



July 2017

FOREIGN TRADE ZONES

CBP Should Strengthen Its Ability to Assess and Respond to Compliance Risks across the Program

Accessible Version

GAO Highlights

Highlights of [GAO-17-649](#), a report to the Ranking Member, Committee on Finance, U.S. Senate

Why GAO Did This Study

The FTZ program was established in 1934 to expedite and encourage international trade and commerce. FTZs provide benefits to companies that import foreign goods for distribution or for manufacturing in order to encourage them to maintain and expand their operations in the United States. The total value of foreign and domestic goods admitted to FTZs in 2015 was about \$660 billion. CBP is responsible for oversight and enforcement in FTZs, including revenue collection and assessing risk of noncompliance with U.S. laws and regulations.

GAO was asked to review CBP's oversight of FTZs and FTZs' economic impact. This report examines (1) the benefits of the FTZ program to companies operating FTZs and revenues collected from FTZs, (2) what is known about FTZs' economic impact, and (3) CBP's ability to assess and respond to compliance risks across the FTZ program. GAO analyzed CBP documents and data, interviewed agency officials and FTZ operators, and visited five FTZs based on trade volume, industry sector, and FTZ activity.

What GAO Recommends

GAO makes three recommendations to CBP to strengthen its ability to assess and respond to compliance risks across the FTZ program, including actions to centrally compile FTZ compliance and enforcement data, and to conduct a risk analysis of the FTZ program. CBP concurred with these recommendations and identified steps it will take to address them.

View [GAO-17-649](#). For more information, contact Kimberly M. Gianopoulos at (202) 512-8612 or gianopoulos@gao.gov.

July 2017

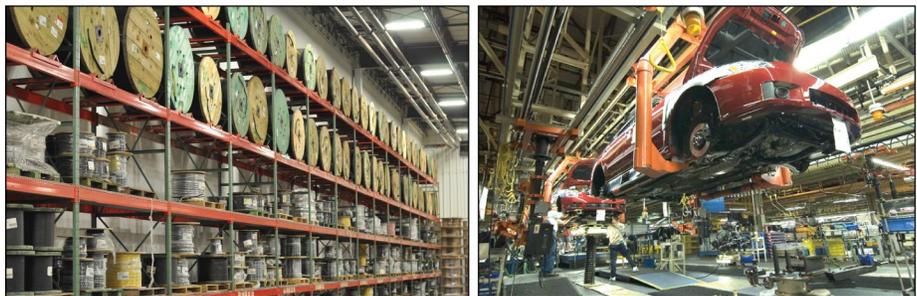
FOREIGN TRADE ZONES

CBP Should Strengthen Its Ability to Assess and Respond to Compliance Risks across the Program

What GAO Found

The Foreign Trade Zones (FTZ) program provides a range of financial benefits to companies operating FTZs by allowing them to reduce, eliminate, or defer duty payments on goods manufactured or stored in FTZs before they enter U.S. commerce or are exported. FTZs are secure areas located throughout the United States that are treated as outside U.S. customs territory for duty assessments and other customs entry procedures. Companies using FTZs may be warehouse distributors or manufacturers (see figure). A manufacturer, for example, that admits foreign components into the FTZ can pay the duty rate on either the foreign components or the final product, whichever is lower—resulting in reduced or eliminated duty payments. Distributors can also benefit by storing goods in FTZs indefinitely and thereby deferring duty payments until the goods enter U.S. commerce. In 2016, U.S. Customs and Border Protection (CBP) collected about \$3 billion in duties from FTZs.

Foreign Trade Zones Include Distribution Warehouses and Car Manufacturers



Source: National Association of Foreign Trade Zones. | GAO-17-649

While FTZs were created to provide public benefits, little is known about FTZs' economic impact. For example, few economic studies have focused on FTZs, and those that have do not quantify FTZs' economic impacts. In addition, these studies do not address the question of what the economic activity, such as employment, would have been in the absence of companies having FTZ status.

CBP has not assessed compliance risks across the FTZ program, and its methods for collecting compliance and enforcement data impair its ability to assess and respond to program-wide risks. While CBP regularly conducts compliance reviews of individual FTZ operators to ensure compliance with U.S. customs laws and regulations, it does not centrally compile FTZ compliance and enforcement information to analyze and respond to compliance and internal control risks across the program. Federal internal control standards state that management should obtain relevant data and assess and respond to identified risks associated with achieving agency goals. Without a program-wide assessment of the frequency and significance of problems identified during compliance reviews, risk levels determined, and enforcement actions taken, CBP cannot verify its assertion that the FTZ program is at low risk of noncompliance. Incorrect determinations about program risk level may impact program effectiveness and revenue collection for the FTZ program, which accounted for approximately 11 percent of U.S. imports in 2015.

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Abbreviations

ACE	Automated Commercial Environment
CBP	U.S. Customs and Border Protection
Commerce	Department of Commerce
DHS	Department of Homeland Security
FTZ	Foreign Trade Zone
FTZ Board	Foreign-Trade Zones Board
FY	fiscal year
HMF	Harbor Maintenance Fee
HSI	Homeland Security Investigations
ICE	U.S. Immigration and Customs Enforcement
MPF	Merchandise Processing Fee
OFO	Office of Field Operations
SEACATS	Seized Assets and Case Tracking System

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July 27, 2017

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate

Dear Senator Wyden:

Foreign Trade Zones (FTZ) are secure areas located throughout the United States that are generally treated as outside U.S. customs territory for the purposes of customs entry procedures, including payment of duties. Congress established FTZs to expedite and encourage international trade and commerce. Companies operating FTZs are able to bring foreign goods into FTZs for distribution or for use in manufacturing new products, among other purposes, without paying customs duties or fees until the goods are transferred from the FTZs for import into U.S. commerce. No duties or fees are paid if the goods are exported from the FTZs. In 2015, the total value of goods admitted to FTZs was approximately \$660 billion, representing goods from foreign and domestic sources. In 2015, the value of foreign goods admitted to FTZs was approximately \$245 billion and represented about 11 percent of the value of total U.S. imports that year. Exports from FTZs have grown from approximately \$54 billion in 2011 to \$85 billion in 2015. U.S. Customs and Border Protection (CBP) is responsible for oversight and enforcement in FTZs, including revenue collection and assessing risk of noncompliance with laws and regulations.

You asked us to review issues related to CBP's oversight of FTZs and the benefits and economic impacts of FTZs. This report examines (1) the benefits that the FTZ program provides to companies operating FTZs and revenues that CBP has collected from FTZs, (2) what is known about the economic impact of FTZs on the U.S. and local economies, and (3) CBP's ability to assess and respond to compliance risks across the FTZ program.

To examine the benefits that the FTZ program provides to companies operating FTZs and revenues that CBP has collected from FTZs, we analyzed and reported on aggregate, national-level data on goods admitted into FTZs and goods entered into U.S. commerce from FTZs. In addition, we characterized the types of benefits that companies operating

FTZs receive by providing illustrative examples and calculations of associated savings at the company level, using financial data and testimonial evidence obtained through interviews with FTZ companies and CBP officials, CBP data, and industry publications. We used CBP data to identify trends in total government revenue¹ collected from FTZs, including user fees. To examine what is known about the economic impact of FTZs on the U.S. and local economies, we reviewed economic studies on FTZs dating back to 1990, including their methodologies, assumptions, and findings. We also reviewed and analyzed economic information from company applications for FTZ production authority to illustrate FTZs' anticipated economic impacts at regional and local levels. We did not assess the FTZ application process. To examine CBP's ability to assess and respond to compliance risks across the FTZ program, we reviewed and compared information on CBP's oversight processes and enforcement actions against CBP requirements, and federal internal control standards.² We also analyzed a random, generalizable sample of CBP compliance reviews of FTZs to determine whether control deficiencies exist in CBP's monitoring and oversight processes. Estimates from this statistical analysis have a margin of error of no more than 8 percentage points. To assess CBP's response to compliance risks in FTZs, we examined data on FTZ enforcement actions and compared the results of these actions against criteria for when and how enforcement actions are to occur. We selected five FTZs in Maryland, Texas, and Virginia for site visits based on factors including trade volume, industry sector, and FTZ activity. For each of the objectives, we interviewed CBP, Department of Homeland Security (DHS), and Department of Commerce (Commerce) officials at headquarters and traveled to FTZ sites to interview CBP officials and FTZ representatives. In conducting our review, we assessed the reliability of the CBP data we used by performing electronic testing of required data elements, reviewing existing information about the data and the systems that produced the data, and interviewing CBP officials knowledgeable about these topics. After conducting these assessments, we found the data to be generally reliable for the purposes of our analysis. See appendix I for additional information about our objectives, scope, and methodology.

¹CBP has a statutory responsibility to collect all revenue owed to the U.S. government that arises from the importation of goods. CBP collects revenue in the form of customs duties, taxes, and fees and is the second leading source of federal revenue after the Internal Revenue Service.

²GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

We conducted this performance audit from July 2016 to July 2017 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The FTZ Program: Purpose and Locations

The FTZ program was created under the Foreign-Trade Zones Act of 1934, during the Great Depression, to expedite and encourage foreign commerce.³ Furthermore, according to CBP officials, the FTZ program aims to encourage companies to maintain and expand their operations in the United States. To encourage such expansion, FTZs provide benefits to companies that import foreign goods for distribution or for incorporation into manufactured products. In this report, we refer to these companies as FTZ operators.⁴ Goods admitted into a zone may be manufactured, assembled, exhibited, repaired, stored, or destroyed, among other processes. Companies using FTZs include both warehouse distributors and manufacturers (see fig. 1). Leading industry sectors by value of foreign and domestic goods admitted into FTZs include petroleum refining, vehicles, and consumer electronics.

³Act of June 18, 1934, ch. 590, § 3, 48 Stat. 999 (codified as amended at 19 U.S.C. §§ 81a – 81u).

⁴CBP defines an FTZ *operator* as a corporation, partnership, or person that operates an FTZ under the terms of an agreement with the grantee, supervises FTZ activity and security, and is responsible for complying with FTZ program requirements established by CBP. A *grantee* is a public or private corporation to which the privilege of establishing, operating, or maintaining an FTZ has been given. CBP defines an FTZ *user* as a corporation, partnership, or person that uses a zone under agreement with the grantee or operator for storage, handling, processing, or manufacturing of merchandise in FTZs. In some cases, FTZ operators may also be users.

