1934, Relating to the Establishment of Foreign Trade Zones, 80th Cong., 2d Sess., 94 Cong. Rec. 4217 (1948). Consequently, the legislative history of these proposed amendments is quite relevant in interpreting the 1950 amendment that was passed.

22. 93 Cong. Rec. A3802 (1947) (remarks of Rep. Celler). Note the emphasis placed on the potential growth of exports through zone usage.

> In each of these zones, the importation of goods for the purpose of display, sampling, or manufacture for reexport should be permitted free of duty. This would avoid extra handling and freight charges, and would eliminate draw-backs on such goods.[23]

The Secretary of Commerce added that:

> [t]he existence of the present trade zones has done much to stimulate American commerce both import and export. The proposed permission of manufacturing in the zones is expected further to assist American business by enabling it to manufacture certain types of products for export under minimum cost conditions.[24]

Nevertheless, the Amendment's supporters undoubtedly anticipated that importation of zone-manufactured goods would occur. One congressional supporter made the following statement:

> The second major change in my bill is the permission to manufacture at a foreign-trade zone with certain limitations. . . . An analysis of the operation of foreign-trade zones or free ports in other countries, as well as experience with our own foreign-trade zones, indicates clearly that where a foreign-trade zone offers facilities completely to prepare commodities for the markets to which they are destined, such facilities are more desirable than those which allow partial activities only. This manufacture would permit not only the importation of foreign merchandise and work thereon by American labor, but would also provide opportunity for American raw materials and partly manufactured goods to be joined with foreign commodities in the production of final products ready and useful either for home consumption or for markets abroad.[25]

The possibility that zone-manufactured goods could be imported was considered to be a beneficial result of the Boggs Amendment. As one supporter predicted:

> Legalizing manufacturing and exhibition in foreign-trade zones will make zones more useful to more products and to more business-

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23. S. REP. No. 1107, 81st Cong., 2d Sess. (1949), *reprinted in* 1950 U.S. CODE CONG. & AD. NEWS at 2534.

24. The Secretary's statement was included in a letter dated March 18, 1949 addressed to the Chairman of the Committee on Ways and Means. 1950 U.S. CODE CONG. & AD. NEWS at 2534.

25. *Foreign Trade Zones: Hearing Before the House Comm. on Ways and Means on H.R. 6159 and 6160 to Amend the Foreign Trade Zones Act of 1934*, 80th Cong., 2d Sess. at 8 (1948) [hereinafter cited as 1948 *Hearing*] (supplemental statement of Rep. Buck, sponsor of the original amendment to permit zone manufacturing).

> men. It will result in an increase in American imports which, by providing more dollars to foreign nations, will increase American exports. . . . Enactment of either amendment into law should stimulate our imports and our exports which in turn should stimulate domestic business.[26]

Although the legislative history demonstrates that Congress foresaw zone manufacturing of merchandise for both import and export, it also shows that the legislators did not believe large-scale manufacturing would occur. Representative Jones, who advocated increased imports through the zone program, stated "that full-fledged manufacturing probably will not assume major proportions in zones in the United States."[27] The Commerce Department also concluded that the high cost of land would make large-scale manufacturing prohibitively expensive. A Commerce Department representative stated the following:

> I believe that the nature of a zone itself, in the facts of the case, would actually deter or discourage the establishment of a large manufacturing industry in the zone . . . . [T]he very fact they are in congested ports where land values are very, very high, makes it very unlikely that any manufacturing company would go into such an expensive locality, such a congested locality, because it would be for such a small percentage of their business.
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> To illustrate the point, I cannot conceive of Mr. Ford wanting to establish his automobile factory in such a location. . . . The advantage, therefore, would be for only the rather small industrial

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26. 94 CONG. REC. A2919, A2920-21 (1948) (remarks of Rep. Jones inserting the foregoing excerpt from a statement by the Foreign-Trade Zone Subcommittee of the World Trade Committee, Seattle Chamber of Commerce).

27. *Id.* at A2920; *see also* 1948 *Hearing*, *supra* note 25, at 19 (colloquy between Reps. Gearhart and Celler) ("there would be no large manufacturing establishments set up within the zone . . ."). Rep. Gearhart's conclusion appears to have been based upon the erroneous assumption that zone manufacturing would not affect the rate of duty assessed upon imported merchandise. He stated that "there would be no advantage in having [a manufacturing operation] within the zone, because when the goods came in to the American market the duty must be paid, and if they change the form of the imported article in the zone, when it goes into the American market they have to pay the same tariff that an importer would pay on the unchanged article . . . ." *Id.* The existence of "inverted tariffs," where the duty rate on a finished product is lower than the duty rates on its component parts, means that there may be duty savings achieved through zone manufacturing. *See infra* text accompanying notes 45-51. Rep. Gearhart's comments went unchallenged at the hearing.

enterprise.[28]

A development that occurred four years after this statement—the authorization of special purpose subzones[29]—rendered the Commerce Department representative's theory invalid.[30] Nevertheless, explicit statements had been made to Congress that foreign trade zones would not be conducive to large-scale manufacturing operations. It is thus highly questionable whether the original proponents of the manufacturing amendment and the Congress which passed that amendment ever contemplated that automobiles would be built in zones, or that other such large-scale manufacturing operations would receive zone benefits. Furthermore, zone manufacturing simply was not seen as a threat to domestic industry. "The entire economy should benefit [from the proposed amendment]. . . . It is believed that no disadvantages will accrue from passage of such legislation and that no interests will be injured."[31]

Perhaps unintentionally, Representative Celler forecast the present policy debate, which nominally focuses on whether the "public interest" is served by zone manufacturing.[32]

> 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. There are all sorts of general limitations in the original act which will have to be considered. When interpretations are made upon what is meant by the word "manufacturing," the weight of those limitations and restrictions will be on the word "manufacturing."[33]

This passage provides no guidance to the Board, or other interested groups, as to the meaning of public interest. The resulting lack of policy direction has forced the Board to confront new problems on a case-by-case basis, without a legislative structure for weighing "public interest" factors.

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28. 1948 *Hearing*, *supra* note 25, at 25.

29. *See infra* Section IV.

30. Ford Motor Company, and other domestic and foreign automobile manufacturers, are currently among the prime beneficiaries of zone operations. *See infra* text accompanying notes 49-51; *see also* GAO REPORT, *supra* note 4, at 15; USITC REPORT, *supra* note 3, at 38-39.

31. 94 CONG. REC. at A2921 (1948).

32. *See infra* text accompanying notes 93-100.

33. 1948 *Hearing*, *supra* note 25, at 18.

