



PREPARING AN FTZ PROJECT FEASIBILITY ANALYSIS

An Essay and Commentary

By

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There are two prudent things to do before one sets out to pursue any particular task. The first is to determine whether or not the particular task can be successfully done; the second is to determine whether or not the particular task is worth doing. Preparing an FTZ Project Feasibility Analysis is important for any community in determining whether it can -- or should -- establish a Foreign-Trade Zone project.

The U.S. Foreign-Trade Zones program has grown phenomenally over the past 21 years. There were 38 Zone projects in 1978. Today there are 238 Zone projects. Clearly, some Zone projects have been more successful than others. In many cases, this is because certain companies in certain locales have found themselves with tariff problems that can best be solved through the use of Foreign-Trade Zone procedures. In some cases, the success, or lack of success, of certain Zone projects has been determined by the amount and quality of homework done before the Zone project was initiated.

Once upon a time, there was an economic development group who called upon a consulting group to help it prepare an application to establish a Zone project.

"We want to hire you to prepare our FTZ application," said the economic development staff person to the consultants.

"Why do you want a Zone project?" asked one of the consultants.

"We want it as an economic development tool," replied the economic development staff person.

"Not good enough," responded the consultant. "Why do you really want a Zone project? What, or who, is driving you to go to the trouble and expense of hiring us to prepare an FTZ application? Please -- tell us the real motivation."

"Well," said the economic development staff person, "Our organization's current president and the incoming president want to leave the Foreign-Trade Zone as their legacy to the community."



"Fine," replied the consultant. "Do they want this legacy to be regarded as a success -- or a failure?"

"Oh," said the economic developer soberly. "I'm not sure that's been considered."

"May I make a suggestion?" asked the consultant. "Do a feasibility study. Then, whether or not you choose to establish a Zone project, and whether or not that project is regarded as successful, at least you will have asked yourselves the right questions. That way you can increase your chances of doing the right thing, and can justify whatever you decide to do."

Today that Zone project helped attract more than \$300 million in new investment to that community, in addition to enhancing the competitiveness of local businesses engaged in international trade.

So, what are the questions that need to be asked when evaluating the decision to establish a Zone project? They fall into four areas of inquiry: market feasibility, regulatory feasibility, economic feasibility, and finally, the evaluation of realistic options for seeing that the U.S. Foreign-Trade Zones program is available to local companies who need it.

I. Market Feasibility

In order to evaluate the market feasibility for a potential Zone project, one fundamental question must be answered: Does the need for Foreign-Trade Zone status exist?

Note the key word of the question -- "need." Often, people engaged in marketing the Foreign-Trade Zones program use terms like "benefits," or even "advantages." One should keep in mind that the "benefits" of FTZ status are not unlike the benefits of certain medicines, that is, they provide relief from an existing malady. In the case of FTZ status, the malady is suppressed profit margin due to tariff costs. Use of Zone procedures can sometimes provide the only relief from certain kinds of tariff problems (and sometimes do so with certain costs and side effects).

A wise man once said, "FTZ services are always bought, they are never sold." This advice should be kept in mind from the very outset, that is, during the evaluation of market feasibility.

The first task in evaluating market feasibility is canvassing the local or regional business community in order to find out which companies may have tariff problems for which the Foreign-Trade Zones program might represent a viable solution.



There are several questions which should be answered as a result of each company visit:
What kinds of operations does the company conduct? (... Manufacturing, distribution.)
If the company manufactures, does the company (or alternatively, one or more of its domestic suppliers) import parts or raw materials?

If the company manufactures, what is the duty rate relationship between imported parts and finished products?

Does the company re-export?

Who represents the company's main competition? ...Other U.S.-based companies? ... Foreign-based companies? ... The local plant's foreign-based sister plants?

Is the company located in an industrial or commercial park setting, or is it relatively isolated from other companies which might use the FTZ program?

