The foreign trade zone tool and the role of local government in economic development: the experience of Great Falls Montana and prospects for success.

Raymond Bruce. Schwartz

The University of Montana
THE FOREIGN TRADE ZONE TOOL AND THE ROLE OF LOCAL GOVERNMENT IN ECONOMIC DEVELOPMENT: THE EXPERIENCE OF GREAT FALLS, MONTANA AND PROSPECTS FOR SUCCESS

by

Raymond Bruce Schwartz
B.A., Montana State University, 1980

Presented in partial fulfillment of the requirements for the degree of Master of Public Administration
UNIVERSITY OF MONTANA
1986

Approved by:

[Signatures]
Chairman, Board of Examiners
Dean, Graduate School

[Handwritten Date]
June 2, 1986
# Table of Contents

List of Tables \hspace{10cm} iv  

1. INTRODUCTION \hspace{10cm} 1  
   Economic Crisis and an FTZ Proposal \hspace{5cm} 1  
   The Policy Analyst and the FTZ Project \hspace{5cm} 2  

2. EVALUATING THE FTZ AS AN INVESTMENT \hspace{10cm} 7  
   Definition of the FTZ \hspace{5cm} 7  
   Marketing the Zone \hspace{5cm} 10  
   Financial Benefits to Users of FTZs \hspace{5cm} 15  
   Grants of Authority and the Costs of FTZs \hspace{5cm} 18  
   Assessing Great Falls as an FTZ Site \hspace{5cm} 23  
       FTZ Finances and Economic Payoffs \hspace{5cm} 24  
       The Local Manufacturing Base and the FTZ \hspace{5cm} 28  
       Sales Potential and the FTZ \hspace{5cm} 31  
       Transportation Facilities and the FTZ \hspace{5cm} 33  
       The Feasibility Study and Economic Development \hspace{5cm} 34  

3. THE CITY OF GREAT FALLS, THE EGC, AND ECONOMIC DEVELOPMENT \hspace{10cm} 38  
   The EGC and the City of Great Falls \hspace{5cm} 38  
   Recommendations to the City \hspace{10cm} 41  
       Reassessing the FTZ \hspace{5cm} 41  
       Disassociation from the EGC \hspace{5cm} 43  
       Local Government and Economic Development \hspace{5cm} 46  

APPENDIX \hspace{10cm} 48  
SELECTED BIBLIOGRAPHY \hspace{10cm} 49  

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.
List of Tables

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 1</td>
<td>Financial Report for Battle Creek FTZ</td>
<td>25</td>
</tr>
<tr>
<td>Table 2</td>
<td>Financial Report for Burlington FTZ</td>
<td>26</td>
</tr>
<tr>
<td>Table 3</td>
<td>Comparative Manufacturing Bases For FTZ Sites, 1977</td>
<td>30</td>
</tr>
<tr>
<td>Table 4</td>
<td>Comparative Sales for FTZ Sites, 1977</td>
<td>32</td>
</tr>
</tbody>
</table>
Chapter 1

INTRODUCTION

Economic Crisis and an FTZ Proposal

In 1979, the U.S. Air Force announced a "manpower realignment" at Malmstrom Air Force Base in Great Falls, Montana. This realignment resulted in the loss of 950 personnel; the Air Force laid off 50 civilians and transferred 900 military personnel out of the Great Falls area. Such federally funded jobs bring money into the community from outside. Thus, they are considered "basic" and of vital importance to a community's economy. In an attempt to minimize the realignment's negative impact on the city, the Department of Defense commissioned the Stanford Research Institute to study the local economy and suggest ways to develop its potential. The Institute's study resulted in the Economic Adjustment Program for Great Falls and Cascade County.\(^1\) The Program suggested, among other things, that the city take advantage of the foreign trade potential resulting from traffic at the international airport.\(^2\) One way to do this would be to establish a Foreign Trade Zone (FTZ) at the airport, to be combined with an already-proposed industrial park. An FTZ, a facility which allows importers

\(^1\)U.S., Department of Defense, Office of Economic Adjustment, Economic Adjustment Program: Great Falls/Cascade County, Montana, March 1980.

\(^2\)Ibid., p. 109.
to avoid tariffs under certain conditions, could draw manufacturing to the community and offset the impact of the Malmstrom realignment by creating new "basic" jobs in the area. The Program suggested that the Economic Growth Council of Great Falls (EGC), a quasi-public local development organization funded mainly through a county-wide tax levy, federal and local grants, and a "gift" from Atlantic Richfield Company to the city, begin to prepare marketing studies and develop contacts with possible users of such a facility. The EGC proceeded with such studies, applied to the federal government for a license to sponsor such a facility, and on December 1, 1983, announced that it had received a grant of authority to operate FTZ number eighty-eight. The EGC billed the facility, designed to take advantage of the city's proximity to Canada, as "the Gateway to the Rocky Mountain West."\(^3\)

**The Policy Analyst and the FTZ Project**

An FTZ can be an economic development tool of significant advantage to a community. Zone use can greatly reduce operating costs for a firm. Thus, possessing such a facility can make a community more attractive to businesses planning to relocate or, more likely, expand their operations into a new community. Such facilities, though, do not come cheaply. According to Marshall V. Miller, a former President of the National Association of Foreign Trade Zones:

> Start up costs alone can run anywhere from $5,000 to $70,000. A Foreign Trade Zone is a full time commitment and a long term financial

---

\(^3\)Economic Growth Council of Great Falls, press release, 1 December 1983.
responsibility. Zones are not like putting in a sewer line, a shell building, or a bridge...that once they are completed you can just leave them. Zones need a total commitment of all parties concerned to turn them into a valuable economic development tool. A community that is not prepared to make this commitment is running a big risk.4

Mr. Miller's cost estimates are somewhat conservative. The EGC has thus far spent approximately $100,000 to establish a zone facility which still does not serve any paying customers. The Growth Council also plans to spend between $50,000 and $100,000 per year operating and marketing the zone.5

Thus, an FTZ is an expensive investment in local economic development. In assessing its overall utility, one must consider cost, potential payoff, and risk, or likelihood of payoff. Such considerations raise a number of questions which must be asked—if not entirely answered—before making this "full time commitment." One likely body which one would expect to ask such questions in the case of the Great Falls FTZ is the city government. Specifically, the city manager's office should oversee such large transfers of city funds to the Growth Council and take steps to see that the money is invested wisely. The propriety of such an oversight role can hardly be questioned; the Growth Council is using public money to establish and operate a public utility, not for profit, but for what is generally thought to be a public purpose. The city's stake in the feasibility and success of the FTZ facility is both financial and "economic" in the broader sense that this


5Interview with Ron Oberlander, Executive Director, Economic Growth Council of Great Falls, 30 October 1985.
facility, like other development projects, promises increased income and employment. The city contributes to this project, as well as all EGC projects, through the allocation of tax and grant monies as well as assistance in preparing federal grant applications. Its role as financial sponsor necessitates financial control of the project.

This paper will attempt to raise and discuss ways of answering questions concerning the FTZ as an investment. The paper will also explore existing mechanisms by which the city controls the use of funds which it transfers to the EGC. The point of view offered will be that of a policy analyst assessing the feasibility of the FTZ project and thus the wisdom of the investment. The policy analyst must be concerned with inputs as well as outputs of programs and projects. Therefore, the wisdom of increasing the investment, as well as cutting the city's losses by withdrawing financial support, will be explored.