IV. 1952 Foreign Trade Zones Board Regulations: Authorization of Special-Purpose Subzones

The Foreign Trade Zone structure changed in 1952, when the Board amended its regulations to authorize "zones for specialized purposes" ("subzones") in addition to "general purpose zones" created by the original act.[34] In contrast to general purpose zones where a municipal corporation leases a portion of the zone area to firms that subsequently locate within that zone, subzones generally are used by only one firm. Subzones are especially attractive to domestic manufacturers that use component parts or raw materials of foreign origin in their operations because subzones can encompass an existing or planned production facility. A manufacturer can seek Board permission to designate its present facilities as a subzone, rather than relocate its facility in an existing general purpose zone. By 1982, sixty-one percent of all zone economic activity and more than ninety percent of all zone manufacturing[35] was conducted in subzones.[36] The rapid proliferation of subzone manufacturing operations has become the subject of considerable debate, and opponents of the zone program have focused their criticisms on subzones.[37]

V. Advantages to Manufacturers Using Zone Operations

Over the past twenty years, total imports from zones have undergone explosive growth. The number of zone sites grew from eight in 1970 to ninety-one general purpose zones and thirty subzones by November 1983.[38] Between 1970 and 1979 the value of import shipments escalated from $105 million to over $2 billion.[39] Similarly, the value of economic activity in Foreign Trade Zones

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34. Foreign Trade Zones Board Order No. 29, 17 Fed. Reg. 5316 (1952). The Board's regulations provide that "[t]he establishment of a zone, or a sub-zone in an area separate from an existing zone, for one or more of the 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." 15 C.F.R. § 400.304 (1985).

35. USITC Report, *supra* note 3, at ix.

36. In 1973, subzones only accounted for 29 percent of zone-produced merchandise. GAO Report, *supra* note 4, at 11.

37. USITC Report, *supra* note 3, at 53; GAO Report, *supra* note 4, at 20-21.

38. USITC Report, *supra* note 3, at ix.

39. *See* Da Ponte, *U.S. Foreign Trade Zones: A Look Back, A Glance Ahead*, Am. Import Export Bull. 12 (Mar. 1980).

increased from $743 million in 1978 to over $3.9 billion in 1982.[40]

A. Custom Duty Savings

The primary reason for the explosive growth in Foreign Trade Zones is the potential savings in customs duty that zones offer their users. Because an importer's duty depends upon the tariff classification of its product, a change in tariff classification due to further processing of an imported product can result in substantial duty reductions. An importer can choose to classify its merchandise for duty liability either when it enters the goods into the zone ("privileged" status)[41] or when it imports the goods from a zone into United States Customs territory ("non-privileged" status).[42] Thus, zone manufacturing for importation is highly attractive[43] because it gives importers considerable flexibility to achieve a lower duty rate.[44]

The benefits of nonprivileged treatment are maximized when imported merchandise is subject to "inverted tariffs." These inverted tariffs occur where the duty rates on a product's component parts are higher than the duty rate on the finished product. For example, the duty rate on passenger automobiles is 2.6 per-

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40. USITC REPORT, *supra* note 3, at ix.

41. 19 C.F.R. § 146.21 (1985). In order to obtain privileged status, the consignee of merchandise in a zone must file an application, accompanied by entry papers, with the district director of the Customs district within which the zone is located. 19 C.F.R. § 146.21(b),(c) (1985). Upon acceptance of the entry, the merchandise is appraised and classified in accordance with its condition and quantity on the date of filing, and duties are assessed. 19 C.F.R. § 146.21(c)(3) (1985).

42. 19 C.F.R. § 146.23 (1985).

43. Upon the District Director of Customs' approval, merchandise of United States origin or previously imported duty-paid or nondutiable merchandise may be designated as "privileged domestic" merchandise. 19 C.F.R. § 146.22 (1985). Privileged domestic merchandise that has not been mixed, combined or repacked in a zone with merchandise having another zone status may be returned to Customs territory without being subject to duties, taxes or quotas. 19 C.F.R. §§ 146.22(d), 146.44 (1985). Under proposed amendments to its regulations governing zone operations, the Customs Service would abolish privileged domestic status and would establish a simple domestic merchandise status. 49 Fed. Reg. 28855, 28869 (1984) (to be codified at 19 C.F.R. § 146.43).

44. Although privileged merchandise is classified and appraised prior to importation, duties are not actually collectible unless and until the merchandise enters United States Customs territory. *See* Customs Service Decision 79-464, 13 CUST. BULL. 1711 (1979).

cent *ad valorem*,[45] while the duty rate on many automotive parts is 4.0 percent *ad valorem*.[46] An automobile producer can bring foreign parts into a zone or subzone under nonprivileged status, use the parts to manufacture completed automobiles, and import the finished products into the United States. This way, the foreign automotive components have an effective duty of 2.6 percent, instead of the rate of duty that would have been assessed had the parts been imported directly into United States Customs territory.[47] Thus, an automobile manufacturer can reduce the effective duty rate on imported parts. Foreign and domestically based automobile companies that manufacture in the United States have adopted this duty-reduction technique.[48]

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45. Item 692.10, Tariff Schedules of the United States Annotated (TSUSA), 19 U.S.C. § 1202 (1982).

46. Item 692.32, TSUSA, 19 U.S.C. § 1202. Most automotive engines are dutiable between 4% and 5% *ad valorem*. Items 660.42 and 660.44, TSUSA, 19 U.S.C. § 1202.

47. Imported merchandise is classifiable in accordance with the condition in which it enters United States Customs territory. 19 C.F.R. § 146.48(e)(1) (1985).

48. For example, Volkswagen of America, Inc. operates special purpose subzone 33A in Westmorland County, Pennsylvania. American Motors Corporation operates special purpose subzone 41A in Kenosha, Wisconsin. Ford Motor Company operates special purpose subzones 70C in Wayne, Michigan, 70D in Wixom, Michigan, and 70E in Dearborn, Michigan. Chrysler Corporation operates special purpose subzone 70B in Jefferson, Michigan. Each of these subzones is involved in the manufacture of automobiles using imported components. In addition, Ford Motor Company operates a tractor assembly plant at special purpose subzone 70A in Romeo, Michigan. Additional operations have been recently approved. Subzone status for automobile manufacturing facilities was recently granted for the Chrysler Corporation plant in Sterling Heights, Michigan, 50 Fed. Reg. 15768 (1985), and the General Motors plants in Kansas City, Missouri and North Tarrytown, New York, 50 Fed. Reg. 15769 (1985), and Lordstown, Ohio, 50 Fed. Reg. 15770 (1985).

Despite arguments to the contrary by some domestic industry groups, strong evidence supports the conclusion that Congress was apprised of potential tariff reductions through use of zone manufacturing operations.

> It is often possible to process goods into a class subject to a lower rate of duty. For example, certain fruit juices may be combined with domestic flavoring while in the zone, and then brought into the country at a lower duty than if imported in the original form.

