

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

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BANK

Changes Needed In U.S. Valuation System For Imported Merchandise

The present U.S. valuation standards are confusing to importers and administratively expensive for the Customs Service. Changes simplifying the U.S. valuation system have been considered in the current round of multilateral trade negotiations and will be part of the trade agreements proposed to the Congress. Information on the issues discussed in this report should be useful to the Congress and the oversight committees in their consideration of the agreements.

The trade agreements would substantially resolve U.S. valuation problems. On the other hand, if the trade agreements are not enacted into law, GAO recommends that the Congress revise the U.S. system by amending the Tariff Act of 1930.



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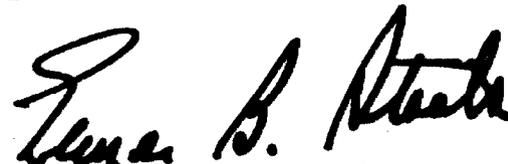
To the President of the Senate and the
Speaker of the House of Representatives

This report describes the operational problems and costs associated with the administration of the U.S. valuation system for imported merchandise and discusses alternatives to the present valuation system.

On September 16, 1977, we made limited distribution of this report to the Chairman, Senate Committee on Finance; the Chairman, House Committee on Ways and Means; and the Special Representative for Trade Negotiations for their use in consideration of changes to the U.S. valuation system or the adoption of a uniform valuation system which was a topic of discussion during the Tokyo Round of multilateral trade negotiations.

On January 4, 1979, the President notified you that the multilateral trade negotiations are within sight of successful conclusion and will involve several international agreements dealing with nontariff matters. One of the agreements will encourage more uniform methods of appraising imports for the purpose of applying duties. We believe the report will be helpful in your consideration of the proposed trade agreements.

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of the Treasury; and the Commissioner, U.S. Customs Service.


Comptroller General
of the United States





COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

B-114898

September 16, 1977

The Honorable Russell B. Long
Chairman, Committee on Finance
United States Senate and
The Honorable Al Ullman
Chairman, Committee on Ways and Means
House of Representatives

This report describes the operational problems and costs associated with the administration of the U.S. valuation system for imported merchandise. The report also discusses alternatives to the present valuation system. U.S. consideration of changes to its valuation system or the adoption of a uniform valuation system is a topic of discussion at the Tokyo round of the current multilateral trade negotiations. We believe the report will be helpful in your consideration of the trade negotiations and any resulting agreements.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Because distribution of the report could adversely affect U.S. strategy during the trade negotiations, no further distribution is intended at this time. We plan, however, to distribute the report to the Congress once the negotiations have concluded.

A copy of this report is being sent to the Special Representative for Trade Negotiations.


Comptroller General
of the United States



REPORT OF THE
COMPTROLLER GENERAL
OF THE UNITED STATES

CHANGES NEEDED IN U.S. VALUATION
SYSTEM FOR IMPORTED MERCHANDISE
U.S. Customs Service
Department of the Treasury

D I G E S T

Over the years, ^{various} changes ^{has occurred} in the U.S. valuation system, ^{which is} the process of determining a unit value for imported merchandise so that duties can be collected. ~~have resulted in nine valuation standards.~~

The ^{nine valuations} standards ^{currently being used} are confusing to importers and administratively expensive for the Customs Service. The valuation system could be simplified and made more specific by

--repealing seven of the valuation standards and revising the definitions of the other two or

--adopting the Brussels Definition of Value or a similar system using transaction value as the basis for duty assessment.

Repealing some and redefining other U.S. standards would result in operational savings of about \$1.8 million for Customs without decreasing dutiable values or reducing protection to domestic industries, save for a small number of products. Protection of these products can be achieved by other methods if necessary, such as quotas and/or changes in duty rates.

NEED TO REPEAL ANTIQUATED STANDARDS

The Customs Simplification Act of 1956 established four new valuation standards in addition to the five contained in the Tariff Act of 1930. For certain products the 1956 act retained the old valuation standards, because a study showed that the new standards would result in a lower valuation of some imports, improving their competitive position in the U.S market.

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(formerly GGD-77-82)

The reasons for extending the use of the old standards are no longer valid. These standards now provide less protection against foreign competition and are a major source of the complexity in the U.S. valuation system.

[Establishing imported merchandise values under ~~these~~ ^{the old} standards involves disproportionate time and effort.] Repeal of the old standards would save Customs about \$1.1 million in annual operating costs. (See pp. 5 to 13.)

TWO NEW STANDARDS COULD BE REPEALED

Find [Of the four valuation standards established in 1956, two (U.S. value and American selling price) either cannot be determined even after much time and effort or apply to only a few items.] These standards could be repealed with a negligible impact on the U.S. economy. (See pp. 13 to 17.)

NEW EXPORT AND CONSTRUCTED VALUE STANDARDS NEED REDEFINING

[The remaining two standards (export value and constructed value) require Customs to determine (1) if a foreign manufacturer's merchandise qualifies for valuation at the point where goods are manufactured and (2) whether agents' commissions are dutiable. At best, application of the standards as now defined is time-consuming; at worst, application results in importers protesting the decisions in court.]

Some of the problems would be eliminated by redefining the export and constructed value standards to include all costs to the place of export, incorporating agents' commissions as part of dutiable value regardless of whether they are incurred by seller or importer. This would save Customs about \$652,000 in annual operating costs. (See pp. 18 to 26.)

ANOTHER ALTERNATIVE

[Repealing some and redefining other U.S. standards is one alternative for eliminating some valuation problems. Another would be to adopt the Brussels Definition of Value or a similar

system in which value is based on the actual price of the transaction. The Brussels method of valuation is used by over 90 nations. It is less complex and hence more easily administered than the U.S. system, yet it results in similar values for all but a small number of products. (See pp. 26 to 31.)

CURRENT STATUS OF AMENDING LEGISLATION

Problems associated with the administration of the U.S. valuation system have been identified and studied at the initiative of several agencies and congressional committees since 1964. Recent moves to enact legislation have been dropped pending completion of the current round of multilateral trade negotiations being conducted by the participating nations in the General Agreement on Tariffs and Trade. (See ch. 4.)

The U.S. negotiating position is that changes to its valuation system require trade concessions in return. To the extent that this gives the United States leverage in negotiations, GAO endorses this position. However, GAO believes that, even without concessions, significant benefits would be realized by changing the U.S. valuation system.

RECOMMENDATIONS TO THE CONGRESS

Rec
This report should be useful to the Congress and its oversight committees in considering any trade agreement that may result from the current round of trade negotiations. [In the event the trade negotiations do not result in adoption of the Brussels system or a similar one, GAO recommends that the Congress amend the Tariff Act of 1930 to:

- Repeal the old valuation standards and the new U.S. value and American selling price standards.
- Modify the definitions of the export and constructed value standards to include all costs. (See pp. 34 to 37.)

has conducted by the participating nations in the General Agreement on Tariffs and Trade, GAO recommends

Pending completion of the current round of multilateral trade negotiations, GAO believes further distribution of this report may not be in the best interests of the Government; for this same reason, GAO did not submit the report to the Federal agencies involved for their official comments. However, GAO's findings were discussed with officials of the Department of the Treasury, the U.S. Customs Service, and the Office of the Special Trade Representative, and their comments were considered in preparing the report.

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ABBREVIATIONS

BDV	Brussels Definition of Value
c.i.f.	f.o.b. plus costs of loading, shipping, and unloading
f.o.b.	all charges to place of export
GAO	General Accounting Office
GATT	General Agreement on Tariffs and Trade

CHAPTER 1

INTRODUCTION

Under the Tariff Act of 1930, as amended, the United States Customs Service, a bureau of the Department of the Treasury, is responsible for enforcing laws pertaining to imported merchandise. Customs determines the value of imported merchandise, assesses and collects duties, and gathers import statistics.

U.S. VALUATION SYSTEM

Valuation, the process of determining a unit value for imported merchandise according to statutory requirements, is undertaken by import specialists. They appraise merchandise, drawing comparisons with values of similar merchandise, examine the importers' records, and use catalogs, price lists, and other sources. In some cases, Customs representatives seek additional valuation information both here and abroad. Duties are assessed on the basis of an amount per unit (specific rate), a percentage of unit value (ad valorem rate), or a combination of specific and ad valorem rates (compound rate).

Collections of import duties in fiscal year 1976 totaled about \$4.9 billion. About 60 percent of dutiable imports, in recent years, have been subject to ad valorem or compound rates.

Valuation standards

Over the years changes to the U.S. valuation system have resulted in nine valuation standards--guidelines by which product value is determined.