The questions of costs and payoffs can largely be addressed through case studies of operating zones. Information germane to the investment decision is presented. The experiences of other communities will not offer precise answers, but the magnitude of costs and benefits can be more easily grasped if the policy analyst has an idea of how zones have developed in other communities. The total costs cannot be measured in terms of monetary outlays alone. The policy analyst must consider the opportunity cost of investing resources in an FTZ rather than another development tool or scheme, such as additional advertising of the city's existing resources, tax expenditures designed to promote relocation of new business or expansion of existing business, urban renewal, subsidization or outright
ownership of troubled industries, or industrial park development. Attempting to estimate the costs and benefits associated with each of these options is far beyond the scope of this paper, but the analyst must keep in mind that dollars spent on an FTZ in an attempt to attract industry and create new jobs could be spent on other projects in an attempt to achieve those goals. The FTZ investment can be one of the more expensive of the city’s development options. It has a responsibility to make such an investment pay off.

This is not to say that an FTZ can never be a sound investment decision for a community. Under the right circumstances, it can be a highly profitable one. This country’s zone program has enjoyed considerable growth in recent years. According to a recent FTZ Board report to Congress, FTZ activity did slow a bit during fiscal year 1981, the low point of the recent recession, but continued to grow. Forty-two zone projects received some three billion dollars worth of merchandise in that year, while $2.7 billion worth had been received at thirty-three zones the year before. Most existing projects saw increased activity even as world-wide trade slowed. Furthermore, exports and re-exports continued to climb, indicating that manufacturers made increasing use of FTZs. Firms with operations within zones employed approximately 40,000 people, and the “multiplier effect” of this employment appeared to create another 80,000 to 120,000 jobs. 


7“A Fifty Year Fight that Finally Paid Off,” American Import Export Management 100 (March 1984): 18.
Yet, for many communities, a zone can be a costly mistake that will sit unused or underutilized for years. For these communities, the zone investment either fails to pay off at all or yields benefits which do not justify the outlays. A recent analysis of zone operations found that only about forty percent operated profitably and many had losses running into the hundreds of thousands of dollars.\footnote{Feldman, "Marketing Concept," p. 40.} In early 1984, forty-one of ninety-seven zones were not actually operating at all.\footnote{"Fifty Year Fight," p. 18.} Such zones may be thought of as "paper zones."

Many communities succumb to the overly optimistic rationale that building a zone facility will automatically provide sufficient cost savings to prompt a firm to locate in that community. A policy analyst employed by the city would have the task of deciding whether Great Falls would be a likely location for a successful zone. In this context, "successful" means both financially solvent—after a reasonable start up time—and beneficial in attracting employment and income to the community.
Chapter 2

EVALUATING THE FTZ AS AN INVESTMENT

Definition of the FTZ

In order to assess the FTZ’s worth to the community, the policy analyst must know what purpose the facility serves and why it might facilitate economic activity. The FTZ is only a single element in what is known as the “temporary entry system,” a set of methods by which importers can defer, reduce, or avoid customs duties on their imported commodities.\(^\text{10}\) Congress designed the temporary entry system in an attempt to increase international trade in this country and, thereby, enhance trade-related employment and income. The FTZ is the most complex of the elements of the system, but allows manufacturers who use imported components or materials the most flexibility.

Customs bonded warehouses provide a means by which the owner or importer may store imported goods under customs supervision, without duty payment, by posting a bond for twice the amount of the duty avoided. The bond insures payment of the duty if the goods are released for domestic consumption. Goods stored in bonded warehouses are exempt from federal taxes as well as duties. Except for the distilling of liquor, manufacturing is allowed in bonded warehouses.

warehouses and owners are allowed to transport bonded goods from any entry point to any bonded warehouse and from warehouse to warehouse.

"Drawback" is a procedure by which federal taxes or duties may be partially recovered or remitted because of the use made of the commodity on which the tax is normally levied. An importer may draw back ninety-nine percent of the duty paid on items to be re-exported. The one percent forfeited is supposed to pay for administration of the program, although it has failed to cover costs in the past.\textsuperscript{11} The drawback privilege has also been extended to virtually all materials to be combined with domestic goods for export. Consequently, the procedure is today used primarily by manufacturers. Duty on the imported goods is paid at the time of entry into U.S. Customs territory and a drawback claim may be submitted any time within three years of the re-exportation of the finished good.

The third component of the temporary entry system is the temporary importation bond, which allows certain articles to be brought into the country duty free upon the posting of a bond which guarantees their destruction or re-exportation within one year. Rather than keep these articles in customs facilities, the importer may repair, alter, or use them at sites of the firm's choosing.

The final component of the temporary entry system, the FTZ, combines many of the advantages of the other three components and adds significant new advantages of its own. It is, however, the most costly of the four. Zone users pay higher rents or purchase prices for their zone locations, but they may also realize

\textsuperscript{11}Ibid., p. 557.
significant cost savings because use of a zone does not require an original cash outlay in the form of duties or bonds. Merchandise imported into the zone is subject to customs duties if sold or sent into the U.S., but not if re-exported. Further savings may result from the less cumbersome reporting and accounting obligations involved in zone use.\textsuperscript{12}

An FTZ is both a physical facility and a process for importing commodities into the country at a savings. The zone must be able to facilitate this importation. Therefore, it often must be quite elaborate and expensive. The facility must be isolated from U.S. Customs territory (i.e., the rest of the country), enclosed, and policed. Located within thirty-five miles of a port of entry, a zone may receive commodities transported by land, air, or water. These commodities may enter the zone for the purposes of storing, manipulating, mixing, manufacturing, repackaging, or exhibiting.\textsuperscript{13}

To be useful as a development tool, the FTZ facility must successfully compete with the other components of the temporary entry system, as well as other business locations, for the patronage of the firms expected to bring economic development to the community. As previously stated, the policy analyst must assess the ability of the zone in \textit{his} community to attract economic activity. Those sponsoring FTZs hope that possessing a zone will provide the added incentive that draws new industry to the community. It is the job of the analyst to

\addcontentsline{toc}{section}{Notes}


\textsuperscript{13} 15 CFR 400. (Chapter IV—Foreign Trade Zones Board)
discover whether those hopes are well-founded. Therefore, the analyst studying the FTZ proposal should be familiar with the technique of promoting the zone to potential clients. Such familiarity will help the analyst judge whether an FTZ will make his community significantly more attractive as an industrial location.

Marketing the Zone

Eric Feldman has written of an approach to FTZ development which he calls the “marketing concept,” a concept “which should permeate all facets of Foreign Trade Zone development, operation, and promotion.” Potential users must be “sold” on the idea of zone use in order for the zone to be a successful tool of economic development. The initial application of this concept, therefore, should be in the evaluation of the market potential of the facility. As explained by Feldman, “the marketing concept is a management orientation that holds that the key task of the organization is to determine the needs, wants, and values of a target market and to adapt the organization to delivering the desired satisfactions more effectively than its competitors. In keeping with this idea, the zone operator conceives of his mission in terms of satisfying a defined set of wants for a defined group of customers. He must recognize that satisfying the wants of potential zone users will require an active program of marketing research to learn these wants. In short, the marketing

---

14 Feldman, Marketing Concept, p. 40.

15 Ibid., p. 41
concept is a realization that a desire for economic development via the zone facility requires a commitment to the selling of a service. This selling job will take a great deal of time, effort, expertise, and money.

An important step in the selling of a zone is market segmentation. Almost any firm engaged in international commerce could find some use for the services offered by an FTZ. Yet, efficiency of marketing efforts and limited resources require some delimitation of the market. In other words, target markets must be selected. These target markets are groups of prospective zone users which have similar or related characteristics, needs, and wants. Such prospects can be expected to respond to like motivations and can be expected to locate in a zone that addresses their needs. The physical facilities of a zone must be specialized and designed to appeal to likely customers. According to Feldman, the growing number of zones in this country makes it "increasingly apparent that the only way to prosper is to service markets whose needs are not being met or are being imperfectly met by other zone facilities."\(^{16}\)

Market segmentation requires the identification of a potential market of zone users and specialization by the operator in the satisfaction of such users' needs. One cannot, however, simply choose a desirable market segment—a segment that fits one's community's needs—and expect to draw such industrial zone users to the FTZ. A system of "commercial intelligence" is required to identify a market segment which the zone has a realistic chance of attracting. A community may

\(^{16}\)Ibid.
find certain industries attractive, for instance, because they may have a history of bringing larger-than-average incomes to local economies or they may be labor intensive and thus promise to relieve local unemployment. Such industries, however, may not be suited to that community or find that community suitable to them. Commercial intelligence can help to identify industries which are well-suited to a certain locale. Development of such an intelligence system requires considerable effort and can be quite expensive.