94 CONG. REC. A747 (1948) (remarks of Rep. Celler inserting the quoted excerpt from an article appearing in the December 30, 1947 issue of the bulletin of the Research Institute of America); *see, e.g.*, GAO REPORT, *supra* note 4, at 21; USITC REPORT, *supra* note 3, at 52; *see also* Armco Steel Corporation v. Stans, 431 F.2d 779, 782, 784-85 (2nd Cir. 1970); Comments of Wald Manufacturing Company, Inc. concerning proposed amendments to Foreign Trade Zones Board

The Customs Service has enhanced considerably the attractiveness of zone manufacturing in inverted tariff situations by not including the manufacturing costs attributable to zone operations in its determination of the dutiable value of an imported product.[49] For example, the costs of completing a zone-manufactured automobile that contains foreign parts are not dutiable upon the automobile's subsequent importation.[50] Thus, the manufacturer may reduce both the applicable rate of duty and the dutiable value for foreign merchandise merely by performing manufacturing operations in a zone, rather than abroad, prior to importation.[51]

B. Duty Avoidance

Duty avoidance is another benefit of zones. Because the Customs Service collects duties only on goods that enter United States Customs territory, foreign merchandise may be consumed in a zone without duty liability.[52] When an importer enters items

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regulations, at 3-4 (April 19, 1983) (on file at Commerce Department Reading Room, Washington, D.C.) [hereinafter cited as Comments of Wald Manufacturing]; S. REP. No. 1107, *supra* note 23, *reprinted in* 1950 U.S. CODE CONG. & AD. NEWS at 2535, 2536; 1948 *Hearing*, *supra* note 25, at 14 (remarks of Rep. Celler).

49. 19 C.F.R. § 146.48(e)(2) (1985).

50. *Id.*

51. Of course, an importer does not pay duty on the value of domestic components used in the manufacturing process. *Id.* Also, in the situation where the duty rate on components is lower than the rate on finished products, an importer can seek privileged status for his imported merchandise. As a result, the tariff classification and dutiable value of merchandise is fixed as of the date of its entry into the zone rather than the date of its importation into United States Customs territory. *See supra* note 27.

52. *See Hawaiian Independent Refinery*, 460 F. Supp. at 1249. There, plaintiff operated an oil refinery located in a zone. Foreign crude oil was entered into the zone, where it was processed into fuel oil and used to power refinery operations, but never entered into United States Customs territory. The Customs Service sought to collect duties on the fuel oil expended in such operations. The plaintiff's claim that the fuel oil was nondutiable, because it never entered United States Customs territory, was upheld by the Customs Court [now Court of International Trade], which stated:

> [E]xemption for merchandise in a zone from the customs laws is the rule; dutiability for such merchandise under the customs laws is an exception which must be specifically provided in some provision of the Act. Unless specifically expressed by the Act to the contrary, the transferral of such merchandise to the customs territory is the occurrence which makes such merchandise dutiable under the customs laws . . . ." (citation omitted).

on which the Customs Service determines duty by weight or volume, the importer can avoid an assessment of tariffs on merchandise that has leaked or evaporated by shipping goods into a zone for the purpose of conducting an inventory. Similarly, importers may avoid duty liability by disposing of any damaged or destroyed merchandise in a zone. Manufacturers also can perform processes that create large quantities of waste products in zones, thereby exempting the waste products from duty upon the subsequent importation of merchandise into United States Customs territory.[53]

C. Exemption from Taxation

Although the Foreign Trade Zones Act appears to exempt merchandise in zones only from United States Customs laws, manufacturers also can use zones to avoid United States excise taxes. Merchandise brought into or manufactured within a zone is not subject to tax unless it is imported into United States Customs territory.[54] Moreover, merchandise "destined for exportation" is not subject to tax.[55] Additionally, many states have explicitly or implicitly exempted goods located in zones from any state taxation.[56] The relative attraction of such state tax exemption is minimized by the Trade and Tariff Act of 1984,[57] which exempts from state and local *ad valorem* taxation all foreign and domestically

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Id. at 1254.

When fuel oil is entered into a zone to generate electricity, and excess electricity from the operation is sold to a local electric utility company, no duty is assessable on the value of the oil used in producing the excess electricity transmitted into Customs territory. Customs Service Decision 83-49, 16 CUST. BULL. 880 (1979).

The Customs Service has provided notice that it will limit its interpretation of the holding in *Hawaiian Independent Refinery* to the particular facts of that case. Thus, Customs will assess duty on production equipment that is brought into a zone and used in the manufacture of merchandise. Customs Service Decision 79-418, 13 CUST. BULL. 1627, 1630 (1979). *See also* Customs Service Decision 82-103, 16 CUST. BULL. 869 (1982).

53. *See Hawaiian Independent Refinery*, 460 F. Supp. at 1249.

54. 26 U.S.C. §§ 4061-4223 (1982).

55. *See generally* Atkins, Doyle and Schwidetzky, *Foreign Trade Zones: Sub-zones, State Taxation and State Legislation*, 8 DEN. J. INT'L L. & POL'Y 445, 447-56 (1979).

56. Some states have exempted zone merchandise from *ad valorem* taxation in order to attract importers and exporters. *See id.* at 460.

57. Pub. L. No. 98-573, 98 Stat. 2948 (1984).

produced merchandise that enters a zone and is destined for exportation.[58]

D. Miscellaneous Advantages

Numerous other benefits are available through the use of zones.[59] First, an importer may keep foreign merchandise in a zone until it receives a purchase order, thereby deferring duty liability and improving cash flow. Second, an importer may exhibit merchandise in a zone without duty liability unless and until importation occurs. Third, an importer may hold its merchandise in zones until a quota opens because goods that are kept in a zone generally are not subject to quotas or other quantitative import restrictions.[60] Fourth, the additional security arrangements required in a zone[61] may reduce thefts of merchandise.[62] Fifth, manufacturers may export merchandise held in a zone without paying customs duties or posting an importer's bond. Sixth, merchandise that is the product of a country which has not been granted "Most Favored Nation" status and that is dutiable at the higher "Column 2" tariff rate may have its duty rate reduced through zone processing. The merchandise may be placed in a zone under foreign non-privileged status. If the foreign merchandise is manufactured into a new and different product having a different name, character and use, it is considered to be a product

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58. Section 231(e) of the Trade and Tariff Act of 1984 provides:

(1) Tangible personal property imported from outside the United States and held in a zone for the purpose of storage, sale, exhibition, repackaging, assembly, distribution, sorting, grading, cleaning, mixing, display, manufacturing, or processing, and tangible personal property produced in the United States and held in a zone for exportation, either in its original form or as altered by any of the above processes, shall be exempt from State and local *ad valorem* taxation.

(2) The amendment made by paragraph (1) shall take effect on January 1, 1983.

Trade and Tariff Act of 1984, Pub. L. No. 98-573, 98 Stat. 2948, 2991.

59. *See, e.g.*, 1948 *Hearing*, *supra* note 25, at 13-14 (remarks of Rep. Celler).

60. Customs Service Decision 79-471, *Foreign Trade Zones: Admission of Quota-Class Merchandise*, 13 CUST. BULL. 1730 (1979).

61. 15 C.F.R. §§ 400.402(a)(12), 400.403 (1985).