The answers to these questions will help you determine not only the viability of establishing a Zone project, but it's shape and character as well. If most of the companies who are identified as having tariff problems are distribution operations, then geography may become more important. This is because these firms can be better served in a general purpose zone environment. If these firms are scattered about the community or region, then a multi-site general purpose zone will have to be considered. (This in turn may create some concern on the part of the Foreign-Trade Zones Board, because the Board would prefer not to designate a single-firm site as a general purpose zone site.)

If most distribution operations are within one or more industrial or commercial park areas, then geographical considerations are less sticky. Manufacturing operations can be scattered with little effect on the physical boundaries of the general purpose zone. This is because all manufacturing or processing activity conducted under Foreign-Trade Zone procedures must have the prior approval of the Foreign-Trade Zones Board. Thus, whether a company who wants to manufacture using Zone procedures is within a general purpose zone or not, an application will have to be submitted to and approved by the Foreign-Trade Zones Board. If the company is located within the general purpose zone, the application will be for FTZ manufacturing or processing authority. Otherwise, the application will be for Subzone status on behalf of the company.

If the company (or one of its domestic suppliers) does not import, then there is no tariff problem to be solved. (It should be noted that domestic merchandise held in a zone for export, as well as foreign merchandise held in a zone, is exempt from state and local



inventory taxes. However, the merchandise must be in the zone for a bona fide customs purpose. This will be difficult to demonstrate if the company does not import.)

If the company does import and appears to have a tariff problem, then further inquiries must be made.

The first of these is whether or not other U.S.-based companies in the same industry are already utilizing the FTZ program. If the company refines oil, manufactures autos or auto parts, or manufactures pharmaceutical products, then the answer will be "Yes." Find out if this is the case. If so, find out how these companies are utilizing the FTZ program. (For example, if a prospective zone user is a ship builder, you will need to know that the Foreign-Trade Zones Board does not allow certain zone "benefits" for certain steel mill products used in shipbuilding.) In this way, you can properly ascertain the viability of the FTZ program as a potential solution to the company's tariff problem.

If the company has other domestic competitors and none utilize the FTZ program, find out why. It may be that the industry has yet to discover the FTZ program; it may be that the industry's use of the FTZ program would be deemed inconsistent with U.S. trade policy. The answer to this question may be important to your overall evaluation.

The answers to these questions, along with the answers to questions concerning duty rate relationships, re-exports, material lost as production waste, and so-on, will help you assess the real viability of each company's use of the FTZ program.

If no real need for the FTZ program already exists within your community, then pursuing the establishment of a Zone project may result in little more than a piece of paper, nicely framed, hanging on a wall. If, however, a need does exist, then the regulatory and economic feasibility of establishing a Zone project should be evaluated. This will enable you to evaluate the best realistic option for providing access to the Foreign-Trade Zones program for companies who need it.

II. Regulatory Feasibility

With over 230 Zone projects already established in the United States, this set of questions has recently become stickier. However, before coming to the sticky bit, a couple of simple questions should first be answered.

1. Are the prospective general purpose zone sites in or adjacent to a Custom port of entry?



If there is a local customs office in your community (as either a port of entry, or a user fee airport), then the answer will be "Yes." If not, then you have a bit of homework to do.

First, find out where the nearest port of entry is. Find out its boundaries. (First, look in Section 101 of CFR 19, Title 19 of the Code of Federal Regulations, and find a complete list of U.S. Customs ports of entry. The boundaries of some ports are referenced in various Treasury Decisions. Find the Treasury Decision pertaining to your nearest port of entry, and you will see its boundaries defined.) Next, find out if your prospective sites meet the adjacency requirements. If the prospective general purpose zone sites are within the port boundaries, then the answer is "Yes." If not, you must determine whether the sites are "adjacent" to the port boundaries. The Foreign-Trade Zones Board regulations as set forth in 15 CFR, Section 400.21, define adjacency as within 60 statute miles or 90 minutes driving time of the outermost limits of a port of entry. If you have any doubts about this, coordinate a joint measurement with the Customs port officials. If the results are affirmative, get the Customs Port Director to confirm it in writing before you begin to prepare your application. Much grief has been avoided by those who have done so.