The Customs Simplification Act of 1956 proposed four new valuation standards for appraising most imports, to replace the five standards contained in the Tariff Act of 1930, which were causing workload backlogs. Before enactment of the 1956 act, however, a study revealed that the act would cause a slightly lower valuation for some products. Domestic industries objected to the reduced level of protection against imports. In response, the Treasury Department proposed a list of articles that would continue to be valued, for a time, under the old standards. This list was to be revised annually, with articles dropped or added as circumstances warranted, and to lapse completely at the end of 3 years.

The Senate Committee on Finance approved the concept of a list, but wanted it to be permanent. The legislation was redrafted to retain the old valuation standards for imports that would decrease in value by 5 percent or more under the new standards. Enactment resulted in establishment of a "final list" (Treasury Decision 54521) of 1,015 items subject to the old standards.

The resulting combinations of the nine valuation standards, in order of precedence, are:

<u>Old standards</u>	<u>New standards</u>
Foreign value	
Export value	Export value
U.S. value	U.S. value
Cost of production	Constructed value
American selling price	American selling price

The old and new standards appear redundant, but differ in definition and interpretation. 1/

Valuation standards are not used optionally. They are applied in order of precedence, as follows:

Old Law's Valuation Standards

1. The foreign or export value, whichever is the higher.
2. If neither can be satisfactorily ascertained, then the U.S. value.
3. If none of the foregoing can be satisfactorily ascertained, then the cost of production.
4. The American selling price when specified in the tariff schedules.

New Law's Valuation Standards

1. The export value.
2. If the export value cannot be determined satisfactorily, then the U.S. value.

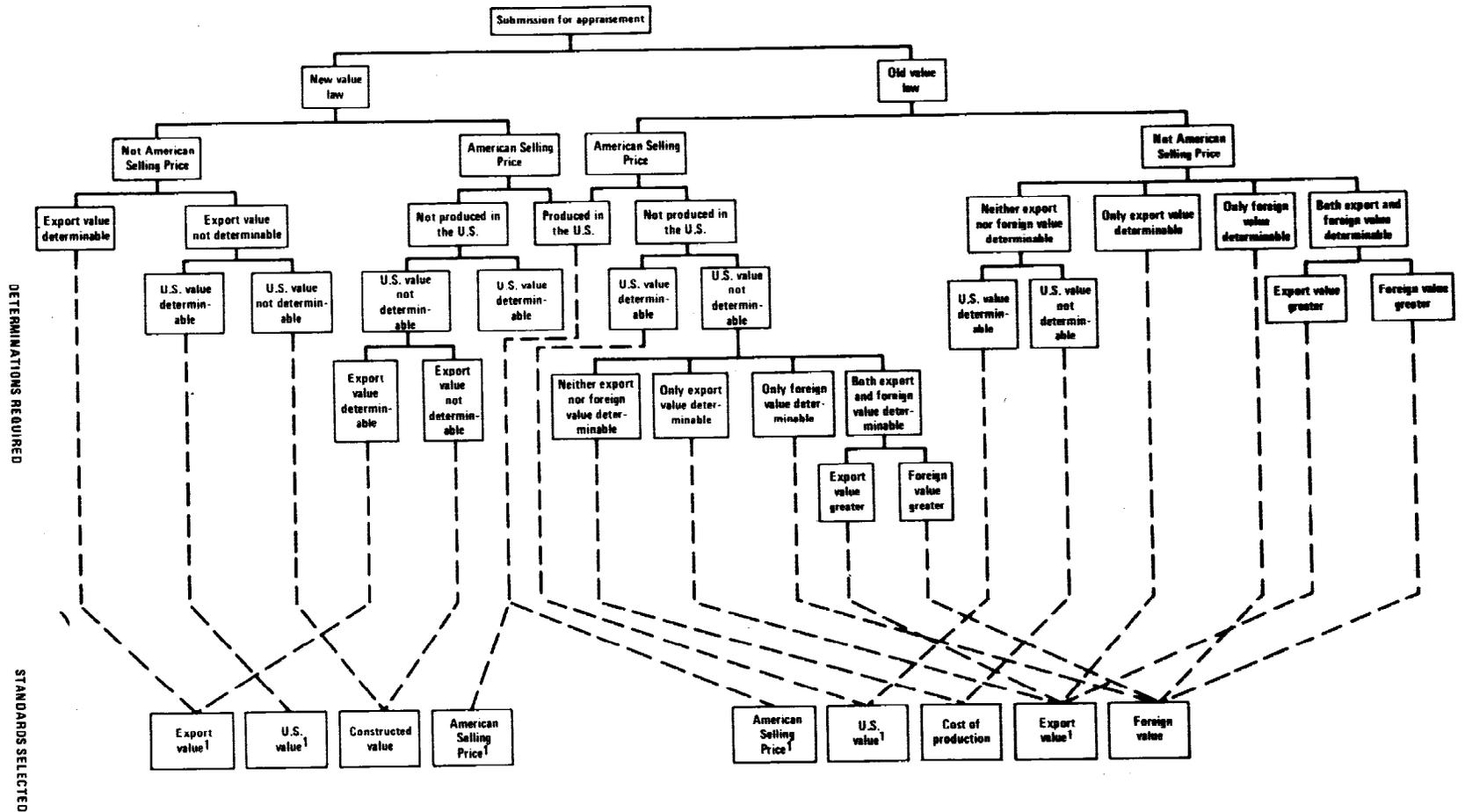
1/See app. I.

3. If neither of the foregoing can be determined satisfactorily, the constructed value.
4. The American selling price, when specified in the tariff schedules.

The chart on the following page illustrates the complexity involved in selecting the appropriate valuation standard. On the infrequent occasions when Customs cannot determine a legal value under one of the above standards, it has authority under the Tariff Act of 1930 to appraise by all reasonable ways and means.

Complexity of standards is not the only problem Customs faces. Expansion of world trade has increased the number of entry invoices which must be processed. During the period 1973-76, the backlog of entry invoices on hand over 30 days at Customs grew 73 percent to 1.9 million. In fiscal year 1976, invoices for \$113.6 billion worth of imported goods were processed--a 14-percent increase over fiscal year 1975. This required the processing of over 3 million formal entries (those exceeding \$250 in value).

SELECTING U.S. VALUATION STANDARDS



4

¹ Although there appear to be identical standards under both the new and old value law, each standard has a distinct definition, either in differences in wording or interpretation.

CHAPTER 2

THE NUMBER OF VALUATION

STANDARDS SHOULD BE REDUCED

Too many valuation standards are involved in the appraisal of imported merchandise, resulting in much lost time and effort. Costs and delays to Customs could be reduced by repealing the old valuation standards and two of the new ones as well. Repeal would have little adverse effect on the protection provided domestic industries.

THE OLD VALUATION STANDARDS NO LONGER SERVE THEIR INTENDED PURPOSE

The five old valuation standards are no longer as protective as they once were and are a major source of the complexity in the valuation system. Attempts to establish imported merchandise values under these standards involve disproportionate time and effort for Customs. Repeal of these standards would save Customs about \$1.1 million in annual operating costs.

The old standards no longer provide added protection

Appraisal of final list items under the old valuation standards no longer achieves the intended protection against foreign competition. A number of studies on the effectiveness of the final list have shown that time has narrowed the differences in valuation resulting from application of the old and new standards, in effect nullifying the purpose of the final list and rendering it obsolete:

- In 1965, Customs valued all final list imports received during the months of April and September under both sets of standards. Final list values were found to average only 2 percent lower under the new standards.
- A similar study for all final list products imported during the last month of each quarter of fiscal year 1971 showed the appraised value of final list merchandise would average slightly

higher under the new standards--a result directly opposite from that intended. 1/

--A 1973 study by the U.S. International Trade Commission 2/ found that 40 percent of the final list items had become duty-free, and the duty-paid price (dutiable value plus applicable duty and taxes) on the other final list products analyzed ranged from a decrease of 0.4 percent to an increase of 0.2 percent. The study concluded, "Erosion of the intended effect of final list valuation is apparent * * *."

Valuation changes--automobiles

Automobiles, which account for about half of all entries subject to appraisal under the old valuation standards, exemplify how the final list has become obsolete because it now produces a result directly opposite of what was intended by the Congress.

The final list was established on the basis of fiscal year 1954 unit values. Since then, changes in automobile sales practices and Customs procedures have caused the unit values to be higher under the new standards.

The U.S. automobile market in the 1950s included only a small number of imports. In 1958, foreign car sales in the United States represented only about 3 percent of total sales, and Japan had not yet entered the market. Because of the small import volume, Customs had to resort to appraising automobiles by "all reasonable means," as provided for in the Tariff Act of 1930.