Figure 1: Companies Using Foreign Trade Zones Include Warehouse Distributors and Car Manufacturers



Source: National Association of Foreign Trade Zones. | GAO-17-649

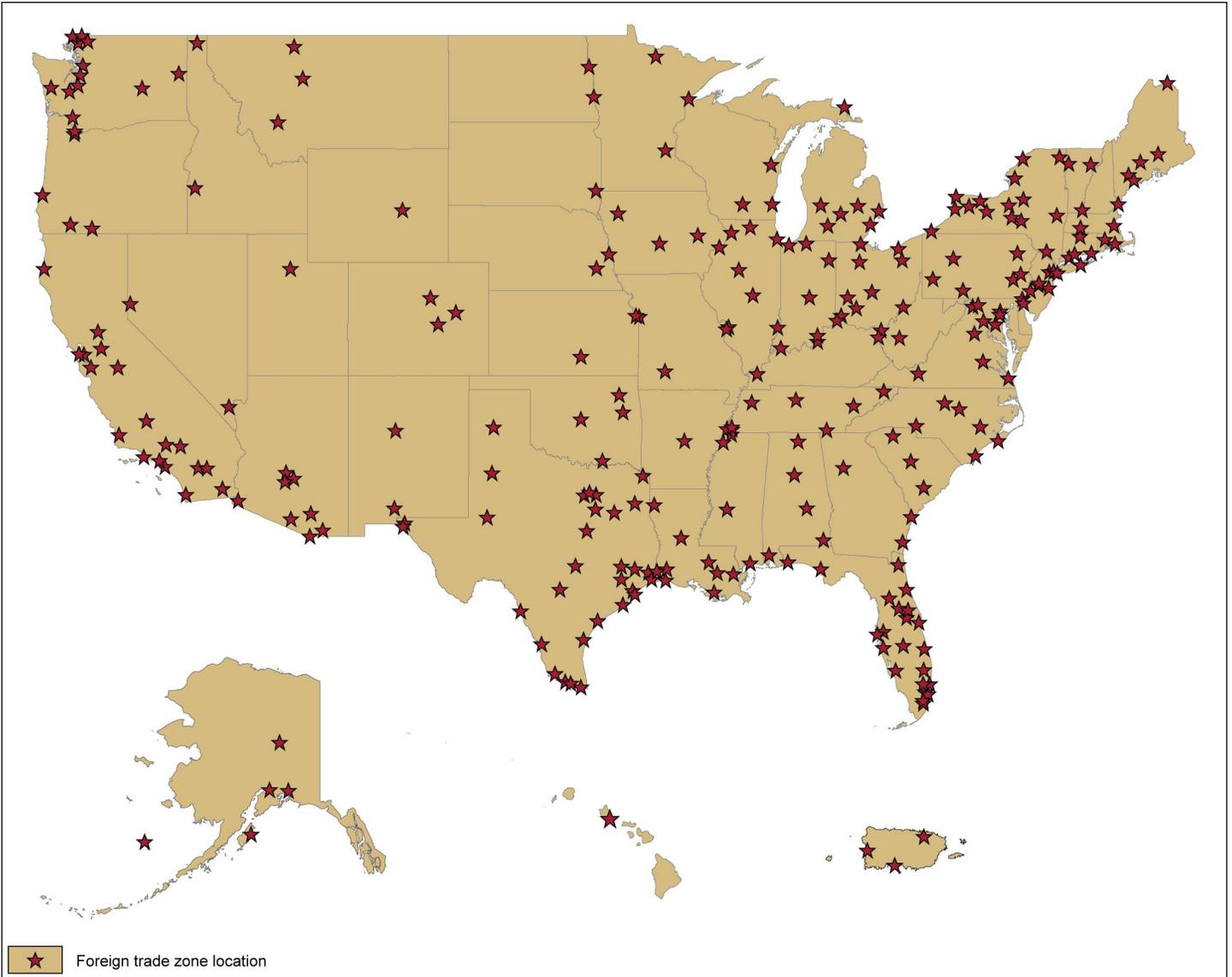
In addition to collecting duties, CBP also generally collects a Merchandise Processing Fee (MPF)⁵ between \$25 and \$485 from importers on a per-shipment basis to offset costs related to customs processing and other functions.⁶ CBP collects data on duties and fees collected from FTZs in its Automated Commercial Environment (ACE), which is the primary system through which CBP electronically collects and distributes import and export data. CBP uses it to, among other things, receive relevant data from FTZ operators and documentation required for the release of imported cargo.

In 2016 there were 276 authorized FTZs across the United States, with at least 1 in each state and in Puerto Rico. Figure 2 shows the locations of FTZs in the United States and Puerto Rico. Generally, one FTZ has been approved to serve an area near each CBP port of entry. Most FTZs consist of multiple physical locations, known as sites or subzones, which include individual companies' plants as well as multiuser facilities such as seaports or airports.

⁵The MPF is an ad valorem user fee set by statute on the declared, invoiced value of entries into U.S. commerce and is intended to offset salaries and expenses incurred for the processing of imports and the release of merchandise into the United States.

⁶The Trade Adjustment Assistance Extension Act of 2011 increased the MPF rate for formal entries—shipments of commercial goods valued at \$2,500 or more—from 0.21 percent to 0.3464 percent, but the minimum and maximum fees of \$25 and \$485, respectively, did not change. Importers will therefore pay a maximum of \$485 for entries valued at \$140,011 or more.

Figure 2: Locations of Foreign Trade Zones in the United States and Puerto Rico, as of 2016



Source: GAO analysis of Foreign Trade Zones Board data. | GAO-17-649

The Foreign-Trade Zones Board and Applications for Production Authority in FTZs

The Foreign-Trade Zones Board (FTZ Board) consists of the Secretary of Commerce and the Secretary of the Treasury. The staff of the FTZ Board is located within Commerce and consists of an executive secretary and eight analysts. The FTZ Board is responsible for approving the establishment of zones and reviewing applications for production authority, among other responsibilities.⁷ Production authority, also called manufacturing authority, authorizes an FTZ operator to make transformations or changes to admitted goods.

Under the FTZ Board's revised regulations adopted in 2012, businesses applying for permission to conduct FTZ production activities must file a *production notification* and then may be required to file a more detailed *production application* if necessary.⁸

- **Production notification.** An applicant first submits a production notification to the FTZ Board that briefly summarizes the proposed production activity and is published in the Federal Register for public comment. The FTZ Board has generally approved a company's notification and granted production authority unless issues or concerns are raised by third parties or industry specialists within the government, according to the FTZ Board. Of the 222 production notifications submitted to the FTZ Board from January 2012 through August 2016, it reported approving 167. For the remaining 55, the FTZ Board reported denying 11 and approving 44 with some restrictions.
- **Production application.** According to the FTZ Board, businesses that have had their production notifications denied or approved with restrictions can continue to seek approval, but they must submit a more detailed production application that discusses the economic factors involved in the proposed activities. According to the FTZ Board, the applicant must demonstrate that approval would result in a net positive national economic effect and a significant *public benefit*,

⁷As required by the FTZ Act, the FTZ Board also submits an annual report to Congress summarizing FTZ activities. In drafting this report, the FTZ Board also collects data from companies operating FTZs, including merchandise received and exports by industry and state.

⁸77 Fed. Reg. 12,112 (Feb. 28, 2012) (codified at 15 C.F.R. part 400).

such as creating employment opportunities and encouraging the retention of domestic business activity. Of the 55 production notifications that the FTZ Board either denied or approved with restrictions, seven businesses continued to seek approval and submitted production applications. The FTZ Board reported that it has disapproved one production application and approved two others with significant restrictions based on industry-impact considerations. The four remaining production applications were pending as of May 2017.

CBP's Oversight and Enforcement Responsibilities in FTZs

Oversight

CBP is responsible for oversight and supervision of FTZ operators, including collection of duties, taxes, and fees. CBP's principal interest and concern in overseeing FTZs is to (1) control movement of the goods in and out of the zones, (2) ensure the collection of duties and taxes owed on goods transferred from FTZs, and (3) ensure that FTZ procedures are in compliance with the FTZ Act and laws and regulations pertaining to zone use.

CBP's responsibility for overseeing goods moving into and from FTZs involves three control points:

1. CBP authorizes and supervises the admission of goods to FTZs.
2. Once the goods are admitted to FTZs, CBP delegates direct supervision of the merchandise and inventory control to the FTZ operator until the goods leave the zone.
3. CBP resumes supervision when goods are removed from zones and enter U.S. customs territory or are exported.

CBP oversees FTZs through the audit-inspection method, meaning that CBP does not maintain FTZ inventory records and that CBP personnel are not physically assigned to FTZs to supervise FTZ operators. To ensure FTZs' compliance with U.S. customs policies, laws, and regulations, CBP primarily conducts compliance reviews, which are periodic visits by CBP personnel to observe or examine FTZ transactions, records, procedures, and conditions. FTZ operators are also required to post an operator's bond, which insures the operator's agreement to comply with the pertinent laws and CBP regulations and delineates the particular responsibilities under the bond. As part of its oversight of FTZ

operators, CBP reviews FTZ operators' bond amounts to ensure that they are sufficient to cover duties and fees owed based on the value of merchandise held in the zone by the FTZ operator.

As part of its compliance reviews, CBP assigns risk levels to FTZ operators based on violations or deficiencies found during the reviews, such as thefts, inventory control problems, or security errors. CBP guidance for conducting compliance reviews is outlined in its *Foreign-Trade Zones Manual*⁹ and its *Compliance Review Handbook for Foreign Trade Zones*.¹⁰ The Compliance Review Handbook specifically directs CBP officers to document the risk level associated with each compliance review. These assigned risk levels—high, medium, or low—determine the frequency of future compliance reviews, with no fewer than one review every other year.¹¹ According to the Compliance Review Handbook, zones found to be not in full compliance (i.e., not low risk) will have no fewer than two compliance reviews per year. CBP considers high-risk determinations to be an unacceptable burden on CBP resources and the handbook states that Port Directors shall take enforcement actions to bring zone operators deemed high-risk into full compliance. For these high-risk zones, the Compliance Review Handbook states that compliance reviews will be performed as often as needed to ensure that the relevant zone operator is following the established improvement plan.