Second, find out whether or not a Zone project has already been established in or adjacent to the nearest port of entry. The Customs officials at the port should be aware if there has been. If not, then you're in luck because, as set forth in 15 CFR, Section 400.21, each port of entry is entitled to a Zone project. If so, you may have a relatively easy -- or tough -- row to hoe. This is because (according to 15 CFR, Section 400.21) additional Zone projects may be established within a single port of entry if the existing Zone project will not adequately serve the convenience of commerce. You will find no definition of the "convenience of commerce" in the regulations. Yet, in order to be granted an additional Zone project, the burden of proof that the original Zone project cannot serve the convenience of commerce is on you. Often, the opinion of the Grantee of the original Zone project is an important factor in the Board's assessment of this question. Therefore, whether you like it or not, find out what the existing Grantee's opinion of your establishment of a Zone project is likely to be. Talk to the existing Grantee. Find out what the goals and objectives of its project are. They may be consonant with your own; thus providing you with an ally rather than a foe. In any event, find out what response you're likely to trigger if you apply for FTZ status.

2. Is your organization qualified to serve as a Zone Grantee under state enabling legislation?

Each state has enacted legislation concerning the establishment of Foreign-Trade Zone projects. Contact your state government (the Secretary of State or Clerk of the Legislature is a good place to start) and get a copy of the latest state enabling legislation. Note that



some states have amended their legislation concerning the establishment of FTZ projects. Be sure you have a copy of the law which is currently in effect.

The state enabling legislation should indicate any special qualifications, if they exist, regarding the nature of organizations which are eligible to serve as Zone Grantees.

III. Economic Feasibility

Evaluating the economic feasibility of a potential Zone project involves a number of issues. These include questions relating to the nature of services the Zone will render (a question that is an outgrowth of the goals the Zone project seeks to achieve); the costs of establishing a Zone project; the costs of providing Zone services; and the means by which these costs will be covered or recovered.

The nature of services the Zone will render will depend upon the reason for its establishment. The reason, or reasons, for establishing a Zone project fall generally into one or more of the following categories:

- Trade and economic development
- Industrial park or real estate development
- Cargo handling or warehousing business development

If trade and economic development is the primary goal of the Zone project, then services rendered will be of an administrative or consulting nature. Expertise in international trade, distribution and manufacturing functions, and U.S. trade policy will be necessary to provide adequate services to FTZ users. The aim of such services will be to enable businesses within the Zone project's service area to utilize the Foreign-Trade Zones program effectively and efficiently. If the Zone project is to be financially self sufficient, the users will be charged ongoing user fees for these services.

If industrial park or real estate development is the primary goal of the Zone project, then services rendered will be more involved with the development of the physical infrastructure necessary to enhance the flow of product to and from companies' facilities. Nevertheless, effective, efficient access to the Zones program remains a service that cannot be overlooked. Some Grantees roll Zone fees into other costs of facilities purchase or use. In these cases the Grantee must make sure that the Zones program is a viable solution for the Zone resident, especially if that company is paying a premium to locate within the Zone. Therefore, knowledge of international trade, distribution and manufacturing functions, and U.S. trade policy remain requisites for providing quality service.



If cargo handling and warehousing is the primary goal of the Zone project, then services rendered will involve storage, handling, inventory control, and other logistical services. Users will no doubt already be aware of the specific tariff problems they want the Zone to solve. Therefore, knowledge of logistics and Customs compliance will be necessary ingredients to success.

If the goals of the Zone project encompass more than one of the areas discussed above, then great care must be taken that the achievement of one set of goals does not impinge upon the Grantee's ability to achieve others. Many a Zone project has been rendered lame by engaging in exclusive operator agreements with parties unqualified to perform certain kinds of services.