Subsequently, sales of imported cars rose to the point where they captured about 19 percent of the U.S. market in 1975--an increase of over 600 percent since 1958. This change in the market structure caused an evolution in Customs appraisal procedures. The result is that under the

1/A major influence on this finding was that automobiles made up 46 percent of final list merchandise, and their value would be 2.2 percent higher under the new law. However, the remaining merchandise showed an average value only 1.6 percent lower--substantially less than the 5-percent criterion used to establish the final list.

2/Renamed by the Trade Act of 1974, dated Jan. 3, 1975. Formerly the U.S. Tariff Commission.

old standard, cost of production, manufacturing costs not directly attributable to the exported merchandise, such as certain overtime charges, are not considered. Also, certain corporate operational expenses such as advertising may, though not related to the particular shipment, be included in the values shown on the manufacturer's invoice. Because these expenses are not used in determining a unit value, automobiles are appraised at less than the manufacturer's invoice price.

A Treasury official, in a recent statement to the Subcommittee on Trade, House Ways and Means Committee, noted that if the final list did not exist, in no case would automobiles be appraised at less than the manufacturer's invoice price. Automobiles would be appraised under the new valuation standard for export value.

The standards are too complex

The complexity of the old valuation standards is a costly operational problem for Customs. Problems attributable to the old standards are primarily caused by how the values are determined.

Appraisement problems

Valuation for final list articles under the old standards begins with Customs attempts to determine both foreign and export value, because appraisement is based on the higher of the two values.

Foreign value is the price in the exporting country plus packing costs. Export value is the price at which goods are offered for sale to the U.S. market. Import specialists complain that foreign value is often omitted from the Customs documentation because the manufacturer either does not sell the item in his home country or doesn't realize the item is on the final list and foreign value must be furnished. When this happens the import specialist must request further information from the importer or manufacturer. He may also request a Customs representative to conduct an inquiry abroad to ascertain foreign value.

Customs' inquiries abroad are often complex and time-consuming, because the foreign value to be determined must have no restrictions on the merchandise relating to its use or resale or the territory in which it is resold. These restrictions often result in an inability to appraise under either foreign or export value, although a great deal of time and effort may be spent in the attempt.

A Customs representative estimated that 90 percent of the inquiries on foreign value are unsuccessful because the sales price is not "freely offered" to all purchasers as required by the 1930 act. Under new valuation standards, export value can meet the "freely offered" definition if the price merely reflects the market value. Old valuation standards for foreign and export values must be at a "freely offered" price, but in addition, there must be no restrictions on the merchandise. If restrictions exist, the foreign or export value cannot be used, even if the sale is in accord with the usual market practice.

One case, still unsettled after 11 years, began with a foreign inquiry in May 1966 to determine if foreign or export value existed. In May 1967 Customs concluded that (1) foreign value did not exist because sales in the exporting country were to selected dealers who were restricted as to territory and/or resale price and (2) export value did not exist because sales to the United States were to selected purchasers. Another foreign inquiry was then requested to determine if foreign or export values existed for merchandise similar to the product in question. Eight overseas inquiries were summarized in a September 1970 report. It concluded again that neither foreign nor export value existed, because the "freely offered" requirements could not be met.

In March 1977 the San Francisco district was still awaiting a decision on the case and had a backlog of over 1,000 entry invoices dating back to 1966. Import specialists familiar with the case told us that if the old valuation standards did not exist this merchandise could have been appraised immediately under the new export value standard, avoiding the time and costs associated with nine foreign inquiries and several years of court litigations.

When the foreign or export value of final list goods cannot be determined, a U.S. value is the next standard to be used. U.S. value is computed by deducting certain charges from the selling price in the United States. Inter-country freight, insurance and other importing expenses, and profit are subtracted from the selling price in the United States to approximate the value in the exporting country. The same restrictive definitions which prevent a determination of foreign or export values usually prevent use of a U.S. value.

Another illustration of the old law's complexity of definition is the quantity to be considered when determining dutiable values. The unit price normally decreases with increases in quantity. The term "usual wholesale quantities" used in U.S. valuation is defined differently for each law. Under the old law, it means the quantity at which the largest

number of sales are made. Under the new law, it means the largest quantity of goods sold.

An import valued under the old law can thus be assessed duty on the basis of a large number of small quantity sales, while the actual transaction could be at a much higher quantity, with lower costs and resulting prices. Customs considers such lack of accord with commercial practice a major source of the complexity in final list valuation.

The result is that in many cases merchandise on the final list must be valued under the old cost of production standard. This requires a determination of costs such as production, general expenses, and profits.

Benefits from use of new standards

If the new standards are used, a much higher percentage of merchandise could be appraised under the more easily established export value standard. A 1971 Customs study showed that final list merchandise was being appraised in the following proportions under the old valuation standards.

	<u>Percent of appraisals</u>
Foreign value	46
Export value	28
Cost of production	24
U.S. value and American selling price	2

If the new valuation standards were used, these same items would be appraised in the following manner:

	<u>Percent of appraisals</u>
Export value	89
Constructed value	10
U.S. value and American selling price	1

Use of the constructed value standard involves a higher proportion of foreign inquiries than use of export value. However, even when the constructed value standard has to be invoked, Customs' appraisal task would be easier than required under the old cost of production standard. Again, this is because of how the old valuation standards are defined.

For example, profit under the constructed value standard is the amount normally added on merchandise sold for export to the United States. Profit under the cost of production standard is not determined by sales to the United States alone, because of a 1953 court decision. ^{1/} The overseas representative has to determine both usual sales quantities and profit percentages for sales (1) to the United States, (2) in the exporting country, and (3) to other countries.

Thus, if the old standards were repealed, 99 percent of all final list products would be valued under the new export value and constructed value standards, both of which are much simpler to apply than their old standard counterparts.

Identification of final list merchandise is a problem

The proper administration of both value laws requires import specialists to determine if each import item is on the final list. This requires time to contact several sources to help identify the item and decide under which law it should be valued.

A 1966 Customs study noted that final list product descriptions are too general and in many cases cover a wide variety of goods. For example, footwear is described as "* * * of India rubber or substitutes for rubber." This includes many commodities and requires a determination as to whether the imported product is a substitute for rubber footwear.

Another problem in determining which value law to use is that descriptions of items on the final list are not similar to those contained in the tariff schedules. One import specialist cited the additional time needed to match (1) "sensitized paper to be used in photography," classified under "photographic equipment and supplies" in the tariff schedules and under "papers" on the final list, and (2) "dart boards of paper," included under "other paper articles" on the final list and under "games and sporting goods" in the tariff schedules.

Thus, if the final list were repealed, import specialists would not have the additional burden of identifying items contained on the list.

^{1/}U.S. v. International Expeditors, Inc., 40 C.C.P.A. 148 (Customs, 1953).

The old standards are costly
to administer

We estimate that it costs Customs an additional \$1.1 million annually to process entries using the old law. In addition, other not readily measurable costs to Customs are incurred when

- Customs representatives conduct domestic and foreign value inquiries,
- Customs Information Exchange personnel process foreign value inquiries and appraisement decisions on old law merchandise,
- headquarters legal staff issue internal advice, information, and interoffice memorandums regarding value questions, and
- headquarters Technical Branch personnel resolve value differences.

Added appraisement costs attributable
to the old standards

It was not practicable to determine what percentage of the 3 million formal entries filed in fiscal year 1975 were appraised using the old valuation standards, as a measure of their share of the import specialists' total workload. For this reason we decided import specialists experienced in handling various lines of merchandise could provide the most accurate assessment of the difference in time necessary to process final list merchandise under the new and old valuation standards.

Using scientific random sampling procedures, we sent out questionnaires to 350 of Customs' approximately 1,275 import specialists. The response was:

<u>By import specialist level</u>	<u>Number of responses</u>
Supervisory import specialists (note a)	16
Import specialist team leaders (note b)	116
Journeyman import specialists (note c)	200
Others (note d):	
Mail unit	4
Compliance	1
System coordinator	1
Branch chief	<u>2</u>
	<u>8</u>
	<u>340</u>

a/Supervises a number of teams responsible for assigned lines of merchandise.

b/Serves as senior member of import team responsible for an assigned line of merchandise.

c/Serves as a member of import team.

d/Persons serving in other than a line capacity.

Import specialists were asked to estimate how they spend their time for a typical month. A typical month was stressed because of seasonal fluctuations in workload. Five categories were used to record the import specialist's time:

- Administration--time spent in activities other than examination of merchandise, training, and entry processing.
- General industry contacts, seminars, and trade fairs--time spent learning the nature of the industry, the product, and changes thereto.
- Training--time spent as a student or instructor covering technical matters pursuant to accepting, appraising, classifying, processing, and liquidating entries.
- Processing entries under the new valuation standards--time spent accepting, appraising, classifying, and processing an entry plus all other procedures including visits or calls to importers, legal and administrative functions, foreign trade statistical verification programs, etc., required to liquidate a specific entry.