The task requires extensive expertise concerning both FTZs and economic development in general. The operator must be familiar with and able to explain to potential customers the advantages and disadvantages of zone use. This requires continued study, since FTZ and Customs Bureau regulations are continually changing. He must also be familiar with advantages and disadvantages of his community as a business location, and maintain contact with local and regional firms to identify potential customers. Finally, he must understand the types of service offered by his most direct competitors—other FTZ operators—and know the prices his competitors offer, so he can price his own services competitively.

Development and maintenance of such an intelligence system can be a quite costly and complicated endeavor, requiring a considerable investment of time, energy, and money. For instance, Michigan's Office of Economic Development maintains offices in Brussels and Tokyo which disseminate information on the Battle Creek FTZ and its operator. Twice yearly, the Office's personnel make foreign trade missions to both Europe and the Far East to contact potential zone clients individually and present seminars. These efforts have figured significantly
in the zone's success, as three Japanese and six German firms have been lured to the zone in this way.\textsuperscript{17}

The operator of the FTZ in Campbell County, Kentucky, an import–export distribution firm, holds several seminars for local companies to explain the zone and its advantages and provides tours for interested groups. Through its affiliate offices, the operator contacts both domestic and international firms to initiate interest in the zone. The State’s Port and River Development Commission and the Northern Kentucky Department of Commerce also aggressively promote the zone as part of the area’s commercial advantage.\textsuperscript{18}

These examples illustrate the type of resources that would have to be developed to market zone services effectively. Those financing the FTZ in Great Falls should be aware that making a go of the project will require more than money. Time and expertise will be required to build a marketing network such as the ones described. The operator or sponsor will likely have to establish offices in Canada if it expects to attract business from that country. The EGC has not done this and has no plans to do so,\textsuperscript{19} although it has sent trade missions to Canada to contact potential clients.\textsuperscript{20}

\textsuperscript{17}Foreign Trade Zones Board, 43rd Annual Report, p. 122.

\textsuperscript{18}Ibid., p. 138.

\textsuperscript{19}Telephone Conversation with Ron Oberlander, 25 February 1986.

\textsuperscript{20}EPIC Research, Inc., "Preliminary Assessment of the Need to Establish a Foreign Trade Zone in Great Falls, Montana." (Great Falls, Montana: 22 October 1980) p. 1.
One of the first indicators of an industry which may be a potential zone user, the indicator relied upon most often, is the existence of high duty rates on imported commodities in a particular industry. However, a firm which currently pays high duties may not necessarily be a likely zone customer. As discussed above, the other elements of the temporary entry system may be sufficient to serve the needs of such companies. The fact that leased or purchased property in a zone is often more expensive than industrial sites outside the zone may discourage operation in the FTZ. Furthermore, other elements affecting industrial location and growth may outweigh any FTZ-related considerations of potential users.

The prior existence of a given industry—an industry which makes use of imports—in an area may well be a more important indicator of a successful market segment than is mere identification of high duty industries. An advantage of identifying and trying to sell zone services to firms in an already existing industry is that they are most likely already familiar with the port of entry involved and the locational advantages and disadvantages of operating in the area. That the potential user knows these things means that the operator can concentrate his efforts more on communicating the benefits of zone use. Another advantage is that a zone which serves a pre-existing industrial base will begin collecting revenues more quickly—and such revenues are often a key factor in zone success. An FTZ is a public utility and is not intended to be a profit-making entity in itself. Yet, within a reasonable period after start up, it should not only be self sufficient but should earn net revenues which are sufficient to provide for future
improvements to zone facilities. A community whose port of entry is not sufficiently close to a substantial industrial base faces a much greater task in making a success of its zone. The operator must not only market the specific advantages of an FTZ, but must also market the community as a place for relocation or start up of a business.

Financial Benefits to Users of FTZs

In order for an analyst to assess the chances of zone success, he must be familiar with the advantages zone use offers a firm. The analyst must ask the question: "Are these advantages enough to make this community a more desirable business location?" A negative answer to this question indicates that the zone is not a worthwhile investment of public money.

Many of the benefits of zone use have been outlined by William McDaniel and Edgar Kossack, who explain that FTZs can reduce operational costs and improve cash flow for firms engaged in international business.\textsuperscript{21} Benefits of zone use can be thought of as falling into one of three categories—zone-related advantages, zone-specific advantages, and the advantages of locating facilities in the United States as opposed to other nations. Discussion of this third set of benefits is beyond the scope of this paper, but zone-related and zone-specific advantages bear directly on the job of the city's policy analyst. Zone-specific advantages are those locational advantages an FTZ site offers, not related to zone

services or tariff savings. They will be discussed in a later section dealing with the advantages offered by Great Falls and other FTZ sites.

Zone-related advantages are those which are directly consequent to operations carried out within or near an FTZ which would not be financially practical if a firm were to conduct those same operations without access to a zone. Such benefits follow from the reduced tariff rates and delayed taxes enjoyed by FTZ users, as well as characteristics coincidental to the zone operational environment—such as the increased security of a zone. They are:\textsuperscript{22}

** a lower rate of theft from zones (near zero) which reduces insurance rates and losses on uninsured inventory

** lower insurance costs resulting from the fact that inventory will be valued at cost only, i.e. excluding the value added by duty, excise, or inventory tax (in the states which have inventory tax)

** non-payment of excise taxes while goods are stored in zones

** delay of the payment of tariff and excise taxes on goods to be imported into U.S. Customs territory

** avoidance of fines for improper labeling (since items stored in FTZs can be relabeled)

** avoidance of duty on goods to be re-exported when the use of duty drawback, temporary import bond, or bonded warehouse is not an alternative

** saving of the time and trouble of drawback, as well

\textsuperscript{22}\textit{Ibid.}, pp. 34–5.
as the one percent of normal duty forfeited

** use of the money that might otherwise go to payment of a temporary import bond (twice the amount of the duty which would normally be paid)

** non-payment of duty on that portion of the inventory found to be defective during tests in the zone

** non-payment of duty on waste materials resulting from a manufacturing process

** saving of duty of any by-product created through manufacturing within a zone

** the ability to select, in advance, the lowest possible tariff

Many of the advantages listed above apply only to importers, or those planning to import and re-export goods. FTZs also offer advantages to manufacturers willing to locate some or all of their operations within the zone. It is these advantages which are expected to draw "basic" (in this case, manufacturing) jobs to the community and make the investment worthwhile. Three duty options are available to a manufacturer using an FTZ. He may reserve the duty rate on the raw materials used and pay the duty at the time the product is shipped from the zone into U.S. Customs territory. He may pay the tariff on the finished goods if it is lower (i.e., if an "inverted" tariff schedule exists). The third option is that he may apply the finished goods tariff rate to the value of the foreign-sourced raw materials. This set of choices effectively eliminates the payment of duty on any value added in processing, manipulation, or manufacture. Thus, the value added to products through manufacture by local industry becomes
Grants of Authority and the Costs of FTZs

Applicants for licenses (grants of authority) to sponsor FTZs must meet four basic requirements. They must show that they are organizations qualified to apply for a zone grant, that there is a suitable location for the project in or adjacent to a customs port of entry, that they possess adequate plans for financing the project, and that there is public need for the zone (i.e., the existence of adequate potential users).