Regardless of the services to be rendered or the goals to be achieved, one fundamental question must be answered: From where is the money going to come? Many Grantees are surprised to find that finding the money for establishing the Zone project turns out to be the easy part. The hard part comes with funding the Zone project on a continuous basis. In more than one instance, businesses within the international trade community who have provided the initial impetus for the Zone project's establishment have never actually utilized Zone procedures.

In developing a schedule of user fees, both sources and uses of funds must be analyzed. Who is going to provide what services on an ongoing basis? What will the user base be? How long will it take to establish that base? From where will operational funding come in the meantime? How will fees be established in a fair way which meets public utility principles? All of these questions should be well on their way to being answered before proceeding. Otherwise, the Zone Grant may turn out to be a piece of paper hanging on the wall, and the Zone project may be hung with the label "boondoggle."

IV. Implementing Realistic Options

Successfully implementing realistic options for providing access to the Zones program involves the correct analysis of the needs of the business community, the objective evaluation of the resources of the prospective Grantee organization, and the wisdom and gumption to act upon these.

For almost any prospective Grantee, there are basically two choices: establish a local Zone project, or allow area businesses that need the FTZ program to use another Zone project within the state.

The answer to this question involves geography, economics, and finance.



Geography comes into play in two ways. First, is whether or not it necessitates the establishment of a local Zone project as a second Zone project for a given port of entry. If so, the Grantee of the existing Zone project may have a lot to say about whether or not such an effort may be successful. Second, the establishment of one or more general purpose zone sites is often dictated by the geographical concentration of firms needing FTZ status and the nature of their particular operations. If potential users are concentrated in one or more industrial park areas, and if they are engaged in activities not involving manufacturing or processing, then clearly, the establishment of the area or areas as general purpose zone sites represents the best solution. If the various firms are engaged in manufacturing or processing, or are scattered about geographically, then the establishment of each as a Subzone may represent the best solution.

One should note that there have been some instances where the proliferation of separate Zone projects has served to create multiple Zone projects, each of which is financially weak. This is a poor alternative to multiple communities enjoying first class service from a single, financially able Zone Grantee.

Some communities have had sites within their community designated as general purpose zone sites of a Zone project already operating in another community. Others have formed multi-entity Grantee organizations. If this sounds appealing, a note of caution is in order. Multi-community Zone projects that have operated successfully have done so because of strict adherence to public utility principles: that is, Zone users have enjoyed the same access to the FTZ program regardless of their location. Before joining another community's Zone project, make sure that Zone services will be available just as readily for the Acme Widget plant in your community as they will be for the Acme Widget plant located in the hometown of the existing Grantee. If not, then strong consideration should be given to forming your own Zone project.

In any case, talk to your local businesses. Find out if they really need the FTZ program to enhance their competitiveness. Find out if they're willing to put their money where their mouth's are. Talk to other Grantees in you state and region. Find out how successful they've been. Learn from their successes as well as their mistakes.

Crunch the numbers. Don't expect any area businesses to use the Zone unless they find it to their economic advantage. Make them understand that you don't intend to establish a Zone project that doesn't eventually support itself.



Ask yourself the really hard questions, such as "Why to we really want a Zone project? Do we really need a Zone project? What are the real goals of Zone project? How will the project be operated and financed in a way to meet those goals?"

If you decide to go ahead, keep in mind that nobody gets it quite right from the beginning. Almost every successful Zone project goes through trials and tribulations, and, as evidenced by the number of Zone projects that have been expanded over the years, growing pains.

If you decide not to go ahead, keep in mind that you can still provide a valuable service to area businesses by putting them in contact with the Grantee of the nearest Zone project within the state. Even if they become Subzone of a Zone project in another community, your community still gains many of the benefits that result from the company's enhanced economic activity. Remember that in the Foreign-Trade Zones program, the competition is overseas.

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