CBP's Office of Field Operations (OFO) manages FTZ policy and operational guidance and is primarily responsible for overseeing the FTZs, including conducting compliance reviews. OFO's Port Directors operating within the jurisdiction of 20 field offices are responsible for overseeing the supervision of FTZs. CBP officers located at the ports conduct compliance reviews in addition to their other trade enforcement responsibilities, such as examining high-risk shipments and reviewing shipment data that arrive at U.S. ports for entry into U.S. commerce. Within CBP, the Office of Trade is CBP's lead entity for developing trade

⁹Department of Homeland Security, U.S. Customs and Border Protection, *Foreign-Trade Zones Manual*, 0000-0559A (Washington, D.C.: 2011)

¹⁰Department of Homeland Security, U.S. Customs and Border Protection, *Compliance Review Handbook for Foreign Trade Zones*, HB-3500-10 (Washington, D.C.: July 2008).

¹¹The biennial compliance review requirement applies to general-purpose or nonmanufacturing subzones that are in full compliance with statutes and regulations governing zone operations. Manufacturing zones are subject to no less than one annual compliance review, although this number can be reduced at the discretion of the Port Director.

policy and operational guidance. Within the Office of Trade, the Regulatory Audit directorate conducts audits, which may involve FTZs. Also within the Office of Trade, the Trade Transformation Office is responsible for collecting trade data from FTZs.

Enforcement

As part of its oversight responsibilities, CBP can take a range of enforcement actions in FTZs. When CBP officials discover FTZ operator violations, the Port Director overseeing the FTZ operator can take enforcement actions depending on the violations uncovered during compliance reviews and audits including, but not limited to, warning letters, assessments of liquidated damages,¹² fines, penalties, and seizures.¹³ CBP's system of record for enforcement actions is the Seized Assets and Case Tracking System (SEACATS), which contains data for seizures, penalties, and liquidated damages on imports in general and not exclusive to FTZs.

The FTZ Program Provides a Range of Financial Benefits to FTZ Operators, and Duties Collected from FTZs Increased over the Past 10 Years

The FTZ program provides a range of financial benefits to FTZ operators by allowing them, in certain circumstances, to reduce, eliminate, or defer duty payments on goods manufactured or stored in FTZs. For example, FTZ operators that admit foreign components to manufacture final products for import can pay the duty rate of either the component part or the final product, whichever is lower—resulting in reduced or eliminated

¹²According to the FTZ Manual, liquidated damages are amounts of money that the FTZ operator agrees to pay for damages arising from a default by the FTZ operator on the terms of an FTZ operator's bond. FTZ operators are required to follow U.S. customs law and take out an operator's bond to guarantee payment of any damages to the U.S. government by a third party if the operator defaults on these payments. Liquidated damages generally cannot exceed the amount of the operator's bond.

¹³According to the FTZ Manual, other enforcement actions that CBP is authorized to use on FTZ operators include revocation of a blanket permit for admission, physical supervision of zone activities, increased bond amounts, suspension or revocation of zone activation status or privileges, and removal of merchandise. We did not examine enforcement actions against parties other than FTZ operators.

duty payments. In addition, companies operating FTZs can benefit from the ability to reduce the frequency of user fee payments and the opportunity to receive tax incentives in certain circumstances. Duties collected from FTZs increased as a proportion of total duties collected on all U.S. imports from 3.3 percent to 8.4 percent over the past 10 years. In addition, MPF collections from FTZs have more than doubled over the same period, though they consistently account for less than 1 percent of CBP's MPF collections from all U.S. imports.

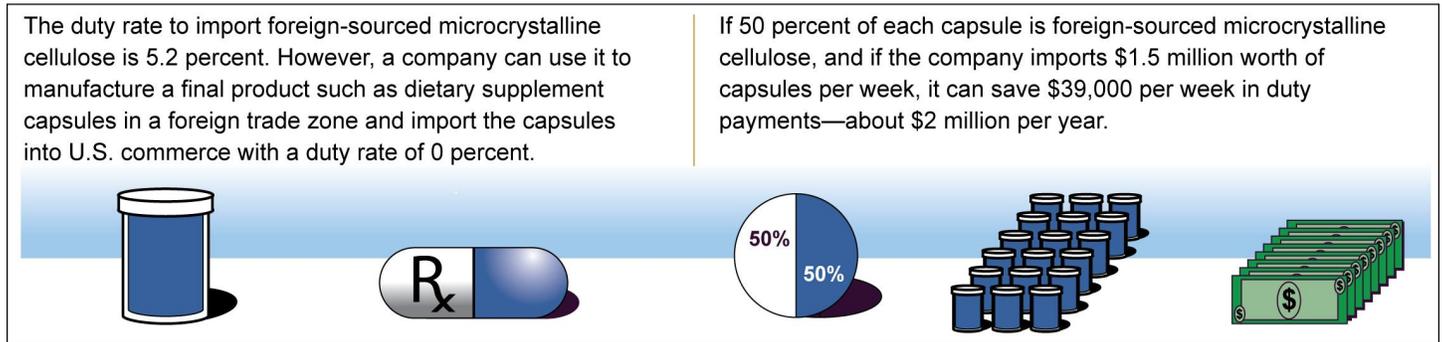
The FTZ Program Provides a Range of Financial Benefits to FTZ Operators

Duty Reduction on Imports and Duty Elimination on Exports

FTZ operators that manufacture final products with a lower duty rate than their imported foreign component parts can elect to pay the duty rate on the final product rather than on the foreign status component.¹⁴ For example, the FTZ Board may authorize an automobile manufacturer to pay the duty rate for finished passenger motor vehicles (2.5 percent) instead of the duty rate on foreign-produced component parts, such as engines, transmissions, and other components, which have duties generally ranging from 0 percent to approximately 10 percent. This benefit provides an incentive to companies to manufacture in the United States rather than move their manufacturing operations overseas to avoid paying U.S. duties. Figure 3 shows an example of duty savings for a dietary supplement product that has a 0 percent duty rate and uses foreign status components with a 5.2 percent duty rate, representing 50 percent of the final product's value. As the figure shows, an FTZ operator importing \$1.5 million in capsules each week can save approximately \$2 million in duties annually on the final product because it would be subject to a 0 percent duty.

¹⁴Products with imported parts that are dutiable at higher rates than the finished product into which they are incorporated are referred to as having an inverted tariff structure.

Figure 3: Illustration of Savings to Foreign Trade Zone Operators by Lowering Duties on Foreign Status Components



Source: GAO analysis of U.S. International Trade Commission tariff data and foreign trade zone data. | GAO-17-649

Similarly, companies operating FTZs pay no duties on goods exported from FTZs to other countries, effectively eliminating duty payments on foreign status goods brought to FTZs either for storage or incorporation into a manufactured product prior to export. For example, a foreign-headquartered power tool manufacturer may establish an FTZ in the United States in order to eliminate duty payments on foreign components in tools that it exports back to its home country.

Actual business savings from duty reduction or elimination vary and depend upon the proportion and dutiable value of foreign status components that the FTZ operator incorporates into production. For example, representatives of a consumer electronics manufacturer that we interviewed stated that duty reduction or elimination resulted in the largest savings associated with FTZ status. The manufacturer reported that it admitted approximately \$189 million in foreign status electronic components into its FTZ in 2015, and according to company representatives, these duty rates ranged from 2.5 to 5.8 percent. The manufacturer paid no duties on these components, however, as they were either incorporated into a duty-free final product for import into U.S. commerce or exported duty free. Company officials stated that the cost savings from duty reduction and elimination enable them to better compete for U.S. market share.¹⁵ For other FTZ operators, the duty savings are a less important benefit of their FTZ status. For example, representatives of a petroleum product manufacturer stated that because of the low duty rates on crude oil imports, cost savings from duty

¹⁵In 2015, exports from FTZs were approximately \$85 billion, representing about 13 percent of the value of goods admitted to FTZs.

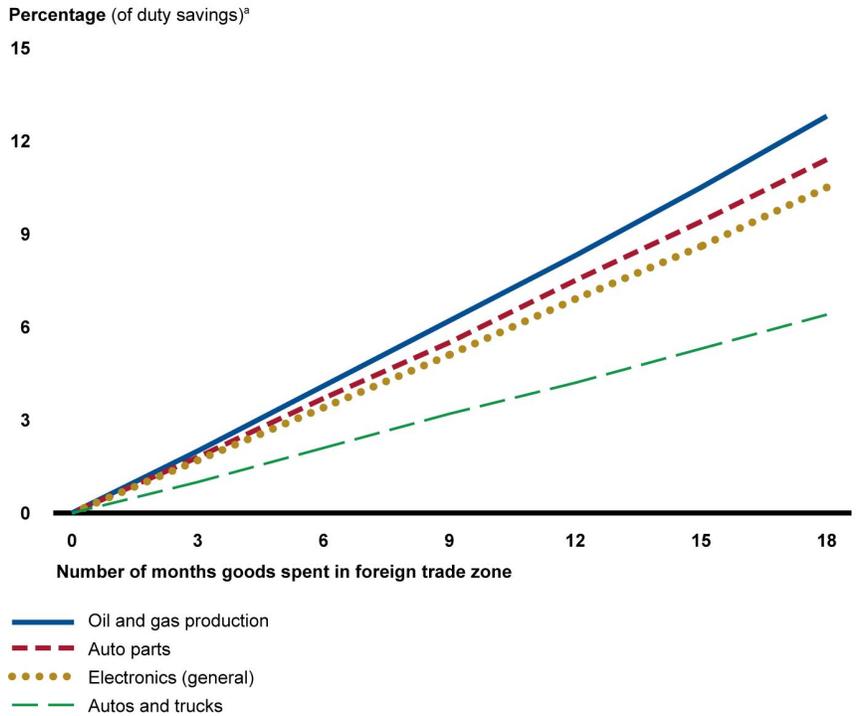
reduction amounted to less than \$500,000 annually, whereas other benefits, such as tax savings (discussed below) were more significant to this manufacturer. Company officials added that the plant would probably not shut down if it lost its FTZ status, as the lost savings would not outweigh the significant cost to relocate.

Indefinite Storage of Goods in FTZs and Duty Deferral

Among FTZ operators we interviewed, those engaged in warehousing and distribution discussed the importance of the ability to store goods in the zone indefinitely and thereby defer duty payments until the goods enter U.S. commerce. FTZ operators engaged in automobile distribution that we spoke with, for example, valued the ability to hold vehicles in the zone for quality inspection and only pay duties on those goods whose functionality has been verified. Similarly, distributors may also reduce their exposure to market variability by holding goods in the zone until seasonally advantageous market opportunities open or retailers liquidate their current inventory. Further, a zone operator that leases space to distributors of quota-restricted commodities, such as sugar and tuna, discussed with us the FTZ benefit of holding onto the stock indefinitely until import quotas are lifted.