Specifically, the FTZ applicant must submit a detailed application to the FTZ Board along with thirteen exhibits, including an economic survey, a complete description of all facilities, and extensive maps. The economic survey must demonstrate to the satisfaction of the Board "that the anticipated commerce, benefits, and returns, both direct and indirect, will justify its construction to expedite and encourage foreign commerce." The survey must show, in detail, (1) the potential commerce and revenue of the proposed zone, (2) present foreign trade of the port area, including transshipment, re-export, and consignment trade, (3) present transportation services and possible increases in such services where necessary, (4) a comparative study of export rates on domestic commodities for mixing with foreign goods, (5) an analysis of transportation rates where applicable.

\[^{23}15\text{ CFR 400.603.}\]

\[^{24}15\text{ CFR 400.400.}\]
to zone activity, (6) potential new markets for zone business, (7) activities best suited to the particular zone, (8) the impact the zone is expected to have on international trade and the U.S. balance of payments, and (9) the expected environmental impact of the facility. The economic survey should, if done properly, answer many of the questions concerning the need for and feasibility of the zone. The Board’s requirements are, in effect, a checklist for a development organization contemplating a zone investment. In the case of Great Falls, its results evidently convinced the EGC that the FTZ investment was a good one. However, the fact that the Great Falls zone has no paying customers more than two years after receiving the grant of authority indicates that the EGC erred in its assessment of the project’s usefulness. A more impartial opinion is instructive; John Leeper, the EGC’s consultant for the project, recommended that the FTZ investment be made even though “the odds against [Great Falls] having a profitable general purpose zone are at least three to one.”

An FTZ is supposed to represent a “true community project.” For this reason, the Board takes quite seriously the requirement that these public utilities be able to serve and facilitate potential commerce. However, it recognizes that a local development group cannot precisely measure the demand for a facility or service that does not yet exist; prospective users can hardly be expected to make

---


legal and financial commitments before the fact. Letters of intent from possible users are accepted as supporting evidence in cases in which a zone project is well conceived in terms of the area's overall trade potential and the application is supported by both state and local agencies. The EGC's application certainly enjoyed substantial political support; the city and county commissions both unanimously supported the project. Representatives of the State Department of Commerce, both Montana Senators, and the Congressman from the State's Eastern District also endorsed the facility. \(^{27}\) The EGC presented, as evidence of its project's potential use to commerce, some eighty letters of intent from firms in the Rocky Mountain region. In such an atmosphere, a significant show of political support can evidently sweep aside concern for a well conceived project.

That the Board makes such exceptions in cases of overwhelming political support places the burden of sound analysis even more squarely on the shoulders of the local zone sponsor. The Board cannot be depended on for advice or guidance in evaluating an FTZ site's prospects for successful development. It has never turned down an application for a grant of authority. In fact it may be illegal for the Board to do so, or even offer advice concerning the wisdom of making the zone investment. According to one FTZ analyst, "We don't make recommendations to anyone." \(^{28}\)

\(^{27}\text{U.S., Department of Commerce, Foreign Trade Zones Board, "Application of Economic Growth Council of Great Falls for Grant of Authority to Operate a Foreign Trade Zone: Transcript of Proceedings." (Great Falls, Montana: 16 September 1982).}\)

\(^{28}\text{Telephone Conversation with Joseph Lowrey, FTZ Analyst, FTZ Board, 10 February 1986.}\)
The Board assumes that the party assuming the financial burden and risks of a new zone will use sufficiently critical judgment in committing itself to zone development. This attitude on the part of the Board, however, does not eliminate the need for an adequate financial evaluation. As the discussion of existing zone operations in a following section will show, zone expenditures are varied and can be quite substantial. Expenditures are determined by the costs of physical facilities and zone operation (administration, marketing, customs fees, and miscellaneous costs).

The type of physical facilities offered by an FTZ vary widely with the differing clientele of different zones. Types of facilities may range from relatively simple warehouses to manufacturing sites within elaborate industrial parks. The latter type of set up is the goal of most developers working with zones. The Great Falls zone is typical in this respect, as it is located within an industrial park adjacent to the airport.\textsuperscript{29} While the operating costs of such "integrated zones" may be reduced by facilities which offer space and services for several related operations, the start-up costs for zones with industrial park "extras" can amount to tens or hundreds of thousands of dollars.

Another cost to be considered is that of Customs supervision. John J. DaPonte, Jr., Executive Director of the Foreign Trade Zones Board, estimates that such costs may range from $20,000 to $75,000 per year, depending on zone size.

\textsuperscript{29}Interview with Ron Oberlander, 30 October 1985.
and operations.\textsuperscript{30} Administrative expenses are also substantial; FTZ sponsors are often well advised to hire professional zone operators to look after marketing and administration of the zone. These operators should have special knowledge of Customs requirements and procedures. Such help, of course, does not come cheaply. The EGC originally planned to avoid this expense by seeking a zone operator who would assume the operation of the zone on a for-profit basis. However, with uncertain prospects for finding FTZ users—and thus uncertain prospects for revenues—it seems unlikely that such an operator will be found.

The marketing of the FTZ will most likely be the major expense of the project. The zone's sponsor should recognize this, and ask itself if it is prepared to take on the expense before assuming such a long term financial responsibility. The cost of developing and making use of the "industrial intelligence" system described by Feldman cannot be estimated for the "typical" zone, since there is no such thing. However, the sponsor considering operating and marketing an FTZ must be aware of the cost of establishing and continually updating a commercial and industrial data base. The costs of establishing overseas marketing offices, if needed, would likely be even greater.

The EGC's estimate of total operating and marketing expenses of between $50,000 and $100,000 dollars may be conservative, considering all of the sources of expense discussed above. It is likely that the zone's sponsor would have to make a substantially larger investment to make the Great Falls zone both a

\textsuperscript{30}DaPonte, "United States Foreign Trade Zones," p. 209.
financial and economic success. The FTZ can become a significant financial burden. Consequently, the Board is often reluctant to grant authority when it considers the likelihood of successful development to be remote. Great Falls showed little potential for zone development, so the Board initially hesitated to designate Great Falls an FTZ site. However, considerable urging by the Growth Council, as well as by business concerns and private and governmental organizations from the community and state, convinced the Board to make the grant of authority. According to one participant in the application process—Roger Young, then Executive Vice-President of the Great Falls area Chamber of Commerce—the Board's grant of authority in the case of a community which did not have a commitment from potential zone users was somewhat "unorthodox." In Mr. Young's words: "The [U.S.] Department of Commerce likes people to have a bird in the hand when they ask for a Foreign Trade Zone; we only had one in the bush."31

Assessing Great Falls as an FTZ Site

Following the "marketing concept" outlined above, the policy analyst must develop and make use of "industrial intelligence" of the type described by Feldman. Only then can this project and its worth to the community be evaluated. In this section, key characteristics of currently operating FTZs are examined and implications are drawn concerning the Great Falls zone project. The examples

31 Telephone Conversation with Roger W. Young, President, Great Falls Area Chamber of Commerce, 18 November 1985.
used are from zones which approximate, very roughly, Great Falls in population.
The FTZ sites examined are: Battle Creek, Michigan (population 136,100), Bangor, Maine (population 86,300), Burlington, Vermont (population 119,700), Campbell County, Kentucky (population 84,300), Dorchester County, South Carolina (population 68,400), and Granite City, Illinois (population 36,815). The sizes of these cities and counties may seem quite diverse, but of all FTZ sites operating in FY 1981, these sites are the smallest and thus most closely resemble Great Falls (population 82,900). With the exception of the Dorchester County zone, which opened in 1975, all the zones began operation after 1978. Information concerning the FTZs was drawn from the FTZ Board’s annual report to Congress, FY 1981.