62. It has been alleged, however, that lax supervision of zones results in fraudulent evasion of the Customs laws. *See* SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS OF THE HOUSE COMMITTEE ON ENERGY AND COMMERCE, 99TH CONG., 1ST SESS., UNFAIR FOREIGN TRADE PRACTICES at 43-49 (Comm. Print) (1985).

of the zone and thus is dutiable at the "Most Favored Nation" tariff rate.[63] Seventh, foreign merchandise entered into a zone is not subject to United States country of origin marking requirements,[64] unless and until imported into United States Customs Territory.[65]

Zones provide decided advantages over bonded warehouses and drawback operations.[66] Drawback is available only upon exportation of merchandise,[67] while manufacturers must export any products manufactured in a bonded warehouse.[68] Zones are comparatively advantageous even where foreign merchandise is destined for subsequent exportation. Drawback importations require an "up front" payment of full customs duties, whereas entries into zones require no duty payment. Finally, the detailed records that manufacturers must keep to validate drawback claims[69] are not required for zone operations resulting in exportations. Bonded warehouse entries do not require payment of duties. An importer, however, must post a bond upon filing the documentation neces-

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63. 19 U.S.C. § 2136 (1982). *See* Customs Service Decision 79-41, *Foreign Trade Zones: Dutiability of Chemicals Manufactured From Components Imported From Communist Country*, 13 CUST. BULL. 1056 (1978) (intermediate chemicals from the Peoples' Republic of China processed into final chemical products in a zone and subsequently imported were subject to "Column 1" (Most Favored Nation) duty rate).

64. 19 U.S.C. § 1304 (1982); 19 C.F.R. § 134.0 (1985).

65. *See* Customs Service Decision 83-48, 16 CUST. BULL. 819 (1983). Presumably, foreign-origin merchandise that is "substantially transformed" in a zone into a product of the United States would be exempt from the country-of-origin marking requirements. *See* 19 C.F.R. § 134.13 (b(3)) (1985).

66. *See supra* note 14.

67. 19 U.S.C. § 1313(a) (1982); 19 C.F.R. §§ 191.4, 191.51-.57 (1985).

68. 19 U.S.C. § 1562 (1982); 19 C.F.R. § 19.1(a)(8) (1985). A major difficulty in warehouse operations producing merchandise for importation is distinguishing between permissible "manipulation" and impermissible "manufacture." The rules for determining whether an operation involves a manipulation are abstruse, causing a large degree of uncertainty for potential users of warehouses. 19 C.F.R. § 19.11 (1985). (For an example of the scholastic ingenuity involved in distinguishing between manipulation and manufacture, see Customs Service Division 82-24, *Manipulation in Warehouse: The Conversion of Concentrated Orange Juice Into Orange Juice not Concentrated in a Class 8 Customs Bonded Warehouse*, 16 CUST. BULL. 713 (1982)). This very difficulty was an important reason for passage of the Boggs Amendment in 1950. Prior to this, manipulation but not manufacture was permitted in zones. 1948 *Hearing*, *supra* note 25, at 14-15, 17.

69. *See, e.g.*, 19 C.F.R. §§ 191.22, 191.32 (1985).

sary for a warehouse entry,[70] an expense that is unnecessary for a zone entry.

VI. Administrative Process

An appreciation of the administrative context under which zone and subzone use has burgeoned is critical to an understanding of the current political debate over the future of Foreign Trade Zones. The administrative process itself is the target of many "reformers" seeking to exclude more traditional manufacturing operations from zones and subzones. The Foreign Trade Zones Board has proposed revised regulations[71] that attempt to address many of the past criticisms and clarify the administrative authorization process. The comments submitted in response to the Notice of Proposed Rulemaking,[72] however, suggest that the Board's proposals will not resolve satisfactorily the tension between parties seeking to expand zone manufacturing operations and those seeking to limit them.[73] A review of the rules and proposed rules governing the creation and operation of zone activity, and their background, is essential to an analysis of the current political debate.

To create a zone, an applicant must file with the Foreign Trade Zones Board.[74] The applicant must be a public or private corporation established for the specific purpose of operating a zone.[75] The Board preferences the applications of public corporations[76] and generally authorizes the establishment of a proposed zone, as long as the corporation meets regulatory "economic, financial, and physical" requirements.[77]

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70. 19 C.F.R. § 144.13 (1985).

71. 48 Fed. Reg. 7188 (1983). There has been no final action taken on these proposed rules. The Board had advised the authors, by telephone conversation on December 12, 1985, that it plans to publish another Notice of Proposed Rulemaking, reflecting public comments on the original Notice, in early 1986.

72. The comments are available for public inspection in the Commerce Department Reading Room (Room B-099), Washington, D.C.

73. See *infra* text accompanying notes 132-35 for a discussion of the public comments concerning the proposed regulations.

74. 19 U.S.C. § 81b(a) (1982); *see also* 15 C.F.R. §§ 400.600-.609 (1985).

75. 19 U.S.C. §§ 81a(e), (f), 81b(a) (1982); 15 C.F.R. § 400.500 (1985).

76. 19 U.S.C. § 81b(c) (1982); 15 C.F.R. § 400.503 (1985).

77. 15 C.F.R. § 400.400-.604 (1985). The exhibits must describe the proposed zone location, show how the proposed zone will be segregated from Customs territory, and describe the fitness of the area for the zone. The applicant must provide full details concerning its plans and ability to acquire title to (or otherwise use) property, other than that owned by the applicant or the United States,

Each Customs port of entry[78] is entitled to one zone.[79] The Board will not authorize additional zones in a port unless the original zone "will not adequately serve the convenience of commerce."[80] The structure that gives preference to municipal and state corporations seeking certification of zones in their jurisdictions has caused intense inter-city competition, not only to acquire the zone, but also to attract economic activity from other ports.[81]

Local port authorities often believe that international commerce will overlook them for ports with zones or subzones if they do not offer the facilities of a Foreign Trade Zone as an adjunct to their regular activities. Many port authorities that already have zones and subzones seek to attract more commerce by offering new, improved, bigger and better options.[82] The result is greater growth of zone operations and imports.[83]

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that is necessary to create the zone. The applicant must also present a detailed description of the proposed method of financing the zone and proof of its ability to obtain such financing. In addition, an economic survey concerning the zone's costs and benefits must be provided. The applicant must present a complete description of the available and proposed zone facilities, detailed cost information, the proposed schedule for completing construction and commencing operations, a detailed blueprint map showing the proposed zone layout, sufficient evidence of construction permits, and detailed evidence of corporate authorization. *Id.*

78. *See* 19 C.F.R. § 101.3 (1985).

79. 19 U.S.C. § 81b(b) (1982); 15 C.F.R. § 400.300 (1985).

80. 19 U.S.C. § 81b(b) (1982); 15 C.F.R. § 400.303 (1985).

81. This competition even extends to an attempt by one municipality to keep another municipality from obtaining a zone. On March 27, 1985, the city of Santa Ana, California filed a request for authority to establish a general purpose zone adjacent to the Los Angeles-Long Beach Customs port of entry. 50 Fed. Reg. 14000 (1985). This request is opposed by the Port of Long Beach, the grantee of Zone 50 which is approximately 30 miles from the proposed Santa Ana site. Long Beach officials fear that a second zone in one port of entry will detract from the success of their zone, and suggest that Santa Ana establish a subzone of Zone 50. Santa Ana officials believe that a zone of their own will encourage further high-tech development in their area. The Board must decide between these competing positions. *See* Mongelluzzo, *Santa Ana FTZ Bid Encounters Opposition*, J. COMM. at B1, May 10, 1985.