FTZ operators we met with did not attempt to quantify the associated savings of indefinite storage and duty deferral. However, as our analysis of different industries' capital costs demonstrates, companies with higher capital costs may benefit more from deferring duty payment. Figure 4 demonstrates the potential cost savings that a company engaged in distributing four different types of goods may obtain from deferring duty payments for 1 or more 3-month periods. For companies importing electronics, for example, cost savings from deferring duty payments for an 18-month period can amount to approximately 10 percent of the value of the deferred duty. Because companies using FTZs pay duties when goods enter U.S. commerce rather than when these goods are admitted to the FTZ, they are able to reduce costs by an amount equal to the company's cost of capital over the period the payment is deferred.

Figure 4: Potential Cost Savings of Deferring Duty Payments in Foreign Trade Zones for Selected Industries



Source: GAO analysis of New York University Stern School of Business data. | GAO-17-649

Note: Cost of capital refers to the cost of the individual sources of capital, weighted by their importance in the firm's capital structure, and reflects the minimum required return on investment for a given company relative to the risk on this return. The data above represent the average cost of equity and the average cost of debt weighted by the average capital structure (proportion of equity and debt) for the industry specified.

^aThe percentage of duty savings is the amount of money saved as a percentage of duties owed.

User Fee Benefits

FTZ operators also can benefit from the ability to file customs entries and pay associated MPFs for imported goods on a per-week rather than a per-shipment basis, which can result in a lower amount of fees paid and potentially reduce the administrative burden. Companies that import frequently and in high volumes may benefit more from FTZs than those that do not. For example, an automobile distributor not located in an FTZ that is importing 10 shipments of vehicles per week and paying the maximum MPF would make 10 MPF payments of \$485 each, totaling \$252,200 per year. With FTZ status, the same distributor could make one \$485 MPF payment per week for a total annual payment of \$25,220,

resulting in annual savings of \$226,980. In contrast, an FTZ operator that imports high-value items on an infrequent basis—such as a heavy machinery manufacturer that we interviewed—would be less likely to see MPF savings as significant.

FTZ operators utilizing a U.S. seaport to admit merchandise to the zone also pay a Harbor Maintenance Fee (HMF)¹⁶ on a quarterly rather than a per-shipment basis, potentially reducing administrative work for the FTZ operator. In contrast to the MPF, however, total HMF amounts are not reduced through FTZ status and remain based upon the value of cargo admitted to the FTZ in a fiscal quarter. We previously reported on challenges that CBP faced in monitoring HMF payments associated with FTZs as a result of CBP's use of paper payment for FTZ operators.¹⁷ CBP now accepts electronic payment of the HMF.

Tax Savings

The FTZ Act also exempts FTZ operators from state and local ad valorem taxation on foreign goods admitted into the zone and domestic goods held in a zone for exportation. According to CBP, some states also provide additional tax benefits to companies operating FTZs, including personal property tax reductions. For some FTZ operators we met with, the benefit of property tax waivers and exemption from state and local ad valorem taxation provided the largest source of savings associated with FTZ status. In Texas, for example, one automobile distributor estimated saving up to \$3 million annually in property taxes granted by the county. To prevent possible negative impacts on local entities, the FTZ Board requires that all applications for FTZ designation contain a list of parties that would be affected by any reduction in local tax collections related to the FTZ and provide evidence that those parties concur with the proposed FTZ designation.

¹⁶The HMF is an ad valorem fee assessed on port use associated with imports, admissions into FTZs, domestic shipments, and passenger transportations. According to CBP, the fee—0.125 percent of the value of cargo—is assessed only at ports that benefit from the expenditure of funds by the Army Corps of Engineers for maintaining and improving the port trade zones.

¹⁷GAO, *Federal User Fees. Substantive Reviews Needed to Align Port-Related Fees with the Programs They Support*, [GAO-08-321](#) (Washington, D.C.: Feb. 22, 2008).

Duties Collected from FTZs Increased as a Proportion of Total Duties Collected on All U.S. Imports over the Past 10 Years

Over the last decade, duties collected from FTZs increased as a proportion of total duties collected on all U.S. imports, as did the proportion of foreign status goods among total FTZ admissions.¹⁸ Duties collected from FTZs have increased from \$854 million to \$2.9 billion in the past 10 years, representing an increase from 3.3 percent to 8.4 percent of total CBP duty collections on all U.S. imports during the same time period (see table 1). While total duty collections on all U.S. imports grew by 34 percent over the past 10 years, collections from FTZs grew by 242 percent over the same time period.

Table 1: Duties Collected on Imports from Foreign Trade Zones (FTZ) Compared to Duties Collected from Total U.S. Imports, Fiscal Years 2007-2016

Fiscal year	Duties collected from FTZs (U.S. dollars in millions)	Duties collected from all imports (U.S. dollars in millions)	FTZ duties as percentage of total
2007	854	26,000	3.3
2008	980	27,600	3.6
2009	767	22,500	3.4
2010	1,006	25,300	4.0
2011	1,327	29,500	4.5
2012	1,619	30,300	5.3
2013	2,471	31,800	7.8
2014	3,175	33,900	9.4
2015	3,091	35,000	8.8
2016	2,923	34,800	8.4

Source: GAO analysis of U.S. Customs and Border Protection and Office of Management and Budget data. | GAO-17-649

Similarly, the proportion of foreign to domestic status goods admitted to FTZs has risen, from 20 percent in 1995 to 37 percent by 2015. According to the FTZ Board, which reports annually on the extent and growth of the FTZ program to Congress, a total of approximately \$659

¹⁸FTZ operators can admit inputs that are provided from domestic sources, called *domestic status* goods, as well as inputs that are imported, called *foreign status* goods. Total merchandise received into FTZs represents both domestic and foreign status goods.

billion in domestic and foreign goods was admitted to FTZs in 2015, of which approximately \$245 billion —about 37 percent—was foreign.¹⁹

User Fees Collected from FTZs Varied as a Percentage of User Fees Collected on all U.S. Imports over the Past 10 Years

User fees collected by CBP from FTZs, including MPFs and HMFs, varied as a percentage of user fees collected on all U.S. imports over the past 10 years. MPF payments from FTZs approximately doubled from fiscal years 2007 to 2016, although these payments have accounted for less than 1 percent of CBP’s total MPF collections (see table 2). Many FTZ operators that we interviewed reported taking advantage of the ability to bundle a week’s worth of shipments in one entry filing, thereby paying the MPF weekly rather than on each individual shipment.

Table 2: Merchandise Processing Fee (MPF) Payments Collected on Imports from Foreign Trade Zones (FTZ) Compared to MPF Payments on All U.S. Imports, Fiscal Years 2007-2016

Fiscal year	MPFs collected from FTZs (U.S. dollars in millions)	MPFs collected on all imports (U.S. dollars in millions)	FTZ MPFs as percentage of total
2007	7.09	1,450	0.5
2008	8.08	1,490	0.5
2009	8.07	1,256	0.6
2010	8.37	1,383	0.6
2011	8.79	1,555	0.6
2012	10.45	2,097	0.5
2013	12.42	2,168	0.6
2014	14.08	2,256	0.6
2015	16.02	2,375	0.7
2016	16.33	2,297	0.7

Source: GAO analysis of U.S. Customs and Border Protection and Office of Management and Budget data. | GAO-17-649

HMF payments on admissions to FTZs, which FTZ operators are authorized to make quarterly rather than on a per-shipment basis, accounted for 17.4 percent of combined HMF collections from FTZs and

¹⁹The FTZ Board submits annual FTZ program reports to Congress that compile data submitted by FTZs. As of June 2017, data were available through 2015.

from all U.S. imports over the same period. HMF payments from FTZs were the highest in fiscal year 2011, accounting for 20.6 percent (see table 3).

Table 3: Harbor Maintenance Fee (HMF) Payments Collected on Admissions to Foreign Trade Zones (FTZ) Compared to HMF Payments from FTZs and U.S. Imports, Fiscal Years 2007-2016

Fiscal year	HMFs collected from FTZs (U.S. dollars in millions)	HMFs collected from FTZs and imports (U.S. dollars in millions)	FTZ HMFs as percentage of total
2007	188	1,183	15.9
2008	265	1,353	19.6
2009	185	1,041	17.7
2010	193	1,104	17.5
2011	275	1,334	20.6
2012	267	1,413	18.9
2013	249	1,389	17.9
2014	251	1,396	18.0
2015	193	1,342	14.4
2016	160	1,237	13.0

Source: GAO analysis of Department of the Treasury data. | GAO-17-649

FTZs Were Created to Provide Public Benefits, but Little Is Known about Their Economic Impact

While FTZs were created to provide benefits to the American public, little is known about their economic impact. For example, few economic studies have focused on FTZs, and those that have do not quantify economic impacts or address the question of what the economic activity, such as employment, would have been in the absence of companies having FTZ status. In addition, the detailed FTZ production applications filed since 2012 by seven companies seeking FTZ Board approval for manufacturing authority provided limited information on economic impact and no data to support their estimates of job creation. Public comments on these applications revealed disagreements among industry members on the anticipated economic impacts of the proposed FTZ activities.

Few Economic Studies of FTZs Have Been Completed, and None Quantify Economic Impacts

Our literature review uncovered few academic studies regarding FTZs. The studies that we reviewed did not estimate the overall economic impact of FTZs on the United States or local economies. Several academic studies we reviewed used a theoretical framework, explaining why it was profitable for companies to use a FTZ, but the assertions were not corroborated with empirical analysis of the effect on the economy. Some studies reported that limited empirical data were available to conclude that FTZs had increased employment, particularly at the national level. This finding is consistent with our prior work on FTZs.²⁰ One study, for example, concluded that because the academic literature on U.S. FTZs did not look at the impact on labor costs as a factor in FTZ location decisions, it was unclear whether FTZs contributed to local employment growth.²¹ Another study, examining the effect of FTZs on the global supply chain, administered a survey to U.S. firms operating in FTZs and found that the most important benefits reported were U.S. duty waivers, potential to increase foreign sales, and relaxed need to apply for drawback.^{22,23}

The annual FTZ Board report to Congress publishes data on FTZs, including employment data. Figure 4 presents the total number of firms that use FTZs and the associated number of employees each year from 2011 through 2015. However, the number of jobs cannot be completely attributed to the existence of FTZs because it does not address whether

²⁰See GAO, *International Trade: Foreign Trade Zones Program Needs Clarified Criteria*, [GAO/NSIAD-89-85](#) (Washington, D.C.: Feb. 7, 1989); *Foreign Trade Zone Growth Primarily Benefits Users Who Import for Domestic Commerce*, [GAO/GGD-84-52](#) (Washington, D.C.: Mar. 2, 1984). In [GAO/GGD-84-52](#), we reported that FTZs' impact on U.S. employment is inconclusive, as FTZs do not necessarily increase employment if businesses operating in zones would still operate outside them.