FTZ Finances and Economic Payoffs

Examination of the financial statements of two operating FTZs should help explain the nature or the “long term commitment” required for establishing such a facility. In this way, the financial resources necessary for zone development and operation can more readily be related to the economic activity and payoff produced.

In fiscal year 1981, the operator of FTZ forty-three, a general purpose zone located in Battle Creek, Michigan, managed to increase its zone’s income by fifty percent over the previous year. More importantly, the zone began to show a profit in this year despite the fact that total expenses increased by nearly twenty-seven percent. Table one shows the FTZ’s finances for that year.

The zone served thirteen business firms and received over six million dollars worth of foreign-sourced commodities in FY 1981. The economic “payoff” of the
### Table 1: Financial Report for Battle Creek FTZ

<table>
<thead>
<tr>
<th>Item</th>
<th>1980</th>
<th>1981</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INCOME</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zone Rental</td>
<td>$40,507</td>
<td>$63,486</td>
</tr>
<tr>
<td>Handling Fees</td>
<td>10,095</td>
<td>13,550</td>
</tr>
<tr>
<td>Other Income</td>
<td>1,657</td>
<td>1,695</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$52,259</td>
<td>$78,731</td>
</tr>
<tr>
<td><strong>EXPENDITURES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and Wages Paid</td>
<td>$42,526</td>
<td>$51,355</td>
</tr>
<tr>
<td>to Zone Employees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reimbursements to U.S.</td>
<td>849</td>
<td>2,353</td>
</tr>
<tr>
<td>Customs Service</td>
<td>13,195</td>
<td>18,011</td>
</tr>
<tr>
<td>Other Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$56,570</td>
<td>$71,719</td>
</tr>
</tbody>
</table>


The zone included private industry employment of up to twelve persons at any one time. At the time of the report, the operator expected another firm to locate within the zone and create approximately one hundred new jobs.

FTZ fifty-five in Burlington, Vermont, which made a profit in the previous year, failed to cover its expenses in FY 1981. It can be seen from examination of Table two that this shortfall results partly from an increase in expenditures. The absence of an operating subsidy, however, ("operating contributions" in the table) weighs even more heavily in the FTZ's change in profitability.
Table 2  Financial Report for Burlington FTZ

<table>
<thead>
<tr>
<th>Item</th>
<th>1980</th>
<th>1981</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INCOME</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operating Contributions</td>
<td>$24,812</td>
<td>$------</td>
</tr>
<tr>
<td>Rental</td>
<td>5,300</td>
<td>17,033</td>
</tr>
<tr>
<td>Miscellaneous Income</td>
<td>------</td>
<td>3,130</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$30,112</td>
<td>$20,163</td>
</tr>
<tr>
<td><strong>EXPENDITURES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All Expenses</td>
<td>$15,866</td>
<td>$21,349</td>
</tr>
</tbody>
</table>

SOURCE: Ibid., p. 147.

Despite the zone's financial difficulties, it has brought significant economic benefits to the community. The zone's only customer, Mitel, a Canadian electronics firm which manufactures telephone switching equipment, moved into the zone four and one half months after it officially opened. The firm, which originally employed only 21 persons, had a work force of 110 full-time workers in FY 1981. In that year, it brought over six and one half million dollars worth of components and materials into this country through the zone.

The economic "payoff" of the zone investment can be considerable, as can be seen from the examples presented. However, the financial resources needed to make the zone a going concern are also substantial. It should be noted that the Battle Creek Zone opened in 1978 and did not become profitable until three years
later. The Burlington zone was profitable on paper in its first year, but only because of an operating subsidy of several thousand dollars. Those assuming the financial responsibility of the Great Falls zone must ask themselves whether they are prepared to subsidize the facility until it attracts enough business to become profitable, if ever.

The EGC's estimate of operating and marketing costs is overly optimistic. This estimate is at least of roughly the same magnitude as the direct expenditures for the Battle Creek zone. However, these figures do not include marketing expense. A cost estimate that includes marketing expenses would be much larger. What may not be realistic at all is the assumption that the money for marketing and operation will be available in the future. According to one local observer, the Growth Council is fast "spending itself out of existence." The Growth Council has no regular source of income and past promotion and lending policies have nearly depleted its resources. Its executive director has said that unless new funding is found, the EGC will not be able to operate past the end of the current fiscal year. The Growth Council is presently "casting about" for funding from the private sector as well as the federal, state, county, and city governments. In times of economic stagnation and government cutbacks, it is probable that the EGC will soon be in no position to support the FTZ financially until such time as the facility can support itself. The EGC presently wants the city to take over

---


33 Jay Goley, "Cash Box Bottom in Sight," Great Falls Tribune 20 October 1985, p. 1C.
responsibility for the FTZ. Should this transfer take place, the cost to the city would be unpredictable. The city could spend little or nothing on the zone and have a little used facility on its hands, or it could spend a great deal on the zone in an attempt to make it pay off. In times of a shrinking tax base and cutbacks in federal grants, the city will be hard pressed to find funding for a new economic development program. The decline in the local tax base may result in a loss of revenue of between $400,000 and $650,000. Federal grants for economic and community development will be reduced by approximately $330,000.

The Local Manufacturing Base and the FTZ

The FTZ’s profitability depends on its ability to serve customers—and the most lucrative of customers for such a facility are manufacturers. Thus, the zone’s financial viability rests, in large part, on the local manufacturing base which will use its services. The city’s policy analyst must ask if sufficient manufacturing exists in the community to support a zone financially. He must also ask whether the present manufacturing base, even with the added incentive of zone services, provides sufficient inducement for other manufacturers to locate in the city.

An indicator of the city’s potential both for supporting a zone with its present manufacturing and attracting new manufacturing is the size of the present

\[34\text{Telephone Conversation with Ron Oberlander, 25 February 1986.}\]
\[35\text{Telephone Conversation with Nathan Tubergen, Finance Director, City of Great Falls, 22 April 1986.}\]
\[36\text{Telephone Conversation with Michael Rattray, Development Supervisor, Community Development Department, City of Great Falls, 17 March 1986.}\]
manufacturing base. Industrial location theories of economics explain that certain types of businesses attract certain others through a process known as agglomeration:

Within the category of national market activities, agglomeration is the result of a kind of inverted pyramiding. One industry—say, shipping—locates at a place because it has a good natural harbor. That activity then attracts others linked to it—say, banking, insurance, inland transport. The concentration of those industries in turn attracts others linked to them—say, a stock market, a commodity exchange, a printing and publishing industry, a university.\textsuperscript{37}

In its location decision, the firm considers several factors. One of those factors is proximity to the manufactured inputs it uses. A firm can enjoy significant cost savings if it can obtain those inputs locally. The firm also benefits from the availability of other inputs such as power, specialized labor, and essential services such as transportation and finance, which already exist in significant volume because of the existing manufacturing. Thus, the larger an area's manufacturing base, the more attractive it is as an industrial location. The more attractive it is as a location, the more likely it is that an FTZ will succeed financially and economically. The city's policy analyst must ask, in essence, whether the local manufacturing base is large enough to support an FTZ. Table three compares the manufacturing bases of the six previously mentioned FTZ sites with that of Great Falls.\textsuperscript{38} The bases used for comparison are manufacturing


employees and the value added to manufactured products through the manufacturing process. Each "manufacturing unit" in the table represents one ten thousandth of one percent of the total value added through manufacture in the U.S.