82. For example, the Port Authority of New York and New Jersey is aggressively marketing facilities in the Port Newark/Elizabeth zone for concentrated orange juice and automobile importations. Banham, *Newark Targets Auto Imports Arena as Opportunity for 1986*, J. COMM. at 5C, Oct. 30, 1985.

83. *See, e.g.*, Dunlap, *Revived Foreign Trade Zone Fever Hits Three More Florida Ports*, J. COMM. at 2C, May 22, 1985.

Although the current regulations do not specifically distinguish between zone and subzone operations,[84] the right of each Customs port of entry to at least one zone[85] can conflict with the Board's rule of granting subzone applications only where "existing or authorized zones will not serve adequately the convenience of commerce with respect to the proposed purposes."[86] As the Executive Secretary of the Board has noted, "[t]hese 'private' zones . . . can be approved only when a public benefit can be clearly demonstrated."[87] Thus, the applicant has the burden of showing that the public will benefit from a proposed subzone.

The Board's proposed regulations would establish clearer standards for the creation of both zones and subzones.[88] Applicants

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84. *See supra* text accompanying notes 74-80.

85. 19 U.S.C. § 81b(b) (1982); 15 C.F.R. § 400.300 (1985).

86. 15 C.F.R. § 400.304 (1985).

87. Da Ponte, *United States Foreign-Trade Zones: Adapting to Time and Space*, 5 MAR. LAW. 197, 211 (1980).

88.

General Criteria: Zones and Subzones.

(a) An applicant for a zone (§ 400.600) must demonstrate to the satisfaction of the Board that its establishment will expedite and encourage commerce in a manner that is consistent with the public interest (§ 400.807). In evaluating the proposed zone, general factors considered by the Board will include:

(1) The need for zone services in the port of entry in question, taking into account existing as well as projected international trade related activities and anticipated employment to be generated or sustained.

(2) Whether an adequate operation plan exists, including a suitable site and facilities, and proof of ability to finance the project.

(3) Local community and State government support, including (i) evidence that the zone project is compatible with the community's master plan or stated goals for economic development, (ii) the views of State and local public officials involved in related economic development programs, and (iii) the views of persons and firms likely to be affected by proposed zone activity.

(b) The establishment of a zone shall normally be considered under the criteria of § 400.400. Proposals for manufacturing in zones or subzones that involve "public interest" questions, shall be reviewed under the criteria enumerated in § 400.807.

(c) In reviewing proposals for subzones (§ 400.101(b)) the Board will, in addition to the economic factors for public zones, consider:

(1) Whether the operation can be accommodated in the public zone serving the area.

(2) Whether efforts have been made to accommodate the operation, such as enlarging the public zone area, the cost of locating in

would be required to provide "convincing evidence" that a proposed subzone would produce a public benefit, measured primarily in terms of new or sustained employment. The proposed regulations, however, do not include any criteria for judging public benefit in terms of lower prices to consumers or increased competitiveness of United States manufacturers.

Domestic industry and labor groups generally oppose individual proposed zone operations, rather than the establishment of the zone itself.[89] The Board asserts that it has been granted the authority to act on such domestic complaints. If it considers the operation to be contrary to the "public interest, health or safety" the Board may prohibit its establishment within the zone,[90] even if the operation would meet the regulations' financial and physical requirements. The 1934 Act and its legislative history provide no guidance for defining the term public interest or the scope of the Board's powers in this area. Despite the vagueness of the current regulation concerning the public interest exclusion,[91] the

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the public zone not being a determining factor.

(3) The specific zone benefits sought, and whether alternative means or remedies are available.

(4) Whether convincing evidence has been presented as to a resulting significant public benefit, including export development and displacement or substitution of imports, usually measured in terms of new or sustained employment.

(d) When appropriate, the Board may approve zones, subzones or zone activity with restrictions, such as types of activity, procedures, and time.

(e) Proposals for new zones, zone expansions, subzones, or manufacturing, which involve operations exclusively for export shall be expedited, and there shall be presumption that such proposals are in the public interest.

(f) Proposals requiring expeditious or special treatment under federal law will be reviewed with special consideration given to the objectives of the programs involved.

48 Fed. Reg. 7192-93 (1983) (to be codified at 15 C.F.R. § 400.400) (proposed Feb. 18, 1983).

89. Of course, to the extent that a proposed subzone would encompass just one controversial operation, the establishment of that subzone will be subject to opposition.

90. "The Board may at any time order the exclusion from the zone of any goods or process of treatment that in its judgment is detrimental to the public interest, health, or safety." 19 U.S.C. § 81o(c) (1982); 15 C.F.R. § 400.807 (1985). By its terms, this provision allows the exclusion of an ongoing zone operation. The Board interprets this section to grant it authority to prevent a zone operation from commencing. Thus, this discussion is equally applicable to proposed and existing operations.

91. The regulation concerning exclusion from a zone of goods or process of

Board has given itself wide discretion to prevent the establishment of zone operations that may cause injury to a domestic industry.[92]

The Board has attempted to provide more practical guidelines for potential zone and subzone users by proposing extensive regulations concerning public interest considerations.[93] The proposed regulations incorporate criteria developed over the past decade and give the Board great latitude in granting or denying requests to either establish or continue zone operations. Although the regulations apply to any zone activity, the Board will use them primarily in evaluating possible zone manufacturing operations. The Board would weigh the likely benefits and potential drawbacks of the operation, based upon the following factors:

> (1) Whether the adverse effect is significant in relation to actual and potential public benefits.
>
> (2) Whether additional exports from the U.S. will be created.
>
> (3) Whether zone procedures will encourage activity related to import displacement or substitution.
>
> (4) Whether employment and investment will be generated or sustained in the U.S.
>
> (5) Whether zone activity will undermine a remedial action or program in effect because of an unfair trade practice, or materially or substantially harm an existing domestic industry.[94]

One of the most fundamental policy considerations facing the Foreign Trade Zones Board with regard to the "public interest" is the threat that manufacturing operations in zones has to United States jobs and industrial output. United States corporations and

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treatment states:

> When it shall be reported to the Board that any goods or process of treatment is detrimental to the public interest, health, or safety, the Board shall cause such investigation to be as it may deem is necessary. The Board may order the exclusion from the zone of any goods or process of treatment that in its judgment is detrimental to the public interest, health or safety.

15 C.F.R. § 400.807 (1985).

92. *See* Da Ponte, *Adapting to Time and Space*, *supra* note 87, at 213.

93. 48 Fed. Reg. 7188-7200 (1983) (Foreign Trade Zones Board Notice of Proposed Rulemaking).