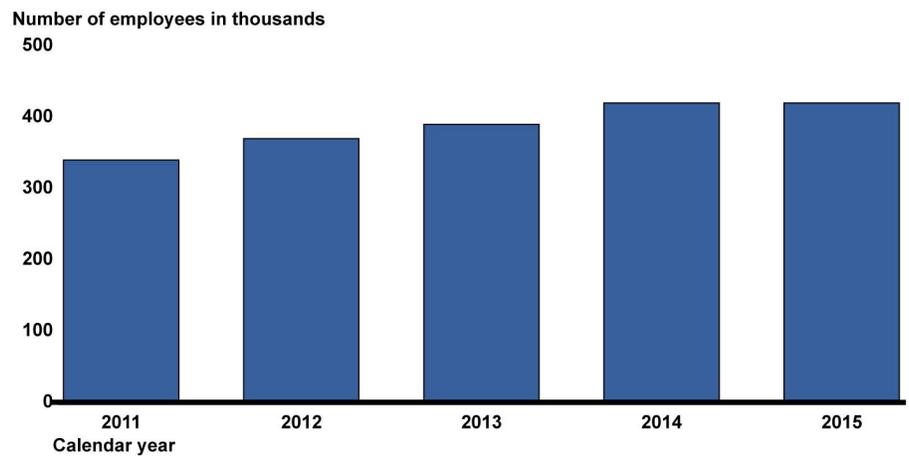
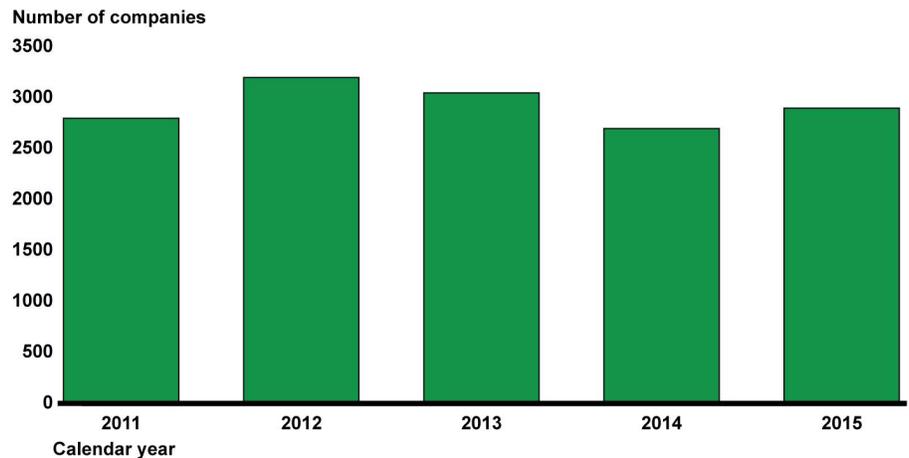
²¹Richard J. Smith, *U.S. Foreign Trade Zones as the Secret Lover: Is Uncle Sam Faithful to Tariff Elimination?* (Detroit, MI: Wayne State University, Social Work Faculty Publications, 2009).

²²Hokey Min and Thomas E. Lambert, *Utilisation of foreign trade zones in the global supply chain: an exploratory study* (Bowling Green, OH: Bowling Green State University: Management Faculty Publications, 2010).

²³Drawback is generally the refund of duties paid on imported articles. Such refunds are allowed upon the exportation or destruction of goods under CBP supervision.

the companies' hiring decisions would have taken place in the absence of the benefits provided by FTZ status.

Figure 5: Employment and Number of Companies Using Foreign Trade Zones, 2011-2015



Source: GAO analysis of Foreign Trade Zones Board data. | GAO-17-649

FTZ operators and representatives of the National Association of Foreign Trade Zones have attributed increased trade and employment to FTZs. For example, in 2016, an official with Hawaii's FTZ reported that FTZ benefits have increased the advantages for refineries to operate in the state. However, it did not provide data that the FTZ status was a deciding factor in the refineries' decisions to locate and continue operations in the state.

Recent Applications for FTZ Production Authority Revealed Disagreements among Industry Members on FTZs' Economic Impacts

Our analysis of the seven applications for FTZ production authority submitted from 2012 through 2016 revealed disagreements among industry members on the anticipated economic impacts of the proposed FTZ activities.²⁴ All seven applications—involving primarily the textiles and industry materials sectors—stated that FTZ manufacturing would have economic benefits and anticipated increases in employment ranging from 10 to 75 new jobs. However, our analysis found that these applications provided limited data to support their estimates of job creation. They also cited other economic benefits, including increases in domestic production, exports, and capital investment but provided limited supporting data.

These seven applications generated a total of 68 opposition letters and 58 support letters including from competitors, suppliers, trade associations, and other relevant entities. Opposition letters from domestic suppliers and competitors argued that the proposed FTZ manufacturing status would have negative, rather than positive, economic impacts. These opposition letters cited negative impact on employment and unfair advantage over domestic producers and suppliers, among other negative impacts. Support letters from industry members, trade associations, and local government representatives, among others, supported applicants' assessment of increased employment and benefits to suppliers, among other positive impacts.

²⁴These seven companies were among the 55 production notifications that the FTZ Board either denied or approved with restrictions between January 2012 and August 2016. These companies then completed a more detailed production application for the FTZ Board to review, with the aim of obtaining approval with little or no restrictions.

CBP's Methods for Collecting Compliance and Enforcement Information Impair Its Ability to Assess and Respond to Compliance Risks across the FTZ Program

CBP has not assessed compliance risk across the FTZ program, and its methods for collecting compliance and enforcement data impair its ability to assess and respond to program-wide risks. For example, while CBP regularly conducts compliance reviews of individual FTZ operators and considers the program to be low risk, it does not centrally compile compliance reviews and FTZ enforcement data to assess risk across the program. As a result, CBP has not reviewed compliance and enforcement information across the FTZ program to assess the frequency and significance of compliance risks and verify its assertion that the FTZ program is low risk. In addition, CBP has not taken steps to update its FTZ policies and procedures and develop best practices for FTZ compliance reviews in response to compliance risks that have been identified. According to federal internal control standards, management should obtain relevant data and assess and respond to identified risks associated with achieving agency goals. CBP assesses liquidated damages as its primary enforcement tool to bring FTZs into compliance, and CBP guidance allows for discretion in reducing the amounts assessed.

CBP Conducts Compliance Reviews of FTZ Operators to Identify Compliance Risks but Does Not Centrally Compile Compliance Reviews and FTZ Enforcement Data

CBP Conducts Compliance Reviews of FTZ Operators to Identify Risks

CBP conducts compliance reviews of individual FTZ operators to ensure compliance with U.S. customs laws, regulations, and CBP policies.²⁵ In

²⁵As stated earlier, FTZ operators are responsible for meeting CBP requirements for compliance within the zone. An FTZ operator is a corporation, partnership, or person that operates an FTZ under the terms of an agreement with the grantee and supervises FTZ activity and security. While FTZ operators may also be users that store, handle, process, or manufacture merchandise within a zone, we refer to FTZ operators in this report when discussing CBP's oversight of FTZs.

these reviews, CBP examines operators' records, procedures, and conditions to assess compliance with laws and regulations, such as by identifying the risk of fraud, duty evasion, or other violations that could result from noncompliance (compliance risk). These compliance reviews are managed at the field office level and conducted by CBP officers at the ports, who use the agency's *Compliance Review Handbook for Foreign Trade Zones* for guidance. The Compliance Review Handbook includes a standard checklist of questions meant to identify and assess risks such as the physical security of the FTZ merchandise and the appropriateness of systems and procedures for inventory management. CBP assigns a risk level to individual zone operators based on the results of the compliance reviews and other risk factors, and the Compliance Review Handbook directs officers to document the risk level associated with each compliance review. These assigned risk levels then determine the frequency of future compliance reviews. CBP guidance states that field office personnel should conduct compliance reviews of FTZ operators at a rate that is generally determined by the magnitude of problems found from previous reviews – at a minimum, every 2 years when no problems have been found, and at least twice a year if serious problems have been found, with exceptions possible at the discretion of the Port Director.²⁶

Enforcement actions taken based on violations found during the compliance review are also managed at the discretion of the Port Director. CBP officials said that their goal is to encourage compliance. According to CBP guidance, when there is reason to believe that minor problems can be corrected upon simple notification of the zone operator, the Port Director may issue a verbal warning or warning letter with the operator with no further penalty. Otherwise, the Port Director has discretion to take a corrective enforcement action commensurate with the seriousness of the violation. Enforcement actions can include liquidated damages, fines, and seizures. Liquidated damages are amounts of money that CBP assesses against FTZ operators following violations of the operator's bond, such as violations involving FTZ inventory control

²⁶The biennial compliance review requirement applies to general-purpose or nonmanufacturing subzones that are in full compliance with statutes and regulations governing zone operations. Manufacturing zones are subject to no less than one annual compliance review, although this number can be reduced at the discretion of the Port Director.

and recordkeeping systems.²⁷ In addition to these civil actions, CBP may also take actions, such as arrests, for violations of criminal law.²⁸

CBP officials conducting compliance reviews may request support from technical experts within the agency. For example, CBP officials stated that they may reach out to CBP's petroleum specialists when they encounter issues with tracking production at an oil refinery. CBP officials stated that they may also refer findings from compliance reviews to CBP's Regulatory Audit officials for more comprehensive audits that include thorough reviews of FTZ operators' inventory and financial records. Regulatory Audit officials told us that 44 audits have been conducted involving FTZs over the past 10 years and that 7 of these audits involved petroleum FTZs. These officials stated that the findings from the FTZ-focused audits typically involved deficiencies with FTZ operators' internal controls over their inventory systems. Regulatory Audit officials stated that audits involving FTZs have been initiated based on referrals from officers conducting compliance reviews, or from other sources, but FTZs have not been a specific focus of Regulatory Audit's planning.