Table 3 Comparative Manufacturing Bases For FTZ Sites, 1977

<table>
<thead>
<tr>
<th>Site</th>
<th>Mfg. Employees</th>
<th>Mfg. Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Great Falls, MT</td>
<td>1,800</td>
<td>73</td>
</tr>
<tr>
<td>Dorchester Co., S.C.</td>
<td>2,200</td>
<td>72</td>
</tr>
<tr>
<td>Campbell Co., KY</td>
<td>2,400</td>
<td>125</td>
</tr>
<tr>
<td>Bangor, ME</td>
<td>8,700</td>
<td>436</td>
</tr>
<tr>
<td>Burlington, VT</td>
<td>9,900</td>
<td>494</td>
</tr>
<tr>
<td>Granite City, IL</td>
<td>7,400</td>
<td>682</td>
</tr>
<tr>
<td>Battle Creek, MI</td>
<td>20,300</td>
<td>1,614</td>
</tr>
</tbody>
</table>

At first glance, the manufacturing bases of Dorchester county and Campbell county may seem somewhat similar in size to that of Great Falls. This appearance is deceptive. Dorchester county is within six miles of the city center of Charleston, N.C., a major sea port and population center, and thus is readily available to potential manufacturers in that city. When the "manufacturing units" and employees of the Charleston metropolitan area are added to those of Dorchester county, the total manufacturing base served by the Dorchester county zone consists of 17,700 manufacturing employees and 776 "manufacturing units."

Similarly, Campbell county is right across the state line from Cincinnati, Ohio. The total manufacturing base served by the Campbell county zone consists of 160,000
manufacturing employees and 9,649 "manufacturing units." Thus, none of the sites chosen for study—and it should again be noted that the smallest operating inland zones are examined here—has a manufacturing base comparable in size to that of Great Falls; the smallest of them, Bangor, Maine, had a manufacturing base several times larger than that found in Great Falls in 1977. It should also be noted that measures of manufacturing base used here come from the 1977 Census of Manufactures, and, for five of the six cases, represent manufacturing bases which existed before the beginning of zone operation. The Great Falls manufacturing base has actually shrunk since 1977. In 1982, the Census Bureau would not disclose the value added or employment figures for the city for fear of revealing proprietary information. However, there were only seven hundred manufacturing employees in all of Cascade county in 1982, fewer than half the number in the city of Great Falls five years previously.\(^{39}\) It would appear that the EGC is putting the cart before the horse by investing in an FTZ before the industry exists to support its operation.

Sales Potential and the FTZ

Although manufacturers are the preferred customers for FTZs because of the higher employment and income they bring to a community, the analyst must also consider that the zone may be used for the warehousing of finished goods in his or her community. While firms that use the zone for such purposes do not create

\(^{39}\) U.S., Department of Commerce, Bureau of the Census, 1982 Census of Manufactures, Geographic Area Series: Montana.
a great number of jobs, they can make the difference between financial success and failure for a zone. The analyst must assess the proposed zone's chances of attracting this type of business as well. Table four compares the retail\textsuperscript{40} and wholesale\textsuperscript{41} sales for the six FTZ sites and Great Falls. The analyst must ask whether the community might have enough warehousing business to justify the expense of a zone operation.

Table 4 Comparative Sales for FTZ Sites, 1977

<table>
<thead>
<tr>
<th>Site</th>
<th>Retail Sales ($1,000)</th>
<th>Wholesale Sales ($1,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Great Falls, MT</td>
<td>$363,994</td>
<td>$631,141</td>
</tr>
<tr>
<td>Dorchester Co., S.C.</td>
<td>103,902</td>
<td>46,830</td>
</tr>
<tr>
<td>Campbell County, KY</td>
<td>217,225</td>
<td>73,724</td>
</tr>
<tr>
<td>Bangor, ME</td>
<td>252,390</td>
<td>336,495</td>
</tr>
<tr>
<td>Burlington, VT</td>
<td>166,672</td>
<td>185,799</td>
</tr>
<tr>
<td>Granite City, IL</td>
<td>138,226</td>
<td>280,868</td>
</tr>
<tr>
<td>Battle Creek, MI</td>
<td>529,689</td>
<td>400,703</td>
</tr>
</tbody>
</table>

Again, the proximity of Campbell and Dorchester counties to Cincinnati and Charleston, respectively, makes the true market areas of these two counties quite large and, thus, incomparable to the Great Falls economy. Comparison of the remaining figures, however, indicates that in 1977 the Great Falls economy was

\textsuperscript{40}U.S., Department of Commerce, Bureau of the Census, \textit{1977 Census of Retail Trade: Geographic Area Series}, states indicated.

\textsuperscript{41}U.S., Department of Commerce, Bureau of the Census, \textit{1977 Census of Wholesale Trade: Geographic Area Series}, states indicated.
somewhat comparable in size to the economies of Bangor, Maine, Burlington, Vermont, and Battle Creek, Michigan. While Great Falls was a bit smaller than the other three in terms of retail sales, it was actually somewhat larger in terms of wholesale sales. Both retail and wholesale sales have grown in Great Falls since 1977, so one would suspect that the city’s zone would be in an even better position to attract warehousing business than those at the other sites considered. It should be noted, however, that an FTZ which relies on local trade and warehousing to supply its customers will provide few benefits to the community in terms of income and employment.\textsuperscript{42}

Transportation Facilities and the FTZ

Potential FTZ users, whether they are manufacturers or warehousers, are concerned with much more, however, than the sales potential of the local market alone; markets that can be easily reached from a manufacturing site are often of much greater concern. Thus, transportation routes and distances to large markets are major concerns. All of the sites of the operating zones whose operations are outlined in this paper have distinct transportation-related advantages, most of which are missing in the case of Great Falls. For instance, the Burlington zone is less than one hundred miles from Montreal, Canada by highway and enjoys air connections via major airlines to several larger U.S. cities and good common carrier service.\textsuperscript{43} The Battle Creek FTZ is midway between Chicago and Detroit, 

\textsuperscript{42}Interview with Ron Oberlander, 30 October 1985.

\textsuperscript{43}U.S., Department of Commerce, Foreign Trade Zones Board, 43rd Annual Report, p. 145.
two major industrial centers, on the I-94 "industrial corridor." Great Falls, on the other hand, is over two hundred air miles from the nearest major Canadian city (the market the zone is specifically designed to serve) and notably lacking in key services in passenger and cargo air service as well as truck transportation. It is also notable that Great Falls is not on an east–west interstate highway. It might well be that the great distances that separate Great Falls from major population centers, combined with the shortage of currently existing transportation facilities, will prevent the city from ever attracting the type of "basic" manufacturing employment the EGC is looking for. In any case, it seems that the EGC has erred in building and paying for a facility before the transportation network it needs exists.

The Feasibility Study and Economic Development

The FTZ has become attractive as an economic development tool because it offers to bring to an area "foreign direct investment"—i.e., investment from other nations. The zone will supposedly lure economic activity which would, in the absence of the zone, be carried on outside U.S. borders.

Regardless of whether the emphasis of economic development activity is on relocation of business or creation of a climate in which either local and/or outside business can expand, its goal is to create favorable conditions for the business

\[44\] Ibid., p. 121.

firm. The FTZ is one tool which, under the right conditions, can do this. The economic study, which the FTZ Board requires anyway before granting zone status, presents one opportunity to determine whether or not these conditions exist. Unfortunately, many communities base their zone investment decisions on privately contracted feasibility studies which do not address the economic questions posed by the FTZ Board's economic survey. The EGC's feasibility study was typical in this respect. The Board's economic survey itself is often either incomplete or ignored.

Daponte has speculated that there is a minimal level of economic activity at which a zone becomes not only justifiable as a public utility but also feasible as a business itself. This point is obviously different for every potential zone site. However, an analyst attempting to assess the chances for successful FTZ development in a particular city can learn much through the study of existing zones and the economies of zone sites.