94. 48 Fed. Reg. 7196 (1983) (to be codified at 15 C.F.R. § 400.807(b)) (proposed Feb. 18, 1983).

labor unions often regard zones as a surrogate for foreign production facilities. Indeed, the thousands of United States jobs that were "exported" between 1980-84 are evidenced by a trade deficit expected to approach $140 billion in 1985.[95] Entire industries, ranging from "high tech" to "smokestack," have been hurt by foreign competition. Foreign Trade Zones operators, however, argue that manufacturing in subzones actually is the "first line of defense" to the exportation of United States manufacturing capability and employment.[96] They claim that subzones prevent marginally competitive United States industries such as bicycle manufacturing,[97] steel fabrication,[98] automobile manufacturing,[99] and electronic components production[100] from being lost entirely to foreign competition. United States manufacturers often look to Foreign Trade Zones as a "halfway house" alternative to becoming importers themselves, establishing offshore operations, or going out of business entirely.

Those who favor manufacturing in zones and subzones argue that zone operations are preferable to "border industry" plants.[101]

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95. Wash. Post, June 1, 1985 at C1.

96. USITC REPORT, *supra* note 3, at 44, 55-57, 106-07.

97. *See* 47 Fed. Reg. 35543 (1982) (Application of the Greater Cincinnati Foreign Trade Zone, Inc., For a Special Purpose Subzone at the Huffy Corporation Bicycle Manufacturing Facility).

98. *See infra* note 113.

99. *See infra* note 110.

100. *See infra* note 112.

101. These plants are organized to take advantage of TSUSA items 806.30 and 807.00, 19 U.S.C. § 1202 (1982). Both of these provisions allow duty-free entry of articles of United States origin that are exported for further fabrication and subsequently imported into United States Customs territory.

Item 806.30 covers:

> Articles returned to the United States after having been exported to be advanced in value or improved in condition by any process of manufacture or other means:
>
> Any article of metal (except precious metal) manufactured in the United States or subjected to a process of manufacture in the United States, if exported for further processing, and if the exported article as processed outside the United States, or the article which results from the processing outside the United States, is returned to the United States for further processing.

19 U.S.C. § 1202 (1982). Under Item 806.30, upon importation the returned merchandise is subject to "[a] duty upon the value of such processing outside the United States." *Id.*

Item 807.00 applies to:

Use of "border industry" facilities provides duty reduction benefits, yet generally requires the employment of foreign as opposed to United States workers. Some proponents of Foreign Trade Zones therefore argue that Congress must clarify United States law to enable zones to compete not only with "natural" foreign manufacturing but also with "artificially induced" production.

Contested zone operations usually have fallen into one of three categories. First, the operation may be an attempt to circumvent an existing antidumping or countervailing duty order. A prerequisite for all antidumping and most countervailing duty orders is a finding by the International Trade Commission that unfairly traded imports are causing or threatening to cause material injury to a United States industry.[102] In such circumstances, the imposition of additional duties offsets the harmful effects of foreign unfair trade practices. The typical attempt to evade an antidumping or countervailing duty order involves entry of component parts under nonprivileged status. Manufacturers utilize the parts to manufacture a finished product and subsequently import the finished product into the United States without paying additional remedial duties on the component parts. In these situations, the Board typically prevents circumvention of the antidumping and countervailing duty law's effects by imposing restrictions that require components subject to an antidumping or countervailing duty order to be granted privileged status[103] at the time of entry into the zone. The Board also can require manufactured products incorporating unfairly-traded components to be exported. Finally, the Board may prohibit the entire operation[104] on the ground that

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> Articles assembled abroad in whole or in part of fabricated components, the product of the United States, which (a) were exported in condition ready for assembly without further fabrication, (b) have not lost their physical identity in such articles by change in form, shape, or otherwise, and (c) have not been advanced in value or improved in condition abroad except by being assembled and except by operations incidental to the assembly process such as cleaning, lubricating, and painting.

19 U.S.C. § 1202 (1982). Item 807.00 provides for "[a] duty upon the full value of the imported article, less the cost or value of such products of the United States." *Id.*

Both Items 806.30 and 807.00 encourage the exportation of United States origin components for further processing and subsequent importation.

102. 19 U.S.C. § 1671d(b)(1)(A) (1982); *see also* 19 U.S.C. § 1303(a)(1) (1982).

103. *See supra* text accompanying note 41.

104. "Zone procedures may not be used to circumvent the requirement of

subversion of remedial measures protecting against unfair imports is contrary to the public interest.

The second type of operation that meets with domestic opposition occurs where an importer uses an inverted tariff structure[105] to reduce its regular Customs duty. Domestic industries often contact the Board when a competing importer takes advantage of the inverted tariff structure. The Board must identify the probable injurious effects of the proposed operation on the domestic industry, and balance these effects against the operation's likely benefits. The Board nearly always has acceded to domestic industry and labor objections, and prevented the importer from fully taking advantage of inverted tariffs in manufacturing operations. The Board again has the option to require that (1) component merchandise be accorded privileged status upon entry into the zone; (2) finished products containing imported components be exported; or (3) the total operation be prohibited.

The third situation arises where a proposed zone operation allows circumvention of an import quota. Assume, for example, that the United States places a quota on a raw material, but not on a product manufactured from that raw material. By transforming the raw material into the nonquota product in a zone, and importing that product, an importer can avoid the quota. The Board typically counters this type of activity by prohibiting the proposed operation or requiring exportation of all the nonquota product.

The Board has been increasingly receptive to arguments that operations involving inverted tariff duty reductions and other duty-saving aspects of zones are contrary to the public interest. In view of the growing protectionist sentiment in Congress, such an approach seems best suited to avoiding legislative restrictions on the zone program. A judicial challenge to a Board decision denying permission to commence an operation in a zone or subzone seems unlikely because courts have granted the Board "broad discretionary authority" to approve or deny subzone applications.[106]

U.S. antidumping and countervailing duty laws and regulations. Upon order of the Secretary of Commerce, or his designee, the Commissioner of Customs, or his designee, shall direct that an importer place goods in a specific status for this purpose, subject to appeal to the Board." 48 Fed. Reg. 7195 (1983) (to be codified at 15 C.F.R. § 400.801(c)) (proposed Feb. 18, 1983).

105. *See supra* text accompanying notes 45-48.

106. *See, e.g.*, Da Ponte, *Adapting to Time and Space*, *supra* note 87, at 213.