CBP Does Not Centrally Compile Compliance Review Information

CBP does not centrally compile—centralize and standardize—information from its compliance reviews of individual FTZ operators. As a result, management cannot reliably obtain compliance review information in a timely manner for assessing FTZ risks and program controls, such as completion of all required compliance reviews. Instead of centrally compiling compliance review information, CBP requires Port Directors to maintain a file for each FTZ operator under their jurisdiction, which stores, among other things, various documents associated with the compliance

²⁷According to the FTZ Manual, liquidated damages are amounts of money that the FTZ operator agrees to pay for damages arising from a default by the FTZ operator on the terms of an FTZ operator's bond. FTZ operators are required to follow U.S. customs law and take out an operator's bond to guarantee payment of any damages to the U.S. government by a third party if the operator defaults on these payments. Liquidated damages generally cannot exceed the amount of the operator's bond.

²⁸When CBP finds potential criminal violations in FTZs, it can make referrals to U.S. Immigration and Customs Enforcement (ICE) Homeland Security Investigations (HSI). HSI officials stated that HSI then makes a determination about whether to follow-up on the referral and conduct an investigation based on the circumstances of each case. HSI officials stated that while the department has conducted investigations in FTZs, HSI's case management system does not specifically track investigations occurring in FTZs, and thus could not provide us the number of investigations it has conducted involving FTZs.

review.²⁹ CBP field offices that we visited employed varying practices for storing compliance reviews, from maintaining an updated spreadsheet containing the risk determination and compliance review documentation for each FTZ operator to maintaining paper and electronic files without centrally tracking compliance review results and status. CBP does not require compliance reviews to use a standardized template or format, such as the checklist in the Compliance Review Handbook, to summarize findings and risk level determinations.

In response to our request to examine all FTZ compliance reviews conducted over the period of fiscal years (FY) 2015-2016, CBP officials estimated that it would take more than 2,600 staff hours to assemble the full set of compliance reviews and warning letters associated with violations in this time period.³⁰ Because CBP could not provide us with copies of compliance reviews for all the FTZs in the program in a timely manner, we examined a generalizable random sample of compliance reviews during this time period from 174 FTZ operator sites.³¹ In conducting an analysis of this sample, we found that field offices managed and stored the compliance reviews in paper files at some locations and electronically at others. In addition, we found that the compliance review checklists appeared in at least eight different formats. The compliance review checklist questions were generally consistent, but the information was recorded in various ways, some with handwritten notes and others electronically.

CBP headquarters officials stated that they were aware that some ports and field offices had developed electronic systems for storing compliance reviews that would enable more efficient access to the results than paper files and handwritten notes. However, they said that they had not examined whether these systems could be scaled across the program or

²⁹These required documents include the application to establish the zone, lists of current employees, and information about the inventory control system used in the zone.

³⁰CBP officials told us that the estimated length of time needed to collect the compliance reviews varied across the field offices; some estimated fewer than 30 hours, while others estimated over 300 hours.

³¹As a result, our estimates have confidence intervals of plus or minus 8 percentage points or smaller with 95 percent confidence. We initially requested a sample of 193 FTZ sites, but determined that 19 of the 193 FTZ sites were out of scope because they were recently established and thus had not yet received a compliance review. Our effective final sample size was thus 174. Our estimates generalize this sample of 174 to the full population of 1,369 active FTZ sites.

whether other options existed for electronic storage of compliance reviews that would meet the needs of the FTZ program. According to federal internal control standards, management should obtain relevant data from reliable sources in a timely manner based on agency goals. With its current information management practices, however, CBP management cannot reliably obtain compliance review information in a timely manner for assessing FTZ risks and program controls.

CBP Collects Some FTZ Enforcement Information in a Database, but Systems Limitations Hinder Compilation across FTZs

While CBP collects some FTZ enforcement data in its SEACATS database, systems limitations impair CBP's ability to compile information on enforcement actions across the FTZ program. CBP officials stated that enforcement actions in FTZs other than warning letters and liquidated damages against FTZ bond-holders are rare, but we found that CBP cannot efficiently determine the total number or type of enforcement actions taken against FTZ operators to examine trends or to verify its assertions that such actions are in fact rare. According to CBP officials, there is no reliable way to determine which of the seizures and penalties recorded in SEACATS occurred in FTZs, although the limited information available suggests that the number of such actions is low.³² According to CBP officials, information about enforcement actions other than seizures, penalties, and liquidated damages is contained in the FTZ files managed by individual field offices and is not centrally compiled. We estimate that 7 percent of FTZ operators with compliance reviews in FY2015 and FY2016 have received at least one warning letter.

CBP centrally compiles FTZ liquidated damages data in SEACATS, but the data are not complete. CBP can retrieve FTZ liquidated damages data because officials can search SEACATS for a statute number specific to FTZ liquidated damages. These data show that CBP assessed 1,103 liquidated damages claims in FTZs from FY2006 through FY2015. The causes of these liquidated damages, however, were difficult to determine because of limitations in the way that data on liquidated damages is

³²In response to our request for information on enforcement actions in FTZs, CBP conducted a keyword search of notes in SEACATS to find enforcement actions related to FTZ violations, identifying one seizure during FY2012 to FY2016 and two penalties over the FY2014 to FY2015 time period. This search only identified seizures and penalties for which an officer had chosen to use the keyword "FTZ" in notes associated with the enforcement action, which is not a CBP requirement, according to officials. These numbers are therefore not a comprehensive record, according to these officials.

categorized in SEACATS. For example, CBP officials stated that SEACATS does not specify the type of violation, such as the operator missing information on FTZ inventory, that triggered a given liquidated damages claim. While CBP officials are able to enter notes into SEACATS, CBP officials stated that notes associated with liquidated damages claims are often incomplete and contain insufficient information without retrieving additional documentation.

According to CBP officials, CBP is upgrading SEACATS to modernize its capabilities, which will improve CBP's capacity to track more specific information on enforcement actions, including on FTZ liquidated damages. For example, CBP officials stated that the SEACATS modernization will allow CBP officers to classify the specific FTZ violations that led to assessments of liquidated damages. However, CBP officials stated that these changes to SEACATS will not enhance CBP's ability to identify seizures and other enforcement actions in FTZs, except insofar as the system improvements will require CBP officers to enter more detailed information in a standardized format. This format may provide more detail on the cause of enforcement actions and enhance CBP's ability to perform keyword searches for seizures and penalties in FTZs. CBP officials stated that data on enforcement actions other than seizures, penalties, and liquidated damages will remain in FTZ files stored at ports and field offices. CBP officials further stated that the SEACATS modernization is scheduled to be fully implemented in September 2017.

While CBP will have more data on liquidated damages from the improvements to SEACATS, and may have some additional information on seizures and penalties in FTZs, information on other enforcement actions will remain in FTZ files stored at ports and field offices along with compliance reviews. According to federal internal control standards, management should obtain relevant data from reliable sources in a timely manner based on agency goals. With its current information management policy, CBP management cannot reliably obtain enforcement information in a timely manner for assessing FTZ risks and program controls, such as completion of all required compliance reviews and associated documentation of enforcement actions.

CBP Has Not Assessed Compliance Risks across the FTZ Program or Updated Guidance to Respond to Identified Risks

CBP Has Not Conducted Program-wide Analysis of Compliance Review Results and FTZ Enforcement Actions

While CBP analyzes risks in individual FTZs as part of its compliance reviews, it has not conducted a program-wide risk analysis using available FTZ compliance and enforcement information. CBP officials told us that they generally consider FTZs' security and revenue risk to be low based on regular compliance reviews of individual FTZ operators and anecdotal evidence from field office personnel. CBP officials stated that these reviews had found relatively few problems and that they had not heard of many major issues, such as fraud, occurring in FTZs. They said that any major issues would be escalated up the chain of command upon discovery by CBP officers. They also noted that the rate at which liquidated damages occur in FTZs—an average of approximately 108 out of 41,000 entries per year from FY2011 to FY2015—is very low in comparison to the rate at which similar problems occur in trade outside of FTZs.

Most of the compliance reviews that we analyzed did not identify compliance problems, but many did not contain sufficient information to verify CBP's assertion that the program is low risk. Our analysis of the FY2015 and FY2016 compliance reviews for the FTZ operators in our generalizable sample showed that CBP found compliance problems for an estimated 15 percent of these operators. Problems identified in our sample of compliance reviews included receiving and storing unauthorized merchandise in the FTZ and missing required documentation for inventory in FTZs, among other issues. FY2015 and FY2016 compliance reviews for an estimated 80 percent of FTZ operators resulted in at least one low-risk determination and no evidence of being medium or high risk during this time period. Compliance reviews of an estimated 3 percent of FTZ operators resulted in at least one medium- or high-risk determination during this time period. Because of missing and incomplete information, however, CBP's risk determination was not clear for an estimated 16 percent of FTZ operators from these compliance reviews.³³ CBP also was not able to provide FY2015-FY2016 compliance

³³These numbers for risk level determinations add to 99 percent because of rounding.

review checklists for an estimated 34 percent of the FTZ operators.³⁴ Incomplete information on the compliance reviews may limit CBP's ability to determine the cause of compliance violations as well as reach conclusions about the overall program risk level. Further, for an estimated 36 percent of FTZ operators, FY2015-FY2016 compliance review documentation did not provide evidence of specific transactions reviewed, which may limit the validity of conclusions reached in the compliance reviews.

CBP officials said that they had not conducted a program-wide risk analysis of the FTZ program because it would be too time-consuming and costly based on how compliance review and enforcement information is currently collected and stored, and because of their assertion that the program has a low risk of noncompliance. CBP officials also stated that the agency had not studied trends in the frequency or cause of liquidated damages claims because they first developed the method for identifying FTZ-specific liquidated damages in response to our request for these data and have considered such an analysis a low priority. Without program-wide analyses of the frequency and significance of problems found during compliance reviews, risk levels determined, and enforcement actions taken, CBP cannot verify that the FTZ program is at a low risk of noncompliance or assess the effectiveness of its internal controls. Data systems improvements, such as the planned enhancements to SEACATS discussed earlier, may reduce the cost of such an analysis, and CBP could further reduce the cost by examining representative samples. According to federal internal control standards, agency managers should comprehensively identify risks and analyze them for their possible effects. Incorrect determinations about risk level may impact program effectiveness and revenue collection for the FTZ program, which accounted for 11 percent of U.S. imports in 2015.