The feasibility study which is made before undertaking a major project like this presents the project's financial sponsors an opportunity to evaluate the financial and economic viability of the project. The type of analysis which appears in the preceding sections should be a major part of the basis for the FTZ investment decision. Yet, no such considerations appeared in the Great Falls feasibility study or the "Preliminary Assessment" which preceded that study. The "Preliminary Assessment" contains several assertions about the relative prices of

---

inputs in Great Falls and Canada, the area from which investment is to be drawn. It is claimed that significant inputs such as land, labor, plant and equipment, and warehouse and manufacturing space are less expensive in Great Falls than in Canada. These claims, though, are unsubstantiated in this preliminary report and do not compare the locational advantages of Great Falls with those of alternative locations in the U.S. The report also said nothing about the output market potential of Great Falls, but significantly did mention the lack of key services such as air and truck transportation.47

The feasibility study itself did virtually nothing to address the cost questions which arise from location theory or answer the majority of the questions raised by the Board’s economic survey format. The study largely concentrated on only one of the Board’s concerns, the potential for avoiding duty costs. It contained a data search of that Customs District’s import and export figures to help identify potential zone tenants. The EGC’s feasibility study identified approximately one hundred commodities whose buyers might be FTZ customers. Some of the commodities entered the country in high tonnage volumes or high aggregate values. The Customs Bureau assessed high duty rates on other commodities identified by the search. The list of commodities enabled the study’s authors to then identify eighty survey respondents as potential zone users. On this basis, the author, a Great Falls native who worked as a consultant in Washington D.C., recommended that the EGC proceed with an FTZ application.

Admittedly, duty costs can be a significant portion of an input's cost. The summary of the EGC's feasibility study claimed that many products crossing the Canadian border carried duties of up to forty percent of their value. However, one must remember that a firm is more concerned with total operating costs than it is with the costs of a single input. It is also important to remember that the duty-related cost savings of using the Great Falls FTZ are no greater than those obtained by making use of the Seattle or Portland Zones. Those communities can likely offer a business significantly more in the way of input and output markets, as well as services.

Regardless of whether one appeals to the industrial location theory of economics or Feldman's case for the need for "commercial intelligence," the feasibility study which assesses a potential FTZ site's chances for success should contain the type of commercial and industrial information discussed in this paper. Such information, when combined with information on duty rates and current foreign trade in an area, will likely be a better basis for an FTZ investment decision than duty information and letters of intent from potential users.
Chapter 3

THE CITY OF GREAT FALLS, THE EGC, AND ECONOMIC DEVELOPMENT

The EGC and the City of Great Falls

The Economic Growth Council of Great Falls formed in 1979 in reaction to the manpower realignment at Malmstrom Air Force Base. The community's economic crisis supplied the organization with a reason for being. The crisis atmosphere in which the organization was formed virtually assured that the EGC would have neither the time nor the inclination to assess its development projects properly. Many of its projects have been ill-advised and hastily executed without careful analysis. For instance, someone in the EGC should have asked the question, "Who would use a Great Falls FTZ?" before the organization sank a significant amount of money into the project. Great Falls now has an expensive facility designed to lure new industry to the city, built largely with public monies, and the question has yet to be asked, much less answered. The Economic Adjustment Program proposed a simplistic answer to a complex problem and the EGC seized on it in an effort to "produce results." Many economic development projects, especially relocation projects such as the FTZ project described here, are undertaken in just such an atmosphere. It is not surprising that an organization, formed in a crisis atmosphere, to do a specific job, would act so hastily. In the

EGC's case, a dramatic, attention-getting response to the problem spelled organizational survival.

During its lifetime, the EGC has spent over two million dollars on economic development projects and has claimed responsibility for the "creation" of about two hundred jobs. The employment the EGC can properly claim to have created can never be determined precisely. Who can say what would have happened to certain businesses had the EGC not been there to lend them money? Nevertheless, this estimate indicates that the organization is spending a great deal of money and meeting with limited success.

The EGC has used two major strategies to promote local economic development: finance of highly visible and expensive projects designed to attract employment and income from elsewhere, and loans and grants to local businesses. The effectiveness of both approaches has been questioned by citizen groups and officials of local government. City commission members and civic groups have accused the Growth Council of "overreaching" with relocation projects that have little chance of drawing employment and income on a long term basis, and officials have questioned the wisdom of lending money to "unstable businesses" which could not obtain financing through private financial institutions. Over the years, the EGC has written off hundreds of thousands of dollars in such loans and repayable grants.

---


50 Sue O'Connell, "Cost Effectiveness Questioned of EGC." Great Falls Tribune 22 July 1981, p. 5A.
EGC programs have also been criticized on the grounds that they do not benefit the poor as much as they should. Federal money which is supposed to be used to benefit the economically disadvantaged is often used for development schemes which benefit that group little, if at all.\(^5^1\)

EGC finances, as well as expenditures, have also been criticized. Members of the city commission and a former mayor have protested in the past that the use of local tax and grant money to finance a non-public organization was inappropriate.\(^5^2\) The Growth Council’s bylaws provide for a fifteen member Board of Directors, with ten members elected from a predominantly private sector general membership. Although three of the five ex-officio members are to come from the public sector—the city, county, and airport authority—their votes carry no special weight, even concerning the expenditure of city tax or grant monies.\(^5^3\) Furthermore, public sector seats on the Board are sometimes unoccupied. Presently, Cascade County and a Great Falls school district have representatives on the board of directors. The Mayor also has a seat on the board. However, the city’s representation is partial, at best. The school district’s representative can hardly be considered a representative of the city government, and the Mayor has announced publicly that he considers his role on the board as that of a private

\(^5^1\) Shirer, "Rich Get Richer."

\(^5^2\) "Special Mill Levies Questioned In City Budget Formulations." *Great Falls Tribune* 23 July 1981, p. 3B.

businessman, not a city official. At times, the city government has had no representation on the board at all.

Recommendations to the City

In this section, I will suggest specific actions to the city of Great Falls in regard to funding the FTZ project, continuation of the city’s relationship with the EGC, and the city’s budgetary process. Suggestions regarding the budget are intended to help resolve the question of the city’s proper role in economic development.

Reassessing the FTZ

The analysis in previous sections indicates that the FTZ is a poor investment for Great Falls. The slim chances for successful zone development in Great Falls indicate that it would be unwise to invest in the building of such a facility. However, this is not the decision which the city faces. The city must decide whether to fund the marketing of a facility which already exists. Given the EGC’s past investment in the zone—sunk costs made with public money, some of it local tax money—the city government should reappraise the zone project. The Growth Council made the investment without adequately assessing costs or benefits of the project; the city should now do the job in an attempt to salvage the project, if possible. The odds are against successful zone development. The size of the

Great Falls economy suggests that a zone project will not succeed, but a significant segment of even a small local economy can be enough to support a zone financially. The city government should investigate whether such a segment of the economy—a market segment—exists.

One possible procedure suggests itself. The feasibility study commissioned by the Growth Council has already turned up the names of approximately eighty potential users and many of these firms have sent letters of intent expressing interest in using the zone. Such letters of intent do not necessarily indicate serious commitment to make use of the facility. The city could confirm the seriousness of such intent with a follow-up survey of these firms. McDaniel and Kossack, who were mentioned earlier, have created a format which allows the interested firm to estimate the cost savings of zone use.\(^5\)

The city should send an outline of McDaniel and Kossack's format for cost savings to the firms already identified, as well as any other likely zone customers, along with a cover letter asking them to estimate their own savings and rethink their interest in the zone. The response to such a follow-up survey would provide a much more reliable indicator of interest in the Great Falls zone than do the present letters of intent. This follow-up survey would have at least three advantages to recommend it. It would be inexpensive and would require less time than alternative methods of estimating use of the facility. It would also serve as the first step in marketing the zone because it would serve to focus the attention

of prospective clients on cash savings. Finally, those firms who respond favorably to the follow-up would identify one or more market segments on which later marketing efforts could be concentrated (if further marketing efforts are justified.)