--Processing entries under the old valuation standards--
time spent performing the same functions as above, for
final list merchandise required to be appraised under
the old valuation standards.

Import specialists on the average spent their time as
follows: 13.9 percent administration, 4.6 percent general
industry contact, etc., 6.4 percent training, 62.0 percent
processing entries under the new valuation standards, and
13.1 percent processing entries under the old standards.

Customs' position that final list merchandise could
be appraised faster under the new valuation standards was
confirmed by 236 (91 percent) of the 260 responses. Of the
24 who felt differently, 22 felt that there would be no dif-
ference, while 2 felt that processing entries under the new
valuation standards could take longer for their lines of
merchandise. The following table shows the estimates of
processing time that would be saved if final list merchan-
dise entries were appraised under the new valuation stand-
ards.

<u>Time saved</u> <u>(percent)</u>	<u>Number of</u> <u>responses</u>	<u>Percent of</u> <u>responses</u>
Less than 3, and 3 to 6	24	10.2
10 to 12	52	22.0
25	63	26.7
50	67	28.4
75	18	7.6
88 to 90, and more than 90	<u>12</u>	<u>5.1</u>
	<u>236</u>	<u>100.0</u>

Based on the import specialists' responses, we estimate
that repeal of the old valuation standards would save, on
the average, 5 percent of the specialists' time. This would
amount to annual savings to Customs of approximately \$1.1
million representing about 62 staff-years of effort. Con-
sidering the statistical sampling error, we believe savings
of between \$967,000 and \$1,280,000 would accrue to Customs
by repealing the old standards.

CONSIDERATION OF REPEALING TWO SELDOM-
USED NEW VALUATION STANDARDS

The repeal of the five old valuation standards would
leave the four new valuation standards in existence. Of the
four, Customs is seldom able to determine the existence of

U.S. value, while appraisement under the American selling price standard primarily functions to restrict imports of a few items.

U.S. value

Efforts to appraise merchandise under the U.S. value standard are difficult, time-consuming, and of limited use. When import specialists attempt to find value under this method, they are seldom successful. Because the attempt to appraise at U.S. value is required but almost never successful, the U.S. International Trade Commission has called it a "purposeless administrative burden."

Import specialists are required to attempt to appraise at U.S. value when export value cannot be established. But one difficulty is determining the price at which such or similar U.S. merchandise is freely sold or offered for sale. Import specialists write, call, and interview importers to obtain price information, and then they assess the validity of the data. However, they rarely obtain adequate price information to successfully appraise merchandise under U.S. value.

Another difficulty is establishing allowable deductions from the U.S. selling price. The old valuation standard for U.S. value furnished some helpful guidelines--commission deductions could not exceed 6 percent, while profit and general expense ceilings were 8 percent. The new standard allows deductions for the "usual" commission, profit, and general expenses.

To determine "usual" allowable deductions requires information on all sales of the same class or kind of merchandise. According to one import specialist, even the Customs Information Exchange in New York, Customs' central clearinghouse for value data, is often unable to gather this information. In addition, importers' accounting systems are often too complicated for import specialists to clearly assess profit and general expenses. One result is a time-consuming investigation.

One import specialist, in arriving at U.S. value, tried over a 6-month period to establish the validity of importers' deductions from domestic selling price for freight and other expenses. Entry invoices in this case were withheld from appraisement pending a report necessary to establish U.S. value. In February 1974, the specialist referred the case to Customs representatives for investigation. The report

was not received until March 1977. The repeal of U.S. value would help simplify and expedite appraisement by reducing the number of valuation standards.

American selling price

The American selling price valuation standard primarily functions to provide trade protection for a small number of domestic producers and is used only when specified in the tariff schedules. This standard is a source of uncertainty and confusion to importers and is time-consuming for Customs to administer.

Under the American selling price standard, values are based on the selling price in the United States of like or similar domestic articles, in effect allowing American producers to set the value on which the foreign goods will be appraised. According to 1972 import data (the latest available) the two main import groups valued under the American selling price standard are chemicals (about 87 percent) and footwear (12.5 percent). The standard could be repealed and any needed protection for affected products provided by alternate means such as quotas and/or changes in ad valorem and compound rates.

The American selling price standard is unwieldy and time-consuming for Customs to administer. To obtain American selling price information, Customs must:

- Determine if the import is competitive with or can be substituted for American products.
- Contact domestic manufacturers for catalogs and price lists.
- Obtain samples of domestic and imported merchandise.
- Keep in contact with U.S. ports to assure that proper information is provided and used.

A Customs official estimated he and his staff of four import specialists could save 16 hours per week if the American selling price standard did not exist--a workload reduction of 8 percent. An import specialist told us he and his colleagues must:

- Control and withhold entries from final appraisement until current American selling price data is received from the Customs Information Exchange.

- Maintain separate files and be knowledgeable of various American selling price value decisions.
- Verify current price information every 3 months (versus about every 2 years under the export value standard.
- Send out an excessive number of duty increase notices to importers because of higher American selling price valuation.

Delays have run to several years. One import specialist has been awaiting American selling price footwear information from the Customs Information Exchange since October 1972. As of March 1977, the import specialist had 540 entry invoices still being withheld from appraisalment.

Importers often do not know what the final appraisalment under the American selling price standard will be. This leads to uncertainty and numerous phone calls and letters to Customs. One import specialist stated he could not satisfy 50 percent of importers' requests for American selling price information because current data on U.S. selling prices was unavailable.

ECONOMIC EFFECTS OF REDUCING THE NUMBER OF VALUATION STANDARDS

A reduction in the number of valuation standards would have a negligible impact on the U.S. economy. If necessary, protection for competitive domestic products can be achieved by changes in ad valorem and compound rates and/or quotas, rather than the inefficient valuation standards.

A 1973 study by the U.S. International Trade Commission found price changes on imported products resulting from elimination of the old valuation standards would have little or no effect on the volume of U.S. imports, domestic production, and consumption. (See p. 6.) However, a few products from certain countries could be valued significantly lower.

The Commission study also analyzed 41 entries appraised under the new valuation standard for U.S. value. The median difference in duty-paid price between U.S. value and export value (invoice price) was a decrease of about 1 percent. When considered with the small number of entries appraised by U.S. value, this indicates elimination would have no appreciable economic impact.

The 1973 study concluded that elimination of the American selling price standard would significantly lower the dutiable values of several articles. However, American selling price standards are applicable to less than 1 percent of the dutiable value of U.S. imports. About 99 percent of these imports are certain chemicals and footwear. These items accounted for only about 19 percent of total chemical imports and less than 3 percent of total footwear imports in 1972. Also, the American selling price standard was primarily established to insure the growth and survival of the infant domestic chemical industry, which today is composed of large corporations.

The Commission in a 1967 report took the position that protection should not be a function of Customs valuation standards. The study found that recurring proposals for extension or adoption of the American selling price concept for general use have been consistently rejected by the Congress. For example, in 1965 the Congress refused to extend American selling price valuation to certain types of brooms. Instead, domestic producers were granted additional protection by increased rates of duty on imports in excess of a tariff quota.

CHAPTER 3

ALTERNATIVES TO THE PRESENT

VALUATION SYSTEM

Repeal of the old valuation standards (the final list) and two of the new standards (U.S. value and American selling price) would leave export and constructed value as the two remaining standards. Redefining these standards would be one way of eliminating some of the remaining valuation problems. Another would be adopting the Brussels Definition of Value (BDV) or a similar system based on transaction value. This is being discussed during the current round of multilateral trade negotiations.

REVISION OF DEFINITIONS OF THE REMAINING U.S. VALUATION STANDARDS

Revising the definition of export and constructed value standards would eliminate some of Customs' appraisal problems in attempting to determine (1) if a manufacturer's merchandise qualifies for valuation at the point where goods are manufactured and (2) the dutiable status of agent commissions. To eliminate some of the appraisal problems would only require revision of export and constructed value definitions to include all costs to the place of export (f.o.b.) and commissions as part of dutiable value, regardless of whether they are incurred by the seller or importer. 1/

Use of f.o.b. prices would simplify appraisal

Consistency with commercial practice and ease of administration suggest the logical place for determining Customs value is f.o.b. rather than ex-factory. The exclusive use of f.o.b. prices would also promote uniformity, thus contributing to more equal competition among domestic importers and foreign manufacturers. We estimate that these

1/Place of export is defined here to include all costs and expenses incurred in bringing the merchandise to the place of loading onto the exporting carrier in the country of exportation. For example, the place of export would usually be a seaport for ocean shipments. Inland freight commissions and insurance charges to the seaport would thus be part of dutiable value.

revisions would save Customs \$652,000 annually. Such changes would have a negligible effect on import prices.