CBP Has Not Updated FTZ Policies and Procedures in Response to Identified Compliance Risks

CBP last updated its *Compliance Review Handbook for Foreign Trade Zones* in 2008, and it has not updated the handbook to respond to compliance risks identified since then, although some ports have made improvements to their processes for conducting compliance reviews in the interval. CBP officials stated that the policies and guidance in the

³⁴Some of the FTZ operators in our sample received multiple compliance reviews.

handbook represent a minimum standard for conducting compliance reviews, but Port Directors have discretion to incorporate additional steps into their compliance reviews. CBP field office personnel we spoke with said that they had added questions or forms to their compliance review process in response to identified problems, and they provided some examples. Our analysis of the generalizable sample of compliance reviews also found that some ports had taken steps to improve their compliance review process. For example, we found that at least some compliance reviews for an estimated 28 percent of FTZ operators included a risk assessment tool that explained the basis for their risk determination, although CBP officials stated that this was not a requirement.

CBP officials stated that they were aware that some ports had developed additional questions and methods to respond to compliance risks; however, these officials said that they lacked the resources to support a working group to examine existing practices and improve the templates used by officers conducting the compliance reviews. These officials stated that they intend to update policies and procedures reflected in the handbook after they add FTZ-related features to ACE.³⁵ However, CBP officials have not reached out to field offices to identify best practices or improvements or provided interim guidance to ports and field offices prior to completing the transition to ACE and formally updating the handbook. According to federal internal control standards, management should respond to identified risks according to program objectives. In doing so, management should consider risk that remains despite its current risk management efforts and design responses appropriate for these residual risks. Because CBP has not made the evaluation of the compliance review process improvements and identification of best practices a priority, CBP may be missing opportunities to reduce compliance risk and lower compliance costs through improved tools and targeting.

³⁵CBP officials stated that they are currently in the process of incorporating FTZ-related processes and forms into ACE, including the form used to document quantity and value of goods admitted into FTZs.

Liquidated Damages Assessments Are CBP's Primary Enforcement Tool to Bring FTZs into Compliance, and CBP Guidance Allows for Discretion in Reducing the Amounts Assessed

CBP assesses FTZ liquidated damages as a primary enforcement tool to bring FTZ operators into compliance, and CBP guidance for assessing liquidated damages allows for discretion in mitigating (reducing) the amount of these assessments.³⁶ Our analysis of SEACATS data on enforcement actions found that liquidated damages assessments accounted for nearly all enforcement actions we and CBP identified.³⁷ CBP guidance states that assessments of liquidated damages against FTZ operators who are in breach of their bond contracts may be mitigated to a lower level if a petition for relief is submitted by the relevant FTZ operator. CBP provides additional guidance to staff for determining the appropriate mitigated amounts for liquidated damages, instructing officials to consider factors such as the frequency of the FTZ operator's past violations, remedial actions taken, and cooperation with agency officials. CBP's mitigation guidance also provides ranges for different types of violations.³⁸ CBP officials stated that if operators are making improvements as part of a mitigation decision, then the liquidated damages have served their function even if the initial amount was

³⁶Mitigation authority is also provided by law and regulation. See 19 U.S.C. § 1618 and 19 C.F.R. § 172.11.

³⁷Our analysis of enforcement actions does not include warning letters because, according to CBP officials, SEACATS does not collect this information. As discussed earlier, CBP identified one seizure during FY2012-2016 and two penalties during FY2014-FY2015. CBP made 140 liquidated damages claims during FY2014-2015. As discussed earlier, because of limitations in SEACATS, CBP may not have identified all FTZ seizures and penalties.

³⁸For example, the guidance states that, if the breach resulted from negligence and there were potentially uncollected duties, fees, and taxes, the mitigated amount for liquidated damages should be set at between one and three times the estimated value of uncollected duties and fees for nonrestricted merchandise and between three and five times the estimated value of uncollected duties and fees for restricted merchandise (or 10 percent of the value of this merchandise, if greater). This may represent a significant decrease from the initial assessed liquidated damages.

mitigated to an amount lower than the range provided in mitigation guidelines.³⁹

We analyzed data on the 1,103 liquidated damages claims made from FY2006 through FY2015 and found that nearly all FTZ operators who were assessed claims for liquidated damages submitted a petition for relief of the liquidated damages, resulting in significant reductions in the original assessed amount (see table 4). CBP assessed approximately \$100 million in liquidated damages claims from FTZ operators from FY2006 to FY2015. CBP officials mitigated approximately 97.5 percent of the liquidated damages claims over this period, resulting in a final total liquidated collection amount of approximately \$2.8 million, representing 2.9 percent of the original assessed amount.

Table 4: Liquidated Damages Claims Assessed by U.S. Customs and Border Protection on Foreign Trade Zone Operators Compared to Mitigated Amounts, Fiscal Years 2006-2015

Fiscal year	Total violations recorded	Liquidated damages as assessed	Liquidated damages as mitigated	Mitigation ratio
2006	92	6,670,967	284,102	4.7
2007	152	5,089,685	165,624	3.3
2008	115	6,858,170	44,910	0.7
2009	121	4,684,216	30,701	0.7
2010	84	12,689,901	110,085	0.9
2011	85	25,675,088	222,992	0.9
2012	127	5,960,772	181,980	3.1
2013	187	23,877,471	1,540,509	6.5
2014	61	3,739,536	122,004	3.3
2015	79	4,193,578	141,991	3.4
Total	1103	99,439,384	2,844,898	2.9

Source: GAO analysis of U.S. Customs and Border Protection data. | GAO-17-649

CBP officials stated that variation in the extent that liquidated damages are mitigated over time might be attributable to variation in the types of cases different ports see, such as unusually large cases, or other factors. In addition, these officials said that they are aware that some CBP

³⁹CBP officials said that judgment can be applied in unusual circumstances and that actual mitigation decisions may deviate from the guidance, although such deviations require the permission of OFO headquarters staff.

officials are consistently reducing liquidated damages to the minimum of the ranges in the guidance while others may mitigate to higher levels. These officials said that, for example, some ports may be overwhelmed with cases and want to clear them by mitigating to the bottom of the range to avoid appeals. CBP officials stated that they have not reviewed or analyzed liquidated damages decisions across the FTZ program, as their focus is on reviewing FTZ liquidated damages decisions on a case-by-case basis to ensure that the mitigations are consistent with CBP policy. These officials also stated that CBP conducts periodic site surveys,⁴⁰ which are intended to review penalties, liquidated damages and forfeiture procedures pertaining to seizure cases. According to CBP officials, while these site surveys are not specific to FTZ violations, they cover FTZ liquidated damages cases to ensure compliance with laws, regulations, and mitigation guidelines. These officials also noted that they are aware the mitigation guidance is out of date and CBP is in the process of updating the mitigation guidelines.

Conclusions

Officials from CBP field offices conduct regular compliance reviews of individual FTZ operators and take a range of enforcement actions based on the violations found. Because of CBP's information management practices, however, CBP officials cannot store and access compliance reviews in a manner that would allow program officials to reliably obtain compliance review and enforcement information in a timely manner for assessing FTZ risks and program controls. Although CBP officials believe that FTZs represent low risk based on individual compliance reviews, CBP has not conducted a systematic risk assessment of the FTZ program to confirm that this is the case. Without a program-wide assessment of the frequency and significance of problems identified during compliance reviews, risk levels determined, and enforcement actions taken, CBP does not have reasonable assurance that the FTZ program is at low risk of noncompliance.

Some CBP field offices and ports have developed innovations for their compliance review processes, such as additional questions and methods to respond to compliance risks. However, CBP has not taken steps to update and improve its compliance review tools and procedures based on

⁴⁰According to CBP, it has completed at least 4 site surveys per fiscal year and has conducted a total of 34 site surveys as of May 2017.

risk reviews, enforcement actions against noncompliant FTZ operators, or innovations by field office staff. As a result, the program may be missing opportunities to mitigate compliance risk and reduce compliance costs through improved tools and targeting.

Recommendations for Executive Action

To strengthen CBP's ability to assess and respond to compliance risks across the FTZ program, we recommend that the Commissioner of CBP take the following three actions:

1. Centrally compile information from FTZ compliance reviews and associated enforcement actions so that standardized data are available for assessing compliance and internal control risks across the FTZ program.
2. Conduct a risk analysis of the FTZ program using data across FTZs, including an analysis of the likelihood and significance of compliance violations and enforcement actions.
3. Utilize the results of the program-wide risk analysis to respond to identified risks, such as updating risk assessment tools and developing best practices for CBP's FTZ compliance review and risk categorization system.

Agency Comments and Our Evaluation

We provided a draft of this report for comments to CBP and Commerce. We received written comments from CBP, which are reproduced in full in appendix II. In its comments, CBP concurred with our recommendations and identified actions it intends to take in response to the recommendations. In response to our first recommendation, CBP indicated that it intends to prepare and disseminate a summary template for compiling FTZ compliance reviews and internal control risks across the FTZ program. In response to our second recommendation, CBP indicated that it will conduct a risk analysis across the FTZ program. In response to our third recommendation, CBP responded that it will finalize a compliance review handbook for ACE that incorporated risk assessment tools and best practices for FTZ compliance review and risk categorization. CBP and Commerce also provided technical comments, which we incorporated in the report, as appropriate.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional members, the Acting Commissioner of CBP, the Secretary of Commerce, and other interested parties. In addition, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-8612 or gianopoulosk@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink that reads "Kimberly M. Gianopoulos". The signature is written in a cursive style with a large initial 'K' and 'G'.

Kimberly M. Gianopoulos
Director, International Affairs and Trade

Appendix I: Objectives, Scope, and Methodology

Our objectives were to examine (1) the benefits that the Foreign Trade Zones (FTZ) program provides to companies operating FTZs and revenues that U.S. Customs and Border Protection (CBP) has collected from FTZs, (2) what is known about the economic impact of FTZs on the U.S. and local economies, and (3) CBP's ability to assess and respond to compliance risks across the FTZ program.