The city could obtain estimates of zone-related employment and income gains, as well as potential rental income, by further questioning positively responding firms about their expansion or relocations plans in the zone. These estimates of potential employment and income would serve as a basis for a decision concerning the inclusion of the FTZ project in the city budget. The commission would then be able to compare economic and community development projects on the basis of income and employment potential, as well as any other criteria which are appropriate. No basis currently exists for a recommendation regarding the funding of the zone project. Completion of the follow-up survey described will provide the information necessary to evaluate the FTZ project along side of alternative projects which vie for city money.

Disassociation from the EGC

The analysis of the zone project presented indicates that the bulk of the Growth Council’s relocation efforts will be fruitless. The same characteristics of the local economy that work against the FTZ project will work against other projects designed to lure businesses from elsewhere. The city should inform the Growth Council that it will not provide it with local money or help it to acquire more federal money.

Disassociation from the Growth Council may, at first, seem a drastic action. However, the consequences of continued association and support could be
dramatic. The EGC has recently changed its name and is becoming more of a "private sector initiative." It plans to become even more involved in relocation projects by buying out-of-town businesses and moving them to Great Falls.\textsuperscript{56}

Such a relocation project would be quite risky. Firms purchased by the Growth Council and relocated to Great Falls would be torn from well-established input and output markets. Such firms will probably not survive long.

The fact that fewer and fewer members of its board of directors will represent the public sector indicates that the potential for establishing public control of the organization is virtually nil.\textsuperscript{57} City representatives on the Growth Council, if there are any, will have little chance of dissuading the EGC from other expensive relocation efforts.

The EGC's failures have received extensive coverage from the news media. Such well-publicized failures can only erode public confidence in economic development efforts and the Growth Council's reputation and track record can only reflect negatively on the development efforts of the city government. The public, which only narrowly supported an additional tax for economic development in 1979, may become unwilling to fund any sort of efforts in the future.\textsuperscript{58}

The Mayor, a director and former chairman of the Growth Council, may be reluctant to abandon the organization. He must be convinced that the confidence

\textsuperscript{56} Goley, "EGC's President Looks Ahead."

\textsuperscript{57} Ibid.

\textsuperscript{58} "Economic Development Mill Levy Passes by Whisper," \textit{Great Falls Tribune} 8 November 1979, p. 8.
and support of the public and maintenance of city development projects are more important to the city, and his performance in office, than is his relationship with the EGC. If economic development efforts are questioned, other city expenditures may soon come under fire.

The city should publicly announce its withdrawal of support from the EGC and intention to continue its own development efforts through the Department of Community Development. The public (as well as the actual) rationale for this announcement is that a department of city government would be more open to citizen input and more responsible in its expenditures. A further rationale, which need not be announced, is that administration of such efforts through a department of city government, which is accountable to the city manager and ultimately elected officials for the way it spends money, would insure that the appropriate analysis be done before public money is spent on an expensive project. The Community Development Department should acquire at least one additional staff person to analyze and coordinate economic development projects. This will not be a needless expense. The EGC has spent a great deal of taxpayers' money on poorly designed projects and programs. The city must insure that such a thing does not happen again. Furthermore, savings on future development projects and programs should return this money several times over.
Local Government and Economic Development

Local government can never hope to replace the private sector as the main engine of economic growth. It should never try to do so. However, local government does have a legitimate role to play. Establishment and maintenance of a public utility such as an FTZ is an example of this role. In fact, the FTZ Board has recently decided that it would prefer that governmental entities hold the grants of authority for all such zones. Ideally, such governmental entities would be in charge of development projects from beginning to end. In the case of Great Falls' FTZ, however, a private organization made the initial investment. It made that investment with public money and, because it risked nothing of its own, it spent the funds carelessly on a project that had not been studied thoroughly. If public funds are to be used for economic development, the use of such funds must be open to public scrutiny. This is possible only if development projects compete openly with one another in the city's budget process. Inclusion of all such projects in the budget process will go far to insure that the projects are properly analyzed before significant amounts of money are sunk into them, that the projects which receive funding are the more promising of those proposed, and that management of those projects is competent and responsible. As long as the FTZ, or any other publicly funded development project, remains in the hands of the EGC, the city is in the awkward position of trying to control the activities of a private organization in order to influence the use of public funds. The budgetary

process is a far more effective control device than is tenuous representation on a private body’s board of directors.
## APPENDIX

**SUMMARY OF BUDGETED EXPENDITURES, GREAT FALLS FOREIGN TRADE ZONE**

<table>
<thead>
<tr>
<th>Expenses</th>
<th>Year-to-Date Proposed Budgeted Amount</th>
<th>Year-to-Date Expenditures</th>
<th>Variance Favorable (Unfavorable)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional Fees</td>
<td>4,170</td>
<td>10,126</td>
<td>$(5,956)</td>
</tr>
<tr>
<td>Mail Outs</td>
<td>830</td>
<td>111</td>
<td>719</td>
</tr>
<tr>
<td>Visual Aids</td>
<td>420</td>
<td>-</td>
<td>420</td>
</tr>
<tr>
<td>FTZ Signs</td>
<td>830</td>
<td>540</td>
<td>290</td>
</tr>
<tr>
<td>Small Brochure</td>
<td>830</td>
<td>-</td>
<td>830</td>
</tr>
<tr>
<td>Prospect Plan Expense</td>
<td>6,670</td>
<td>-</td>
<td>6,670</td>
</tr>
<tr>
<td>Large Color Brochure</td>
<td>4,170</td>
<td>-</td>
<td>4,170</td>
</tr>
<tr>
<td>Travel and Entertainment</td>
<td>25,000</td>
<td>4,499</td>
<td>20,501</td>
</tr>
<tr>
<td>Advertising</td>
<td>2,080</td>
<td>796</td>
<td>1,284</td>
</tr>
<tr>
<td>Activation Expense</td>
<td>20,830</td>
<td>-</td>
<td>20,830</td>
</tr>
<tr>
<td>Execute Operator Contract</td>
<td>1,670</td>
<td>-</td>
<td>1,670</td>
</tr>
<tr>
<td>Telephone/Telex</td>
<td>2,920</td>
<td>146</td>
<td>2,774</td>
</tr>
<tr>
<td>Insurance</td>
<td>1,670</td>
<td>-</td>
<td>1,670</td>
</tr>
<tr>
<td>Subscription/Dues</td>
<td>830</td>
<td>3,398</td>
<td>(2,568)</td>
</tr>
<tr>
<td>Rent</td>
<td>1,500</td>
<td>1,471</td>
<td>29</td>
</tr>
<tr>
<td>Utilities</td>
<td>4,170</td>
<td>2,292</td>
<td>1,878</td>
</tr>
<tr>
<td>Depreciation</td>
<td>2,684</td>
<td>2,684</td>
<td>-</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>1,250</td>
<td>1,684</td>
<td>(437)</td>
</tr>
<tr>
<td>TOTALS</td>
<td>$82,524</td>
<td>$27,750</td>
<td>$54,774</td>
</tr>
</tbody>
</table>

SELECTED BIBLIOGRAPHY


______. "EGC's President Looks Ahead to Council's Future." Great Falls Tribune, 20 October 1985, p. 1C.


______. Telephone Conversation. 25 February 1986.


"Special Mill Levies Questioned in City Budget Formulations." Great Falls Tribune, 23 July 1981, p. 3B.

Tubergen, Nathan. Finance Director, City of Great Falls. Telephone Conversation. 22 April 1966.


______. 1977 Census of Wholesale Trade, Geographic Area Series. Various states.

______. 1982 Census of Manufactures, Geographic Area Series: Montana.

______. 1982 Census of Wholesale Trade, Geographic Area Series: Montana.


______. "Application of Economic Growth Council of Great Falls for Grant of Authority to Operate a Foreign Trade Zone: Transcript of Proceedings." Great Falls, Montana: 16 September 1982.


Young, Roger. President, Great Falls Area Chamber of Commerce. Telephone Conversation. 18 November 1985.