Problems with appraisement
at ex-factory prices

Depending on how goods are offered for sale or sold, the value for Customs purposes is generally f.o.b. or ex-factory. Ex-factory appraisement allows the importer to receive a lower valuation of his merchandise than f.o.b. because overseas inland transportation costs are not considered in determining dutiable value. Determining if a shipment qualifies for ex-factory appraisement is often time-consuming and uncertain. It sometimes requires foreign inquiries, and the determinations made by Customs are a source of much litigation.

Questionable practices used to qualify for ex-factory appraisement--To be considered for ex-factory appraisement, an importer need only furnish an affidavit from the manufacturer which states that he sells or offers his merchandise at ex-factory prices. There are strong indications many entry documents from the Far East involve fraudulent practices in stating ex-factory prices when the goods are in fact sold f.o.b.

On merchandise from Japan, for example, over 6,000 manufacturers have submitted affidavits that they sell at ex-factory prices for 115 categories of merchandise. However, import specialists and other individuals familiar with trade practices in Japan claim most Japanese exports are sold f.o.b. Customs has attempted to cope with this by establishing a Japanese ex-factory list, containing all manufacturers and commodities which allegedly qualify for ex-factory appraisement; however, unless it is the subject of a specific inquiry, the documentation submitted to establish ex-factory values is not verified by Customs.

Due to the volume of submissions and the limited Customs staff, a 1973 Customs circular restricted overseas inquiries on ex-factory claims to those involving at least \$5,000 in revenue. Prior to this time, studies of foreign value inquiries cast doubt on the authenticity of the Japanese ex-factory list:

--The San Francisco district in 1965 compiled the results of 62 requests for information on sellers from Japan. Fifty-one of these concerned the f.o.b. versus ex-factory question. It was determined

merchandise should be appraised f.o.b. in 49 of the cases (96 percent). In addition, results from inquiries on 22 manufacturers from Hong Kong indicated all should be appraised f.o.b.

--Customs representatives to Tokyo analyzed the results of inquiries requesting verification of items on the Japanese ex-factory list over the 15-month period October 1968 to December 1969. Of the 40 items studied, only 1 was found to be actually offered for sale at an ex-factory price.

In May 1976, Customs' Tokyo representatives stated the situation remains unchanged. They estimated the vast majority of firms claiming sales at ex-factory prices actually sell either f.o.b. or at the warehouse of the buyer or shipper. Customary sales practice in Japan is not on an ex-factory basis.

Although manufacturers sign documents that say they sell ex-factory, Customs representatives are unable to document a recent sale to support this. In one case, the manufacturer signed statements attesting to sales ex-factory, but the Customs representative found the last ex-factory sale had occurred 5 years previously.

Manufacturers tell Customs representatives they sign incorrect documents attesting to ex-factory sales because they are requested to do so by agents and importers. Some state they have been told by customers that Customs requires the papers, so they sign them with no understanding of their content. A Customs representative, on a visit to a Japanese trading company, found a file of 38 identically worded affidavits from 38 manufacturers attesting to exfactory sales. He contacted four of the manufacturers and found no such sales took place. According to three manufacturers, the buying agent typed the document and requested they sign it. All stated this was routine.

Administrative difficulties with ex-factory valuation--
Import specialists told us that suspect practices were prevalent on entries claiming ex-factory valuation, and it is time-consuming to decide if the entry should be valued at an f.o.b. or ex-factory price.

To verify ex-factory claims on merchandise from Japan, the import specialist must determine whether each manufacturer and each product are on the ex-factory list. This list must be referred to many times in a typical workday. The

list contains 115 merchandise categories as well as 6,000 manufacturers. One entry may have 15 or 20 manufacturers, all of whom must be checked. More time is required to adjust invoice values and prorate f.o.b. charges when some manufacturers on an entry qualify for ex-factory treatment and some do not.

Import specialists are often unable to verify price deductions claimed for overseas inland transport costs in arriving at ex-factory prices. To determine the accuracy of such deductions requires a thorough knowledge of current internal market conditions and practices in foreign countries. This expertise is often difficult to obtain without a foreign inquiry. Consequently, several import specialists stated they usually accept inland freight and insurance deductions, even though they represent estimates, not actual costs.

A Customs overseas representative stated he often found the deductions made for inland freight and insurance in arriving at ex-factory prices to be unrealistically high for the distances involved. In his opinion, buying and selling agents inflate delivery charges to the place of export in order to offset anticipated costs. For example, a buying agent admitted inland charges included an additional margin to protect the firm against unfavorable exchange rate fluctuations. The buying agent's estimate of the extra margin used for such protection varied from 2 to 8 percent.

Litigation problems--Because the information regarding ex-factory valuation and deductions is largely unverified, Customs is in a poor position to dispute declarations made regarding ex-factory prices and is often challenged in court when it does not accept such claims. A 1973 study by the International Trade Commission found that half the appraisal litigation in recent years represented attempts by importers to have goods valued at an ex-factory rather than an f.o.b. price. At the beginning of fiscal year 1976, the U.S. Customs Court had a backlog of over 114,000 cases.

Cost savings attainable
by f.o.b. appraisalment

We estimate that if all valuation were based on the f.o.b. price, import specialists could save 2.9 percent of their time. This would amount to annual savings to Customs of about \$652,000, or 36 staff-years of effort. Allowing for statistical sampling error, the potential savings to Customs could range between \$366,000 and \$937,000.

Our questionnaire asked import specialists to estimate the time spent processing entries claiming ex-factory valuation. The responses indicated time expenditures of about 20 percent. We then asked import specialists to estimate the effect on their time of appraising these entries at the f.o.b. price. A total of 252 (88 percent) of the import specialists said they could process entries faster if the f.o.b. rather than ex-factory price were used. The following table shows the percentages of time that could be saved.

<u>Time saved (percent)</u>	<u>Number of responses</u>	<u>Percent of responses</u>
Less than 3, and 3 to 6	45	17.9
10 to 12	93	36.9
25	53	21.0
50	48	19.0
75	9	3.6
88 to 90, and more than 90	4	1.6
	<u>252</u>	<u>100.0</u>

Elimination of nondutiable commissions would simplify appraisement

Valuation procedures allow importers to deduct buying agents' commissions from dutiable value. Determining the duty-free status of commissions, however, often involves questionable practices and is a source of appraisement difficulty for Customs. Making all commissions--those of both buying and selling agents--dutiable would eliminate the time-consuming delays in determining the status of commissions.

How Customs determines the duty-free status of commissions

American importers, especially in Far East trade, commonly deal with agents rather than manufacturers. Agents can act for the importer, the manufacturer, or themselves. In different transactions the same person can serve in different capacities. Whether the commissions paid them are dutiable depends on the services rendered.

Fees paid to buying agents are generally not dutiable, while those paid to a selling agent or one who buys for resale on his own account are dutiable. The theory is that a

buying agent represents the importer, who could either deal through the agent or directly with the manufacturer. Whether or not an importer uses a buying agent, purchases of identical merchandise from the same source should be valued at the same price. A selling agent, on the other hand, is controlled by the manufacturer, and the importer is normally unable to purchase from the manufacturer without his services. Thus, his commission is part of the dutiable value. These concepts have long been a part of U.S. valuation policy.

Generally, a legitimate buying agent

- does not control prices (although he tries to negotiate the lowest price for the importer);
- places orders, inspects merchandise, and arranges for shipment;
- may disburse funds of the importer and make advances for the importer's account;
- keeps no stock on hand;
- receives only a commission, which is not shared with the manufacturer; and
- has no ownership interest in or control of manufacturing facilities.

Because an agent's role can change with each transaction, Customs' position is that before determining the buying agent's status there must be (1) a buying agreement between a domestic firm and the buying agent and (2) some evidence of offers by the manufacturer to sell directly without the use of the agent. Import specialists report that the normal procedure is to accept the commission at face value if a buying agreement is on file in the district office. A test for the second requirement is made only when at least \$5,000 in revenue is involved.

Customs representatives in Tokyo told us most small and medium-sized Japanese firms use agents for sales exclusively, while the larger firms deal directly with importers. Japanese firms do not use both methods. Customs representatives feel it is almost impossible to buy merchandise directly from small and medium-sized firms in Japan without the use of agents. They stated these firms have no knowledge of export procedures; therefore, sales to the United States could not occur without the use of an agent.

Thus, Customs' twofold criteria for a valid buying commission cannot be met for transactions involving small and medium-sized Japanese firms.