To examine the benefits that the FTZ program provides to companies operating FTZs and revenues that CBP has collected from FTZs, we analyzed and reported on aggregate, national-level data on goods admitted into FTZs and goods entered into U.S. commerce from FTZs. In addition, we reviewed documents from CBP headquarters and field offices and the Foreign-Trade Zones Board and interviewed CBP and FTZ Board officials. We selected five FTZs in Maryland, Texas, and Virginia for site visits based on factors including trade volume, industry sector, and FTZ activity. At these sites, we interviewed representatives of FTZ operators engaged in warehousing and manufacturing in the vehicle, oil refinery, consumer electronics, and other industries. We also characterized the types of benefits that FTZ operators received by providing illustrative examples and calculations of associated savings at the operator level, using financial and testimonial evidence obtained through interviews with FTZ operators and CBP officials and reviewing CBP data and industry publications. For example, we conducted illustrative calculations of duty and cash-flow savings using duty rates on select component and final products, annual financial data provided by FTZs to the FTZ Board, and cost-of-capital figures published by the New York University Stern School of Business.

To identify trends in total government revenue collected from FTZs, including from user fees, we obtained and analyzed CBP data from the Automated Commercial Environment (ACE) for fiscal years 2007 to 2016 on total customs duties, Merchandise Processing Fee (MPF), and Harbor Maintenance Fee (HMF) collections from FTZs. We compared revenues and fees collected from FTZs to revenues and fees collected on total U.S. imports using Office of Management and Budget data from fiscal years 2007 to 2016 on duties collected on total U.S. imports, CBP data from

annual budget requests on total MPF payments on total U.S. imports, and Department of the Treasury data on HMF payments on total U.S. imports. To assess the reliability of the ACE data, we held a series of meetings with CBP ACE specialists to define and refine our requests for relevant data to request from the system and to assess their reliability checks and testing of the system. We also reviewed relevant instructions and data dictionaries on the data and the system that produced them. We performed electronic testing by pairing these datasets and conducting statistical tests on portions of the data with missing information to determine that the missing data are random with respect to variables of interest. We found the ACE data to be generally reliable for the purposes of our analysis.

To examine what is known about the economic impact of FTZs on the U.S. and local economies, we reviewed economic studies on FTZs published since 1990. We reviewed the studies primarily to obtain information on the range of effects on the economy, different methods and assumptions used, and insights gained from these efforts. We identified these studies through a literature search and discussions with representatives from CBP, the Foreign-Trade Zones Board, and the National Association of Foreign Trade Zones. We also reviewed and analyzed economic information found in FTZ production applications prepared by companies seeking FTZ Board approval for production authority, which allowed us to illustrate FTZs' anticipated economic impacts at regional and local levels. We reviewed FTZ production applications since 2012, when the current regulations for FTZ production applications were adopted.¹ We also interviewed officials from CBP, the FTZ Board, and the National Association of Foreign Trade Zones.

To examine CBP's ability to assess and respond to risk across the FTZ program, we reviewed and compared information on CBP's oversight processes and enforcement actions against CBP requirements and federal internal control standards.² We examined a generalizable random sample of compliance reviews from 174 FTZ sites out a population of 1,369 FTZ sites, from fiscal years 2015 through 2016 to determine whether control deficiencies exist in CBP's monitoring and oversight processes. We initially requested a sample of 193 FTZ sites, but

¹77 Fed. Reg. 12,112 (Feb. 28, 2012).

²GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

determined that 19 of the 193 FTZ sites were out of scope because they were recently established and thus had not yet received a compliance review. Our effective final sample size was thus 174. Our estimates generalize this sample of 174 to the full population of 1,369 active FTZ sites. As a result, our estimates have confidence intervals of plus or minus 8 percentage points or smaller with 95 percent confidence. Our estimates reflect documentation or compliance problems found in any of the compliance reviews for a given operator over this time period unless noted otherwise. We also examined data on FTZ enforcement actions and compared the results of these actions against criteria for when and how enforcement actions are to occur. We examined data on liquidated damages, liquidated damages mitigations, and CBP officer notes at the case file level in CBP's Seized Assets and Case Tracking System (SEACATS). To do so, we consolidated and matched data from multiple tables within this system, consolidating information as necessary to examine at the case file level. To assess the reliability of the SEACATS data, we conducted electronic testing of required data elements to determine inconsistencies in the data; reviewed the data dictionary and associated documentation about the data and the system that produced them; and interviewed CBP officials knowledgeable about the data system. We also consolidated SEACATS tables into a single analysis file for reporting estimates on liquidated damages in FTZs. We found the SEACATS data to be generally reliable for the purposes of our analysis. We also examined warning letters and other enforcement-related information that we requested from CBP from the same FTZ operators included in our compliance review sample. We also interviewed CBP and Department of Homeland Security officials and FTZ representatives.

Appendix II: Comments from the Department of Homeland Security

U.S. Department of Homeland Security
Washington, DC 20528



**Homeland
Security**

July 13, 2017

Kimberly M. Gianopoulos
Director, International Affairs and Trade
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Re: Management's Response to Draft Report GAO-17-649, "FOREIGN TRADE ZONES:
CBP Should Strengthen Its Ability to Assess and Respond to Compliance Risks across the
Program"

Dear Ms. Gianopoulos:

Thank you for the opportunity to review and comment on this draft report. The U.S. Department of Homeland Security (DHS) appreciates the U.S. Government Accountability Office's (GAO) work in planning and conducting its review and issuing this report.

The Department is pleased to note GAO's positive recognition that U.S. Customs and Border Protection's (CBP) regularly conducted compliance oversight reviews of the 276 active Foreign Trade Zones (FTZ) across the country. For example, CBP's Office of Field Operations (OFO), which collects duties, taxes, and fees related to the FTZs, has successfully increased total duties collected by 163 percent during the past ten years. CBP's OFO is also currently collaborating with the trade community represented by the National Association of Foreign Trade Zones to build an enhanced FTZ online electronic admission system into the Automated Commercial Environment (ACE) to better meet the needs of the business community. This improved capability is scheduled for deployment by August 30, 2017.

The draft report contained three recommendations with which the Department concurs. Attached find our detailed response to each recommendation.

Again, thank you for the opportunity to review and comment on this draft report. Technical comments were previously provided under separate cover. Please feel free to contact me if you have any questions. We look forward to working with you again in the future.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim H. Crumpacker".

JIM H. CRUMPACKER, CIA, CFE
Director
Departmental GAO-OIG Liaison Office

Attachment

**Attachment: DHS Management Response to Recommendations
Contained in GAO-17-649**

GAO recommended that the Commissioner of Customs and Border Protection:

Recommendation 1: Centrally compile information from FTZ compliance reviews and associated enforcement actions so that standardized data are available for assessing compliance and internal control risks across the FTZ program.

Response: Concur. CBP's OFO will identify requirements and costs to build a manual process to be used for all compliance reviews and internal control risks across the FTZ program. Once the manual process is finalized, OFO will prepare and disseminate an interim compliance review results summary template and memorandum requiring personnel to utilize the interim collection process for all compliance reviews. Estimated Completion Date (ECD): October 31, 2017.

Recommendation 2: Conduct a risk analysis of the FTZ program using data across FTZs, including an analysis of the likelihood and significance of compliance violations and enforcement actions.

Response: Concur. OFO will collect data to conduct the risk analysis across the FTZ program. Estimated interim milestones are:

- October 1, 2018: Data will be available for analysis across the FTZ program.
- December 31, 2018: OFO will complete preliminary work on the risk analysis.
- February 28, 2019: OFO will complete the risk analysis using the first full year of fiscal data across the FTZ.

The overall ECD is March 31, 2019.

Recommendation 3: Utilize the results of the program-wide risk analysis to respond to identified risks, such as updating risk assessment tools and developing best practices for CBP's FTZ compliance review and risk categorization system.

Response: Concur. OFO will draft and finalize a compliance review handbook for ACE that incorporates the updated risk assessment tools and best practices for FTZ compliance review and risk categorization. Estimated interim milestones are:

- October 31, 2017: OFO will provide interim guidance in the form of memos and musters to field personnel until the handbook is finalized.
- April 30, 2018: Conduct a formal review of the FTZ compliance review handbook to coincide with the ACE updates.
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- December 31, 2018: OFO will use the results of the program-wide risk analysis to update and modernize risk assessment tools as part of the update to the handbook.

The overall ECD is September 30, 2019.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Kimberly M. Gianopoulos, (202) 512-8612 or gianopoulosk@gao.gov

Staff Acknowledgments

In addition to the contact named above, Christine Broderick (Assistant Director), Jeremy Latimer (Analyst-in-Charge), Sada Aksartova, Pedro Almoguera, Debbie Chung, Neil Doherty, Andrew Kurtzman, Jill Lacey, Grace Lui, Susan Murphy, and David Wishard made key contributions to this report.

Appendix IV: Accessible Data

Data Tables

Accessible Data for Figure 3: Illustration of Savings to Foreign Trade Zone Operators by Lowering Duties on Foreign Status Components

The duty rate to import foreign-sourced microcrystalline cellulose is 5.2 percent. However, a company can use it to manufacture a final product such as dietary supplement capsules in a foreign trade zone and import the capsules into U.S. commerce with a duty rate of 0 percent.

If 50 percent of each capsule is foreign-sourced microcrystalline cellulose, and if the company imports \$1.5 million worth of capsules per week, it can save \$39,000 per week in duty payments—about \$2 million per year.

Source: GAO analysis of U.S. International Trade Commission tariff data and foreign trade zone data. GAO-17-649

Accessible Data for Figure 4: Potential Cost Savings of Deferring Duty Payments in Foreign Trade Zones for Selected Industries

Number of months spent in foreign trade zones	Percentage: Autos and trucks	Percentage: Electronics (general)	Percentage: Auto parts	Percentage: Oil and gas production
"0"	0	0	0	0
"3"	1	1.7	1.8	2
"6"	2.1	3.4	3.7	4.1
"9"	3.2	5.1	5.5	6.2
"12"	4.2	6.9	7.5	8.3
"15"	5.3	8.6	9.4	10.5

Accessible Data for Figure 5: Employment and Number of Companies Using Foreign Trade Zones, 2011-2015

	Employees	Companies
2011	340000	2800
2012	370000	3200
2013	390000	3050
2014	420000	2700
2015	420000	2900

Agency Comment Letter

Accessible Text for Appendix II: Comments from the Department of Homeland Security

Page 1

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Washington, DC 20528

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Director, International Affairs and Trade

U.S. Government Accountability Office

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Director

Departmental GAO-OIG Liaison Office

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Page 2

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