One court decision states the following:

> The [Foreign Trade Zones] Act gives the Trade Zones 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, both export and import.
>
> Congress has delegated a wide latitude of judgment to the Foreign Trade Zones Board to respond to and resolve the changing needs of domestic and foreign commerce through the trade zones concept. Because of the complexity and vagaries of our highly developed systems of trade, and the pressing needs for varying solutions to the problems that inevitably arise, it is imperative that the Board be permitted to experiment at the fringes of the tariff laws. As long as the Zones Board remains within the fringes and does not stray to areas clearly outside its delegated authority, a court should not interfere except for compelling reasons . . . .[107]

The Board has exercised its judicially sanctioned discretion by becoming far more protectionist since 1980, when its Executive Secretary wrote:

> Because manufacturing and processing operations offer the greatest potential for achieving the objectives of the Act, the Board can be expected to continue carefully evaluating and weighing both sides of public interest cases. There is no basis for concern that industry complaints automatically result in denials or curtailments. The fact that zone plants compete mainly with offshore facilities must always be considered. If the same Customs results can be achieved by placing an operation abroad, why not allow it in the Zone? Actions of the Board would suggest that this question is implicit in its review of public interest cases.
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> The Board has not dismantled the tariff wall between zones and customs territory and has avoided restricting operations unless an independent, significant government policy action has acknowledged an affected industry as "import sensitive."[108]

Now, however, domestic opposition is usually sufficient to in-

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107. *Armco Steel Corp.*, 431 F.2d at 785, 788. Although this case did not specifically consider the scope of the Board's public interest authority under 19 U.S.C. § 81o(c), it grants a great degree of judicial deference to the Board in determinations concerning the desirability or undesirability of a specific operation. *Accord, Hawaiian Independent Refinery*, 460 F. Supp. at 1256-57 (dicta).

108. Da Ponte, *Adapting to Time and Space*, *supra* note 87, at 216-17.

sure a curtailment of zone benefits. According to the ITC, the Board imposes restrictions on most proposed operations that are opposed by domestic interests.[109] Between 1981 and 1983 the Board approved seven controversial zone or subzone projects. Only one of the seven, which involved automobile manufacturing, was unconditionally granted.[110] Another, involving pick-up truck manufacturing, was given a five-year conditional approval with a review of operations after four years.[111] Of the remaining five applications, the Board approved two on the condition that the manufacturer would agree to forego any benefits under inverted tariff structures,[112] and three on the condition that the manufacturer would agree to produce its merchandise solely for export.[113]

Numerous other controversial applications remain pending.[114] These applications probably will receive conditional Board approval that eliminates the most attractive features of zone manufacturing operations.[115] The Board has shown a clear willingness to accommodate domestic concerns at the expense of manufacturers seeking to take full advantage of zone benefits.

The Board's role as chief promoter of zone usage appears to

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109. USITC REPORT, *supra* note 3, at 95-99.

110. Application of Chrysler Corporation to assemble automobiles at Zone 70, Detroit, Michigan.

111. Application of Toyota Motor Manufacturing U.S.A., Inc. to assemble pick-up truck bodies at Zone 50, Long Beach, California.

112. Applications of: Sanyo Manufacturing Corporation to manufacture color televisions at Subzone 14A, Forrest City, Arkansas, and Toshiba America, Inc. to manufacture color televisions at Subzone 78A, Lebanon, Tennessee. In both cases, the applications would have incorporated foreign-origin tubes, which have a high rate of duty, into color televisions, which have a lower rate of duty, and imported the televisions into the United States. Domestic corporations and labor unions objected to this use of inverted tariffs to achieve duty savings, claiming that the domestic television manufacturing industry was "import sensitive" because an antidumping order had been imposed upon televisions from Japan. The Board approved the operation only on condition that tubes be given zone-privileged status, thus insuring that full duties were assessed on the tubes.

113. Applications of: UNR-Leavitt Division of UNR Industries, Inc. to manufacture foreign-origin steel into steel tubing at Subzone 22A, Chicago, Illinois; Pedigree USA, Inc. to manufacture skiwear at Subzone 55A, St. Albans, Vermont; and Port of Houston Authority to conduct steel-related manufacturing operations at Zone 84, Harris County, Texas.

114. USITC REPORT, *supra* note 3, at 99-101.

115. *See, e.g.*, Da Ponte, *A Look Back, A Glance Ahead*, *supra* note 39, at 12.

conflict with its role as regulator of the zone program.[116] This latter role requires the Board to balance local benefits of a particular proposed operation against the political resistance of industry and labor groups to any diminution of their tariff protection. This task is complicated in cases such as auto manufacturing, which pit different "domestic" interests against each other. In these situations the Board tends to make those decisions that minimize adverse political consequences. Although this approach has not silenced domestic industry and labor critics, it seems to have temporarily averted Congress from attempting to curtail the zone program.

The following case study illustrates the political dangers which the Board must face in approving or disapproving a proposed operation. In July of 1982 Huffy Corporation ("Huffy") applied to the Board for authorization to create a subzone at its bicycle manufacturing plant in Celina, Ohio.[117] The operation would have been benefitted by the use of an inverted tariff structure to manufacture low-cost foreign-origin parts into finished bicycles.[118] Huffy claimed that the duty savings from the inverted tariff arrangement would make its products more competitive with foreign bicycles in both the United States and export markets. The proposal greatly alarmed domestic bicycle parts producers as well as Huffy's domestic competition. The parts producers feared that they would lose Huffy as a purchaser, while domestic bicycle producers feared that Huffy's probable price advantage would cause them to lose a portion of their United States market share.

Imported bicycles are subject to duties ranging from 5.5 percent to 15.0 percent *ad valorem*.[119] Bicycle parts are subject to

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116. As one comment on the Board's proposed regulatory revisions stated: "The performance of the Foreign-Trade Zones Board should not be measured purely in terms of the number of zones and subzones that it has granted. Indeed, the rapid growth of the number of zones and subzones, coupled with the inability of U.S. Customs to keep up with this growth, is suggestive that they are being granted indiscriminately." Comments submitted by Robert Auerbach, Esq., General Counsel, Cycle Parts and Accessories Association, Inc., at 23. These comments are available for public inspection in Room B-009 of the Commerce Department headquarters, Washington, D.C.

117. Application of the Greater Cincinnati Foreign Trade Zone, Inc. for a Special Purpose Subzone at the Huffy Corporation Bicycle Manufacturing Facility in Celina, Ohio. 47 Fed. Reg. 35543 (1982) (Foreign Trade Zones Board Docket No. 17-82).

118. *Id.*

119. Items 732.02-732.26, TSUSA, 19 U.S.C. § 1202 (1982).

widely varying duty rates. Certain parts, because they are not manufactured domestically, are granted duty-free status.[120] Other parts are subject to duties between 7.5 percent and 15.0 percent *ad valorem*.[121] Thus, bicycle and bicycle parts imports do not typify the classic inverted tariff situation, where the rate on parts is higher than the rate on finished products. Nevertheless, careful use of privileged status for nondutiable and lower duty rate parts and nonprivileged status for higher duty rate parts would permit a zone bicycle manufacturer to achieve substantial duty savings.

A Commerce Department study supported Huffy's contention that its reduced duty liability would lead to greater competitiveness against Taiwanese and Korean bicycle imports.[122] Subzone manufacturing could lead to greater domestic production of lightweight bicycles with high specification components. This type of bicycle, according to the Commerce Department study, could be more competitive with imports and lead to greater exports of domestic bicycles.[123] The Commerce Department also concluded that granting a subzone to Huffy Corporation would increase the net employment in the domestic bicycle industry and benefit consumers through lower costs.[124]

The Board suggested conditions for Huffy's proposed operation in the hope of defusing the opposition. The chief condition was a percentage limitation upon the amount of imported parts that Huffy could import into the subzone. The Board would allow Huffy to purchase imported parts for the subzone operation "based on its average use of imported parts over a five year period."[125] The Commerce Department believed that this condition, along with the absence of domestic production capacity for high-quality parts, would protect adequately the domestic parts industry.[126] The Board also removed Huffy's advantage over other domestic bicycle manufacturers by giving the latter the option of establishing their own subzones.