Questionable practices used
to qualify for nondutiable treatment

Customs representatives feel allowing nondutiable commissions creates a climate that is conducive to fraud. As in the case of ex-factory valuation, manufacturers frequently report they sign false papers attesting to the nature of the agent and offers of direct sales because such documents have been requested by the agent or importer. When Customs representatives query such firms, they report manufacturers are very direct in describing the actual nature of the agent--documents they may have signed to the contrary are considered as just another procedure to be followed in order to export their merchandise or satisfy their U.S. customers.

A 1965 study by the San Francisco Customs district showed that 39 of 41 claims (95 percent) for buying commission deductions involving merchandise from Japan were actually dutiable. In all 16 cases in which "buying commission" was examined in Hong Kong, the charges were also found to be dutiable.

Determining an agent's status with a manufacturer is a source of disagreement--The criteria used to determine an agent's status with a manufacturer are a source of disagreement within Customs. Some Customs personnel believe the advancing of funds by a buying agent shows that the agent controls the importer and is evidence the manufacturer cannot sell directly. However, Customs' official position is that advances by agents to manufacturers do not rule out the buying agency concept. Different interpretations are also possible in attempts to determine (1) whether sales to a shipper place the shipper in the position of being a seller to the importer (in which case all commissions are included in the price) and (2) whether, if a buying agent deceives the importer regarding prices, the agent-principal relationship is thereby destroyed or the commission can still be deducted.

Because of the difficulties in determining the agent's status with a manufacturer, the duty-free status of commissions is questionable. An import specialist in San Francisco received an entry which claimed a firm as the buying agent for two categories of merchandise from the same company. He sought verification of the agent's status through use of the buying agency agreement list and by contacting the domestic

importer for purchase orders, offers, and price lists connected with the shipment. He concluded that the manufacturer only sold through the agent and that the commission in question was therefore dutiable.

The import specialist contacted Customs' national advisory import specialists for each of the two merchandise categories to obtain their opinion of his decision. One concurred in his findings and the other did not. The entry was appraised with the commission included in dutiable value, nearly 16 months after it was received. The importer then protested the appraisal in January 1975. No final decision had been reached as of March 1977. The import specialist stated that if all commissions were included in dutiable value, he could have appraised the entry when it was initially received. The time and costs associated with inquiries to the importer and other Customs personnel, as well as the legal action that ensued, would have been avoided.

Commissions are a source of appraisal problems

While many claims for buying commission deductions are questionable, these claims are also a source of numerous appraisal problems for Customs. Although Customs representatives no longer make inquiries when the potential loss of revenue is under \$5,000, a third of the 43 inquiries opened in Customs' Tokyo office during 1975 involved determining the dutiable status of commissions.

Import specialists must verify buying commission deductions. They do this by referring to a list of buying agency agreements and comparing information obtained from other districts or the Customs Information Exchange. In the San Francisco district the list of buying agency agreements for Japan contains the names of over 1,000 agents and 2,365 importers. A similar list for Hong Kong contains about 750 agents and 1,500 importers.

It is time-consuming to determine the dutiable status of commissions. If only some of the commissions deducted by manufacturers on an entry are found to be bona fide, the import specialist must then determine the deductions which cannot be claimed. In one case involving entries for a large department store chain, a firm claimed buying commission deductions for fees from 54 manufacturers. However, the import specialist stated that 2 days were required just to determine that the agent did not meet bona fide buying agent criteria for 34 of the 54 manufacturers.

ECONOMIC EFFECTS OF F.O.B. VALUATION

The International Trade Commission in a 1973 study of over 1,600 entries stated that all f.o.b. charges including commissions changed dutiable values only for a small number of entries, and the price effect was negligible in most cases. The Commission found that including all charges would affect values on only 2 percent of the entries analyzed. The median increase in value for the affected entries was 3.6 percent. However, the median increase in the duty-paid price of the items analyzed was only 0.1 percent.

AN ALTERNATIVE VALUATION SYSTEM

Use of the Brussels Definition of Value in lieu of U.S. valuation standards may be part of future proposed trade legislation. The United States is one of the few major trading countries which does not use this method. The trade negotiations are discussed in chapter 4.

Brussels Definition of Value

BDV is an appraisement method used by over 90 nations. It would reduce the operational problems with valuation mentioned in this report by basing value on the actual price of the transaction. The Brussels method is less complex and more easily administered than the U.S. system. Customs' position is that use of BDV results in similar values for all but a small number of products.

International organization

The Brussels system is administered by the Customs Cooperation Council through its Valuation Committee. The Council, headquartered in Brussels, is made up of representatives from 75 countries, including the United States.

BDV was incorporated in the Convention on the Valuation of Goods for Customs Purposes, signed in Brussels in 1950. Thirty countries, including most of Western Europe and Japan, are members of the Convention. At least 60 other countries also base their valuation methods on BDV. While the United States is not a member of the Convention on Valuation and does not use BDV, a U.S. representative sits in on the Valuation Committee meetings of the Customs Cooperation Council.

The Brussels system simplifies valuation

Appraisement under BDV is simplified because valuation in most cases can be established by a commercial invoice. The actual transaction price paid for imports is accepted as the basis for valuation if it represents a sale in the open market between independent buyers and sellers.

Adjustments to the transaction price may be necessary under certain circumstances for freight, insurance, commissions, brokerage fees, etc. A more complicated type of adjustment, commonly referred to as "uplift," may be used for certain transactions such as those between related parties. About 9 percent of the entries received by Common Market countries are subject to uplifts to approximate a competitive price.

BDV does not prescribe a standard quantity to be valued. Imported merchandise is valued in the quantity purchased, even when identical goods are sold at different unit prices to other importers buying in different quantities. Under the U.S. valuation system, the dutiable values of similar articles exported on the same day are identical, regardless of the unit values indicated by the invoices.

Because BDV in most cases uses the actual price to define value, it eliminates the problems in the U.S. valuation standards noted in this report. Customs would be primarily concerned with price--proceeding from one valuation standard to another in attempts to appraise merchandise would be unnecessary. Appraisement is also simplified because the use of actual prices does not require independent inquiries to establish uniform theoretical valuation components such as "usual wholesale quantity" or "principal market."

Pending use of the Brussels system on either an f.o.b. or a c.i.f. basis

The element of place in valuation is a controversial subject which in the past was a barrier to U.S. adoption of BDV. The difference between f.o.b. and c.i.f. is that the former includes only charges to the place of export, while the latter also adds the costs of loading, shipping, and unloading the goods between the points of export and import. This may no longer be a problem because of a recent recommendation to allow adoption of BDV using either basis.

The United States generally uses an f.o.b. standard, while most other countries use c.i.f. Those who favor c.i.f. valuation feel it is more in accordance with commercial reality, because it includes all costs necessary to produce and deliver a product to market. Dutiable values would thus generally be greater under the c.i.f. alternative. Advocates of c.i.f. contend that because f.o.b. does not include shipping costs to the United States, it favors trade with distant countries to the disadvantage of nearby countries.

Proponents of f.o.b. argue that it does not favor or penalize any country because of the chance factor of location, while c.i.f. discriminates against distant sources. Thus, they believe the f.o.b. basis is more equal and a fair trade policy. Imports are also less restricted and lower in cost to consumers because the dutiable value excludes shipping costs to the United States.

The United States has stated during international trade discussions that adverse trade effects could occur with a shift from f.o.b. to c.i.f. Problems could include:

- Trade patterns. Shippers would choose ports as close as possible, causing the exclusive use of east coast ports by European exporters and west coast ports by Asian exporters.
- Trade agreements. Article II of the General Agreement on Tariffs and Trade (GATT) could require the United States to grant compensation for duty increases resulting from including additional shipping costs in dutiable value under c.i.f.
- Transportation. Air freight charges are generally higher than sea freight--c.i.f. would add to this disadvantage, because making shipping costs dutiable would cause importers to seek lower cost transportation. Freight carriers and "inland ports," such as Kansas City, could be affected.

In addition to the impact on trade, since c.i.f. results in different values at different U.S. ports, the Office of the Special Representative for Trade Negotiations has questioned whether this can be interpreted as inconsistent with the U.S. Constitution. Article I, sections 8 and 9, states that all duties shall be uniform throughout the United States, and no preference shall be given by regulation of commerce or revenue to the ports of one State over another.

Under the f.o.b. concept, any inequality in valuation would result from differences in where the goods came from, not where they are landed. Goods from the same seller would be uniformly valued throughout the United States regardless of the entry port. Because c.i.f. includes shipping charges to the entry port, goods from the same source could be valued differently depending on the location at which they are landed.

