

THE FOREIGN-TRADE ZONES ACT: KEEPING UP WITH THE CHANGING TIMES

by *John J. DaPonte, Jr.*
Executive Secretary, Foreign-Trade Zones Board

As the 20th Century draws to a close, our laws and institutions alike are challenged to enter the new millennium with resilience and without missing a beat. The hectic pace of the world economy offers little time for pause or idle speculation as to what the future holds in store.

Especially sensitive to the turbulent economic tempo of our times are our trade laws, one of which is the Foreign-Trade Zones (FTZ) Act. As the legislative backbone of the FTZ program, this 63-year-old statute has adapted quite well to the shocks that have beset the global marketplace over the past quarter-century. A glimpse into its past is helpful to understanding how the law achieved its present state of fitness, as well as instructive in terms of the future effort that will be needed to keep it in tune with the times.

A Law Not too Lately Known

Enacted in 1934—after a long spell as a legislative proposal—the FTZ Act (19 U.S.C. 18) added to our Customs system a new alternative procedure borrowed from the historic free port

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paradigm to help businesses in the Customs phase of their operations. Initially, though, the new law received only limited attention. As of 1970, fewer than 10 communities had applied for and received FTZ authority.

The law's prospects changed for the better, however, in the highly-charged economic climate of the 1970s. As international trade with a more complex trade mix escalated, demand grew for the type of special Customs procedures it made available, as well as for reasonable access to them. By the mid-1980s, the number of approved zone projects had multiplied tenfold.

Thus, in its fourth decade the FTZ Act at last found itself beginning to fulfill its purpose—a late blooming nurtured by the energizing forces reshaping the world economy. Paradoxically, it

was the age-old free port concept embodied in the law that helped project its central purpose. That is, once the adaptability of the concept was recognized.

Free Ports and Their Free Zone Progeny

The role of free ports in promoting world trade is legendary. The historic cities that began using this strategy were mindful of the negative economic consequences of excessive tax impositions on trade, and the importance of a cost-effective business environment. Today, one can find this guiding principle still at work as part of the special provisions of Customs systems and economic development programs throughout the world.

Modern editions of the free port range from the export processing zones of developing economies to various types of free zones and flexible entry procedures in most other trading countries. The defining characteristic they have in common stems from special Customs treatment that permits duty-free exports and deferred duty/excise tax payments, often in combination with other kinds of investment incentives.

As the U.S. variant, the foreign-trade zone was crafted in a legislative format that has proved to be particularly resilient. The special procedures sketched out by Congress allow businesses to defer formal Customs entry on foreign items, subject to their being reported to Customs and remaining within designated FTZ sites. Exports emerge free of tariffs and certain excise taxes, and goods sold in the domestic market are subject to entry impositions at that time. Activity under FTZ procedures can range from warehousing to manufacturing, with entries in the latter case made either on the components or the finished product.

Though this procedural framework was inspired by the historic free port archetype, the U.S. version of the free zone was viewed not as a restatement of the classic form, but rather as a variation of it—a sort of new world opus.

Authorizing Zones vs. Regulating Zone Activity

For one thing, Congress provided a greater opportunity for wider local community participation than does the historic norm. Every U.S. Customs port of entry area—there are over 300—became eligible to apply for an FTZ license. Congress also prescribed an approval standard for general-purpose (multi-user) zones that is rather liberal. Applicants are "entitled" to a grant of

authority upon presenting workable plans in applications that also show their ability to carry out their projects in a public service context. Upon satisfaction of these basic requirements, the FTZ Board is expected to pass the baton.

On the other hand, the authorization of activity in zones was subjected to a stricter standard. The board was delegated broad discretionary authority that included responsibility for adopting rules for reviewing and regulation manufacturing to ensure that activity conducted under FTZ procedures would be in the public interest. Customs law enforcement was assigned to the Treasury Department and the Customs Service. As proposals involving manufacturing increased, the public interest assessment of this activity became the board's main task.

Trade Horizon Spreads Inland

With geo-economic shockwaves reaching the heartland and global commerce expanding beyond coastal areas, the vista for foreign-trade zones widened during the 1970s. Inland trade centers began taking on port characteristics as modernized intermodal transportation systems eased the flow of foreign trade. The latent FTZ law soon gained the attention of local public officials in these communities and became a common component of their economic efforts.

These developments gradually broadened the field of operations for FTZ activity to such a degree that during the 1980s the number of projects at inland port areas increased to over 50 percent of the total.

"Zoneness" Redesigned and Redefined

With the program in ascent, the time came to review practices adopted during its less active early years. It became apparent, for example, that the configuration of the early zones was in need of reexamination. Despite the intent that the U.S. free zone model should be customized to suit the U.S. economy, the design that was holding sway emulated too closely the old free port format. Influenced by the free zones that were then operating within the former free port cities of Europe, the typical layout of an early U.S. zone consisted of an isolated enclave, skirted with a high chain-link fence.

A practice also had evolved that restricted the use of approved zone space to FTZ activity. Because zone sponsors were reluctant under these circumstances to commit facilities before they had users under contract, the size of individual zone sites tended to be minimized, handicapping marketing efforts. Time-consuming applications were required for every new prospect needing a significant amount of space.

All of this meant that the few early U.S. zones had to make do in a constrained setting with burdensome operating costs. Recognizing that this was a hindrance to the FTZ program's potential, the board took a closer look at the Act and found the latitude it needed to contemporize the program.

Soon more expansive zone plans were accepted so that communities could tailor their projects to address local business needs. Form was now to take more notice of function, unfettered by outmoded historic structures. At the same time, the control

element inherent to FTZ operations was not to be ignored.