The proposed conditions and projected benefits of Huffy's op-

120. Item 912.10, TSUSA, 19 U.S.C. § 1202 (1982).

121. Items 732.30 - 732.37, TSUSA, 19 U.S.C. § 1202 (1982).

122. Potential Effects of Foreign Trade Subzones on the Bicycle Industry: Memorandum of the Office of Consumer Goods, United States Department of Commerce, for the Foreign Trade Zones Board (March 9, 1984).

123. *Id.* at 2-3.

124. *Id.* at 4.

125. *Id.* at 3.

126. *Id.*

eration did not quell the opposition. Parts manufacturers urged their congressmen to lobby against the proposal. Other bicycle manufacturers, including Huffy's allies in an antidumping case brought against bicycles imported from Taiwan,[127] followed suit. While some congressmen introduced legislation that would have removed zone benefits for foreign-origin bicycle parts,[128] the Ohio representatives supported Huffy's subzone application, observing that "the domestic parts industry stands to benefit if Huffy can sell more bicycles at home and abroad."[129]

Perhaps anticipating a legislative solution, the Board refrained from deciding the application. Congress eventually did pass legislation that prevents foreign-origin bicycle parts from receiving the benefits conferred by a zone, as part of the Trade and Tariff Act of 1984.[130] Although the legislation is written unclearly,[131] it

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127. I.T.C. Investigation 731-TA-111, USITC Pub. 1417 (1983). In that case, the International Trade Commission found that allegedly dumped bicycles from Taiwan, the largest exporter of bicycles to the United States, were not causing or threatening to cause material injury to the United States bicycle industry.

128. *See* H.R. 657 and S.722, 98th Cong., 1st Sess. (1983).

129. Letter of Reps. Thomas N. Kindress, Clarence J. Brown and Michael G. Oxley to John Da Ponte (December 2, 1982).

130. Pub. L. No. 98-573, § 231(a), 98 Stat. 2948 (1984), which states:

> (a)(1) The Congress finds that a delicate balance of the interests of the bicycle industry and the bicycle component parts industry has been reached through repeated revision of the Tariff Schedules of the United States so as to allow duty free imports of those categories of bicycle component parts which are not manufactured domestically. The Congress further finds that this balance would be destroyed by exempting otherwise dutiable bicycle component parts from the customs laws of the United States through granting foreign trade zone status to bicycle manufacturing and assembly plants in the United States and that the preservation of such balance is in the public interest and in the interest of the domestic bicycle industry.
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> (2) Section 3 of the Act of June 18, 1934 (commonly known as the Foreign Trade Zones Act (19 U.S.C. 81c)), is amended—
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> (A) By inserting "(a)" immediately before the first word thereof;
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> (B) by redesignating paragraphs (a) and (b) as paragraphs (1) and (2), respectively; and
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> (C) by adding at the end thereof the following new subsection: "(b) The exemption from the customs laws of the United States provided under subsection (a) shall not be available before June 30, 1986, to bicycle component parts unless such parts are reexported from the United States, whether in the original package, as components of a completely assembled bi-

does remove the inverted tariff benefits that otherwise would be available to bicycle manufacturers in a zone or subzone.

The legislation indicates that Congress is willing to intrude upon an ongoing Board investigative proceeding whenever proposed manufacturing operations would harm or potentially harm politically vocal domestic interests, regardless of the operation's overall benefits. Congressional activism of this nature probably will cause the Board's future decisions to follow a more "protectionist" line.

Domestic groups also are urging the Board to become more restrictive in its approach to authorization of zones and subzones. The AFL-CIO has recommended the entire abolition of the zone program,[132] while the United Auto Workers union has suggested the repeal of the Boggs Amendment.[133] One bicycle parts producer has argued that the Board's proposed presumption, that zone activity that is exclusively for export is in the public interest,[134] encourages exporters to replace domestically produced parts with those produced abroad.[135] Additionally, the Electronics Industry Association is seeking the elimination of all operations that benefit from inverted tariff structures.[136]

The Board is limited in its ability to adopt some of these extreme suggestions. Domestic groups, however, will seek judicial and legislative solutions to the extent that they are dissatisfied with Board decisions. The threat of such "solutions" may be enough to cause the Board to further circumscribe zone operations. Considering the important role that zones can play in encouraging manufacturers in the United States, such a result

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cycle, or otherwise."

131. The section does not make clear whether its "exemption from the Customs laws" merely requires immediate payment of Customs duties upon entry of affected goods into a zone (a sort of enforced privileged status) or whether the affected bicycle parts are considered to have been imported into United States customs territory when placed in the zone. Also, the Act fails to provide refund provisions for duties collected on foreign-origin bicycle parts that subsequently are reexported from a zone.

132. USITC REPORT, *supra* note 3, at 51.

133. *Id.*

134. *See* 48 Fed. Reg. 7196 (1983) (to be codified at 15 C.F.R. § 400.807(d)).

135. Comments of Wald Manufacturing, *supra* note 48, at 16.

136. The Statement of the Components Group of the Electronic Industries Association (EIA) to the Foreign Trade Zones Board Regarding the Proposed Change in Regulations Governing Foreign Trade Zones, (Apr. 19, 1983) at 2-3 (copy on file at Commerce Department Reading Room, Washington, D.C.).

would indeed be unfortunate.

VII. Conclusion

The policy considerations of the Foreign Trade Zones manufacturing debate are not easily identified nor reconciled. The relative strength of the dollar vis-à-vis foreign currencies, IMF inducements to foreign competition, and the relative ease of establishing offshore operations have caused many to view zone manufacturing as "defensive," essentially preserving United States jobs and firms. While Foreign Trade Zone manufacturing undoubtedly has deficiencies, it may represent a final defense for many companies and entire industries that face the unpalatable alternative of moving offshore or becoming importers.

The Foreign Trade Zones Board has not yet considered the relatively sophisticated defensive aspects of zone manufacturing in the analysis of its decisions, but has harkened to the protestations of the opposing extreme elements. Moreover, the current protectionist mood suggests that any policy encouraging United States companies to avoid higher duties faces an arduous route through Congress. Congress should pass legislation compelling the Board to consider zone manufacturing as serving the public interest in those cases where United States industry or labor can demonstrate that zone manufacturing represents the last chance for preserving a deteriorating domestic industry.

Confrontations will continue between the Foreign Trade Zones Board and local zone operators and users. As competition to attract manufacturing business intensifies among the various zones, industries will resist zone growth by pressuring both Congress and the Board to maintain or restrict the expansion of zone manufacturing. The Administration and Congress must balance these various considerations in formulating a Foreign Trade Zone policy if they are to accomplish the broader interests of United States economic trade policy.