However, another interpretation of the uniformity clause is that the duty rate must be uniform, while dutiable values may vary. Thus, values could differ as long as the same rate of duty applied in all parts of the United States. Regarding the preference clause, the Supreme Court has held that a preference resulting incidentally from geography is not a preference given to the ports of one State over those of another. The Office of the Special Representative for Trade Negotiations has requested its general counsel's position on whether nonuniform valuation is inconsistent with the Constitution. This matter is still pending as of February 1977.

The International Trade Commission in a 1967 report recommended that the United States not adopt BDV because it required c.i.f. as the element of place in valuation. It was felt the additional increases in value would have an adverse impact on other countries, ports of entry, and means of transportation.

In a 1973 report the Commission recommended an international valuation system similar to BDV, although no agreement was reached regarding the use of f.o.b. or c.i.f. The study indicated that establishing the new system on an f.o.b. basis would have a negligible effect on dutiable value except for items valued under the American selling price standard and in some final list categories. The impact of these changes is discussed in chapters 2 and 3 (pp. 5 and 18, respectively).

The anticipated impact of a c.i.f. basis in the 1973 study was considerably less than the 1967 report indicated. In addition to items valued under the American selling price standard and a few final list categories, the effect would be greater on goods from more distant countries and articles shipped by air. However, the median price increase would be less than 1 percent. The 1973 study also questioned whether this would affect shipping patterns, because of the time and economic advantages provided by air delivery. It concluded that the c.i.f. impact on imports, domestic production, consumption, and the balance of payments would be small.

Since the 1973 study, steps have been taken to eliminate the choice between f.o.b. or c.i.f. as an impediment to adoption of BDV. During an October 1973 meeting of the Valuation Committee, the United States noted that adoption of BDV would be discussed in this country if it were available on an f.o.b. basis. In June 1974 the Customs Cooperation Council approved a recommendation to amend the Convention on the Valuation of Goods for Customs Purposes to permit countries to adopt BDV on an f.o.b. basis.

The recommendation will not be effective until affirmed by all 30 member nations of the Valuation Convention. As of April 1977, 23 countries had approved the recommendation. In the opinion of a U.S. Customs Observer to the Valuation Committee, the concept will be adopted. The United States will thus have the flexibility to consider adoption of BDV on either an f.o.b. or c.i.f. basis.

In suggesting use of an f.o.b. price under the current U.S. valuation system (p. 18), we are primarily concerned with eliminating the operational problems Customs encounters with ex-factory valuation and buying commissions. Since the United States already uses an f.o.b. basis and the effects of converting to c.i.f. are uncertain, we did not consider this option. However, Customs is of the opinion that from an administrative point of view there would be little difficulty in the application of BDV on either an f.o.b. or c.i.f. basis.

The United States has some reservations regarding the Brussels system

The United States has also pointed out certain areas of concern regarding BDV:

- Each nation which uses BDV has the right to determine the details of how it is applied. The uplifts applied to certain transactions may be arbitrary. The United States has proposed that all countries explain on request how uplifts were determined and allow importers to comment.
- The system requires no procedure for judicial appeal--most nations provide only for administrative review by customs officials.

Application of BDV can also vary in the area of buying commissions. BDV explanatory notes and opinions state that buying commissions are includable in dutiable value. The majority of countries applying BDV do so. However, it is

not required. The majority view is contrary to court decisions in certain countries, which makes uniform application difficult. BDV nations plan to devote further study to this matter.

The principal BDV countries have indicated a willingness to consider modifications to the Brussels system. The United States also has the flexibility to negotiate for needed changes by (1) making such changes a precondition of U.S. acceptance of BDV or (2) adopting the system and working within the Valuation Committee as a contracting party.

CHAPTER 4
PROPOSED CHANGES TO THE
U.S. VALUATION SYSTEM

Problems associated with the administration of the U.S. valuation system have been identified and studied at the initiative of several agencies and congressional committees since 1964. However, no legislation has been passed to correct these deficiencies. The lack of effective change is attributable to the desire of the Congress for adequate concessions from other nations in return. Recent moves to enact legislation have been withheld pending completion of the current round of multilateral trade negotiations being conducted by the participating nations in the General Agreement on Tariffs and Trade.

PREVIOUS PROPOSALS TO CHANGE THE
U.S. VALUATION SYSTEM

A review of past actions and recommendations regarding the U.S. valuation system disclosed that the problems cited in this report have been known for over a decade:

- 1964. A Customs management report recommended legislation to eliminate the final list and uniformly value imports at f.o.b. prices.
- 1965. Customs solicited opinions from field offices on additional legislative changes to simplify valuation. Several districts suggested that export value and constructed value are the only standards necessary.
- 1966. The Senate Finance Committee directed the International Trade Commission to study different valuation standards and submit recommendations for improving U.S. appraisement laws. Customs suggested that the Commission recommend using only the export value and constructed value standards as well as uniform f.o.b. valuation.
- 1967. The Commission study, incorporating the recommendations suggested by Customs, was sent to the Finance Committee.
- 1968. An update of Customs' 1964 study noted that elimination of the final list and ex-factory valuation were included in the Commission's 1967 report.

These actions were thus labeled "approved in principle." Legislative proposals were withheld, anticipating public release of the report (the report was not released).

- 1969. An international committee was established to examine valuation methods and how they might be made more uniform. During these discussions U.S. representatives stated that the United States was prepared to consider eliminating the final list and the American selling price standard if appropriate concessions were offered by other nations.
- 1970. As part of agreements reached during the Kennedy round of GATT negotiations, legislation was drafted which included U.S. elimination of the American selling price standard in exchange for European concessions on road taxes and chemical tariffs. The proposed law was not approved by the Congress.
- 1971. The Senate Finance Committee and its Subcommittee on International Trade requested the International Trade Commission study valuation procedures of the United States and other countries, to develop and suggest uniform standards.
- 1973. The Commission, in response to the 1971 request, recommended a uniform international customs valuation system similar to BDV, although agreement was not reached on the element of place (f.o.b. vs. c.i.f.).
- 1973. The current multilateral trade negotiations began. Proposed legislation by the Administration to permit U.S. participation in the negotiations included authority to eliminate such trade barriers as the final list and the American selling price standard without prior approval of the Congress. The House version of the bill (which became law as the Trade Act of 1974) requires congressional approval of all trade agreements.
- 1974. The Customs Cooperation Council approves an amendment to permit adoption of BDV on an f.o.b. basis (affirmation by all member nations is still pending).
- 1974. Customs recommends that the Treasury Department seek adoption of BDV on an f.o.b. basis as the only foreseeable means of achieving uniform application of one valuation system by all nations.

Officials of several agencies mentioned possible reasons for the lack of effective change. A Treasury Department representative cited a negative response by the Congress regarding attempts at change in the past. An official in the Office of the Special Trade Representative agreed with this position. He cited the lack of action on the previous legislative proposal to eliminate the American selling price standard as a reason why no recent legislation on valuation has been drafted. A review of the legislative history of the Trade Act of 1970 disclosed that a major reason for the failure to eliminate the American selling price standard was that the Congress did not believe the United States received adequate compensation for doing so. Based on the need for compensation, the trade official stated that acceptable changes to the U.S. valuation system would only be achieved as a result of the current multilateral trade negotiations.

A representative of the International Trade Commission suggested that its 1973 report recommendations have not been implemented because the current GATT round began about the time the report was completed. Any move to enact value legislation would thus be withheld pending the outcome of current trade discussions.

MULTILATERAL TRADE NEGOTIATIONS

The United States is involved in multilateral trade negotiations which may result in a proposal to adopt BDV or a similar system based on transaction value. U.S. negotiators have authority to enter into such agreements, subject to approval by the Congress.

The current round of multilateral trade negotiations began in September 1973 with the signing of the Tokyo Declaration by representatives of more than 100 countries. The Trade Act of 1974, signed by the President on January 3, 1975, provided authority for the United States to participate in the negotiations. The target date for completion of the negotiations is early 1978.

U.S. negotiators have authority to eliminate duties based on 5 percent of value or less, and to reduce other value-based duties by up to 60 percent. In addition to tariff reductions, a primary goal of the current negotiations is to reduce nontariff trade barriers, which restrict imports by means other than actual duties.

Status of discussions on an
alternative valuation system

A uniform valuation system in all countries has been discussed in a GATT working group as a possible solution to such nontariff trade barriers. In particular, universal adoption of BDV on either an f.o.b. or a c.i.f. basis is favored by many countries as the ultimate solution.

Certain features of the U.S. valuation system, such as the final list and the American selling price standard, are included in a GATT inventory of nontariff barriers. Complaints have been registered by representatives of Canada, Japan, and the European Economic Community. A primary complaint is the uncertainty and complexity of the U.S. system--foreign exporters feel it is frequently impossible to foresee under which of the nine valuation standards their merchandise will be appraised. During the October 1976 GATT discussions, the United States indicated its willingness to consider changes in its valuation system, but such changes would depend on the reciprocity offered by other countries.