Customs Control Considerations

Staying within acceptable parameters that did not compromise Customs security concerns presented no large problem. In fact, the Customs Service was developing new approaches to Customs law enforcement that seemed perfectly suited for foreign trade zone use.

Activation Procedures

As a corollary to greater openness in design, new practices made it possible for an FTZ project to have approved zone space available on a standby basis. Unless and until "activated" under separate Customs procedures, zone space could now be used for non-zone activity. Activity not conducted under FTZ procedures simply remained subject to normal Customs rules.

The FTZ Board also adopted abridged administrative procedures so that grantees could more readily revise and update their zone layout plans. The main function left for the board in the activation process was the review of proposed manufacturing.

With the new format and procedures, business access to zones greatly improved, making it possible for the FTZ program to become a more effective component of state/local economic development programs. FTZ status could now be combined with economic programs such as enterprise zones to highlight their international potential. As more local public agencies became zone sponsors, they became direct participants in the approval process because of the preliminary local public interest assessment they conducted before submitting applications.

Subzones as Private Adjuncts

Another initiative that helped invigorate the FTZ statute was the introduction of the "subzone" as an offshoot of the basic general-purpose zone format. Introduced by the FTZ Board in 1952 as an interpretative amendment to its regulations, this litigation-tested extension of the law's core concept allows privately-owned manufacturing plants to operate as adjuncts to general-purpose sites.

While subzone status became an important means of extending the FTZ opportunity to manufacturers, only a handful of applications was submitted at the outset. But, this changed during the 1980s when the number rose steeply. With subzones and manufacturing on the increase, the board amplified the public interest standard, scrutinizing such activity more intensely in terms of its net economic effect and consistency with trade policy. Authority was denied or restricted when negative economic consequences were indicated. By the 1990s, manufacturing plants with FTZ subzone status had begun to account for over 75 percent of overall FTZ shipments by value.

Congressional Oversight—Revised Regulations

The fast-paced FTZ program growth of the 1980s led to studies by the International Trade Commission and Government

Accounting Office, and eventually to Congressional oversight hearings in 1989. Out of this public scrutiny came a reaffirmation of the FTZ program, and with it the expectation that manufacturing activity would remain subject to a thorough review process.

Receiving Congressional encouragement to proceed with rulemaking on draft revisions to its regulations, the FTZ Board grasped this long-awaited opportunity to codify practices and interpretations that had been developed on a case-by-case basis since the start of the program's growth spurt.

The new regulations went into effect in November 1991. They were—and still are—generally viewed as providing a balanced procedural framework for a sound participatory decision process suitable for addressing current issues.

Time Present

The role of the FTZ Act in our economy continues to be important both for reasons of business demand and public policy. More than ever, the FTZ program is engaged as part of the government's total efforts to maintain a level playing field for international trade. With refined versions of free port procedures widely available in other countries, our domestic program continues to be needed as a counterbalance.

In assessing business demand, it is useful to first note that the expansion of the program has made the supply of zone services available throughout the country. Wherever demand arises, it should today find a reasonably accessible service provider.

The level of demand for FTZ procedures has followed the overall growth trend for global trade and investment. Presently, some 150 FTZ projects are in operation and, as part of their activity, over 180 manufacturing plants are operating with subzone status (of the 90 applications currently pending with the FTZ Board, 50 are for subzone status). Warehousing and manufacturing activity combined account for incoming zone shipments of some \$165 billion annually, and over 2,800 firms employing over 315,000 persons are now using FTZ procedures. These numbers represent the sum of a pattern of growth that stretches over the past 25 years, averaging 15 percent each year.

Statistically, the growth of international trade itself—now some 25 percent of our GDP—poses the prospect for new activity. The continuing high rate of export growth—twice that of the GDP—should also affect potential demand. Additionally, the use of FTZ procedures to offset the unintended negative effects of inverted tariffs appears to be extending to a wider range of industries, given the fact that tariff rate reductions often apply to

finished products but not to all their component parts.

There are as well, indications of a greater use of FTZ procedures by the logistics sector, itself undergoing intensive change. Technologically-driven improvements in logistics management are increasing production and distribution efficiency, with optimal time scheduling along the production/distribution chain a key factor. Whatever the efforts to create a borderless global economy, the Customs border clearance phase of the logistics process remains a reality. Because of the jurisdiction Customs retains over zone shipments, FTZ procedures offer a means of facilitating the border process.

On the whole, as trade negotiations further affect tariff rates in ways that can lessen demand as well as create new aspects of it, all who are involved in the FTZ program must stay informed and alert to change. Too, the reach of the program must be viewed in terms of all forms of international trade impositions, not just conventional tariffs.

Looking to the Future

The odyssey of the FTZ Act through the economic tempests of the time-warped second half of the 20th Century has been a maturing experience. At first considered outdated because of its weak early impact, the law turned out to contain an enduring concept that found renewal in the new world economy. It has indeed demonstrated the stamina needed to navigate the economic rapids that surge from recent past into foreseeable future.

Looking to the future, thanks to the unique nationwide network the law has made possible, the FTZ program—at full tilt—should be able to move seamlessly past the daunting datelines that lie ahead. Whether it succeeds in continuing to adapt to change and meet new challenges will depend upon how innovatively the local, state, and federal agencies involved in its administration carry out their intersecting roles. Just as important is how effectively they work as partners with the business sector to achieve a goal we all share: helping improve the international competitiveness of businesses located in the United States.

This article is based on a speech recently given by John DaPonte at the national Association of Foreign Trade Zones 25th Annual Seminar/Conference and Exposition. For more information about foreign trade zones, contact the FTZ staff at the International Trade Administration of the Department of Commerce, tel. (202) 482-2862.