The U.S. negotiating position is that different valuation systems do not of themselves constitute trade barriers. Because adoption of BDV would require changes to the total U.S. valuation system, U.S. negotiators require trade concessions in return.

An official involved in the current trade negotiations stated that the International Trade Commission will be asked to update the economic effects of adopting BDV, such as elimination of the American selling price standard, the final list, and the possible use of c.i.f. valuation. Other areas of concern will include consideration of appropriate measures regarding products adversely affected by changes in valuation methods.

During the course of the negotiations the Special Representative for Trade Negotiations is charged with keeping the official advisors, selected from the House Committee on Ways and Means and the Senate Committee on Finance, informed on U.S. negotiating objectives, the status of negotiations, and the nature of any changes in domestic laws or their administration which may be recommended to the Congress to carry out any trade agreements. These committees will also consider implementing legislation after the trade agreement package is received.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

Valuation's primary objective is to determine a unit value for imported merchandise so that duties may be assessed. The U.S. Customs Service is required to use nine different valuation standards for appraisement. However, Customs is unable to efficiently process the increasing volume of paperwork because most of the valuation standards are too complex, difficult to administer, a source of much litigation, and often inconsistent with commercial trade practices.

The U.S. valuation system would be simplified and made more specific by

- repealing seven of the valuation standards and revising the definitions of the remaining standards or
- enacting any future trade legislation which may include provisions for adopting the Brussels Definition of Value or a similar system using transaction value.

Changes to the U.S. valuation system would save Customs time and money and improve efficiency, with a minimal impact on the price of most imports.

The impact, if any, which the above changes may have on the protection still afforded some domestic industries could be determined by updating part IV, "Probable Economic Effects * * *," of the 1973 study. (See pp. 16 and 26.) While we are not in a position to identify the specific imports, Customs or the International Trade Commission could do so. For these imports alternate means could be used to continue protection of domestic industries. This could be accomplished using quotas and/or changes in ad valorem and compound rates, which would result in substantially the same duty-paid price.

RECOMMENDATIONS TO THE CONGRESS

U.S. willingness to consider changes to its valuation system or the adoption of a uniform valuation system is a topic of discussion at the current round of multilateral trade negotiations. Information on the issues discussed

in this report should be useful to the Congress, as well as to the oversight committees, in considering any trade agreement that may result from the current round of trade negotiations.

In the event the trade negotiations do not result in a proposal to adopt the Brussels system or a similar system using transaction value, or if the proposal is not enacted into law, we recommend that the Congress further amend the Tariff Act of 1930 to:

- Repeal the five old valuation standards and the two new standards, U.S. value and American selling price.
- Modify the definitions of the export and constructed value standards to include all charges to the place of export, whether incurred by the seller or the importer.

CHAPTER 6

SCOPE OF REVIEW

We made our review primarily at U.S. Customs Service Headquarters in Washington, D.C. and Customs regional and district offices in San Francisco. We also visited the Customs Information Exchange in New York, Customs regional and district offices in Houston and Chicago, and offices of Customs attaches in Bonn, Frankfurt, and Tokyo.

We reviewed the valuation system required of Customs to determine the problems involved in its application and areas where procedures could be simplified, enabling Customs to cope more realistically with its increasing workload. We examined (1) valuation policies and procedures, (2) files, studies, and other management data on valuation, and (3) market value inquiries opened by Customs offices in Germany and Japan during calendar year 1975.

We discussed the problems caused by the U.S. valuation system and the impact of possible changes with Customs personnel and officials of the Departments of the Treasury and Commerce, the International Trade Commission, and the Office of the Special Trade Representative.

A questionnaire concerning the time and costs associated with administration of certain valuation requirements was sent to a sample of 350 Customs import specialists nationwide. The names were selected using scientific random sampling procedures. A total of 340 usable responses were received, a response rate of 97 percent.

DEFINITIONS--THE NINE U.S. VALUATION STANDARDS

1. Foreign value (old law)--The price, at the time of exportation to the United States, at which such or similar merchandise is freely offered for sale to all purchasers in the usual wholesale quantities in the principal markets of the exporting country for consumption in that country, plus the cost of packing the merchandise for shipment to the United States.

2. Export value (new law)--The price, at the time of exportation to the United States, at which such or similar merchandise, packed ready for shipment to the United States, is freely sold or offered for sale in the usual wholesale quantities in the principal markets of the exporting country for export to the United States.

3. Export value (old law)--The price, at the time of exportation to the United States, at which such or similar merchandise, packed ready for shipment to the United States, is freely offered for sale to all purchasers in the usual wholesale quantities in the principal markets of the exporting country for export to the United States.

4. U.S. value (new law)--The price, at the time of exportation of the merchandise being valued, at which such or similar imported merchandise, packed ready for delivery, is freely sold or offered for sale in the usual wholesale quantities in the principal U.S. market for domestic consumption, less (1) the usual commission or usual profit and general expenses, (2) transportation, insurance, and other necessary expenses from the place of shipment to the place of delivery, and (3) all customs duties and other Federal taxes payable by port of importation.

5. U.S. value (old law)--The price, at the time of exportation of the merchandise being valued, at which such or similar imported merchandise, packed ready for delivery, is freely offered for sale to all purchasers in the usual wholesale quantities at the principal U.S. market for domestic consumption, less (1) a commission not exceeding 6 percent or profits not exceeding 8 percent and general expenses not exceeding 8 percent, (2) transportation, insurance, and other necessary expenses from the place of shipment to the place of delivery, and (3) the import duty.

6. Constructed value (new law)--The sum of (1) the cost of producing such or similar merchandise at a time before the date of exportation which would permit production, (2) the usual general expenses and profit made by producers in the exporting country on sales of such or similar merchandise in the usual wholesale quantities for export to the United States, and (3) the cost of packing the merchandise for shipment to the United States.

7. Cost of production (old law)--The sum of (1) the cost of producing such or similar merchandise at a time before the date of exportation which would permit production, (2) the usual general expenses (but not less than 10 percent of the cost of production) and the usual profit (but not less than 8 percent of the sum of the cost of production and the allowance for general expenses) made by producers in the country of manufacture on sales of such or similar merchandise, and (3) the cost of packing the merchandise for shipment in the United States.

8. American selling price (new law)--The price at which a competitive article, produced in the United States and packed ready for delivery, is freely sold or offered for sale in the usual wholesale quantities in the principal U.S. market for domestic consumption, or the price which the owner would have received or was willing to receive for such article when sold for domestic consumption in the usual wholesale quantities.

9. American selling price (old law)--The price, at the time of exportation of the imported article, at which a competitive article, produced in the United States and packed ready for delivery, is freely offered for sale to all purchasers in the usual wholesale quantities in the principal U.S. market for domestic consumption; or the price which the owner would have received or was willing to receive for such merchandise when sold for domestic consumption in the usual wholesale quantities.

PRINCIPAL OFFICIALS RESPONSIBLE FOR ADMINISTERING
ACTIVITIES DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
<u>DEPARTMENT OF THE TREASURY</u>		
SECRETARY OF THE TREASURY:		
W. Michael Blumenthal	Jan. 1977	Present
William E. Simon	Apr. 1974	Jan. 1977
George P. Shultz	June 1972	Apr. 1974
UNDER SECRETARY OF THE TREASURY (note a):		
Bette B. Anderson	Apr. 1977	Present
Jerry Thomas	Apr. 1976	Jan. 1977
ASSISTANT SECRETARY (ENFORCEMENT, OPERATIONS, AND TARIFF AFFAIRS) (note b):		
John H. Harper (acting)	Jan. 1977	May 1977
Jerry Thomas (acting)	Sept. 1976	Jan. 1977
David R. Macdonald	May 1974	Sept. 1976
COMMISSIONER OF U.S. CUSTOMS SERVICE:		
Robert E. Chasen	July 1977	Present
Glenn R. Dickerson (acting)	May 1977	July 1977
Vernon D. Acree	May 1972	Apr. 1977
<u>OFFICE OF THE SPECIAL REPRESENTATIVE</u> <u>FOR TRADE NEGOTIATIONS</u>		
SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS:		
Robert S. Strauss	Mar. 1977	Present
Frederick B. Dent	Mar. 1975	Mar. 1977
William D. Eberle	Nov. 1971	Mar. 1975

a/Functions and responsibilities of the Assistant Secretary were transferred to the Under Secretary on May 3, 1977.

b/This position was eliminated on May 3, 1977.



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