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DLA-93-P10198

PROCESSING COST FOR DUTY-FREE ENTRY CERTIFICATES

November 1992

OPERATIONS RESEARCH AND ECONOMIC ANALYSIS OFFICE

DEPARTMENT OF DEFENSE

DEFENSE LOGISTICS AGENCY

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John S. McKinney

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DEPARTMENT OF DEFENSE

DEFENSE LOGISTICS AGENCY

OPERATIONS RESEARCH AND ECONOMIC ANALYSIS OFFICE

CAMERON STATION

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CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

FOREWORD

This report provides information regarding the costs and benefits associated with the Duty-Free Entry Certification Program. Duty-free certificates are issued by the DCMC International Office (DCMCI) in New York City to allow DoD duty-free importation of defense goods. The U.S. Customs Service receives the certificates and in turn releases the shipments. This study analyzes the costs and benefits of four different procedures for processing duty-free entry certificates.

Roger C. Roy
Assistant Director
Policy and Plans

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EXECUTIVE SUMMARY

The Defense Contract Management Command (DCMC) Contract Management Directorate, Transportation Division, asked the Defense Logistics Agency (DLA) Operations Research and Economic Analysis Management Support Office (DORO) in Chicago to determine the cost of issuing duty-free entry certificates. These certificates are issued by the DCMC International Office (DCMCI) in New York City to allow DoD duty-free importation of defense goods. The U.S. Customs Service receives the certificates and allows these shipments to be free of any duty. DLA avoided $41 million in duties in FY 92 at a total cost of $1.6 million.

The status quo and three alternatives were analyzed for their effectiveness in reaching the program's goals. The savings that come from not paying duties are not true savings to the Federal government as a whole. Even if these duties were paid by DLA, these amounts would stay within the government as U.S. Customs revenues. Alternatives were considered that involve paying certain duties instead of avoiding them.

A major policy change that incorporates the payment of duties was evaluated, although implementing it is probably not feasible. However, there are smaller changes that can be made to improve the efficiency of this program. One recommendation is to use a threshold to eliminate shipments with a value less than $1,160 from consideration for duty-free status. At a cost of $33 for

each certificate issued and an average duty rate of 2.9 percent, shipments under $1,160 cost more for DLA to process than the duty being avoided. Additionally, the computer system used by DCMCI should be modified to retrieve tariff codes upon input of an item description. These two modest changes together would yield savings of 3 workyears the first year, and 4 workyears in succeeding years.

These savings are actual savings to the Federal government. The cost of the amount of any duty paid is not a cost to the Federal government. These would also not be costs to DoD if reimbursed. (But they would be costs to the Army, Navy, and Air Force if not reimbursed at that level).

SECTION 1

INTRODUCTION

The Defense Contract Management Command International, International Logistics Office (DCMCI-I) in New York is charged with issuing duty-free certificates for imported defense-related goods. In accordance with Federal Acquisition Regulation (FAR) 52.225-10, no import duty is paid for certain goods and materials imported for use by defense contractors in fulfilling government contracts. Shipments from overseas consigned directly to military activities are also duty-free. Payment of these duties would in essence be a payment from one government agency to another. This FAR regulation defines which shipments will be duty-free according to criteria such as: type of item, dollar amount of contract, and whether the goods will be used solely to fulfill government contracts. The Defense Logistics Agency (DLA) must comply with the rules set forth by the U.S. Customs Office, which regulates all importation processes under the Harmonized Tariff Schedules of the United States.

When a shipment of defense goods arrives in a U.S. port, DCMCI-I first verifies that the shipment should be duty-free. This verification matches contract shipment information submitted by Administrative Contracting Officers (ACOs) with notification from U.S. Customs that a shipment has arrived in port. DCMCI-I then sends a duty-free certificate to U.S. Customs who in turn allows the shipment to be duty-free. The regulation was intended for use in solicitations and contracts over $100,000, but can also be used in smaller dollar contracts. The ACO has discretion in the application of this rule, and will often apply it to contracts well under $100,000.

The Defense Contract Management Command (DCMC), Contract Management Directorate, Transportation Division (DCMC-AT) asked the DLA Operations Research and Economic Analysis Management Support Office (DORO-C) in Chicago to perform a cost-benefit analysis of the duty-free certification program. One of the goals of this study is to find the point at which the administrative cost of issuing a duty-free certificate is greater than the duty amount DCMC wishes to avoid. Benefits that will be addressed include savings from not paying duty and the efficient use of personnel to accomplish these tasks. This study also examines alternative approaches that could be used.

SECTION 2

METHODOLOGY

2.1 APPROACH

Several alternatives for administering duty-free shipments are considered. The costs and benefits of each alternative are evaluated. These evaluations also consider the effectiveness of each alternative. A summary of the costs and benefits of each alternative is shown in Appendix B.

2.2 ALTERNATIVES

2.2.1 ALTERNATIVE ONE - STATUS QUO

Utilizing 17 workyears, DCMCI-I processes 200 or more requests for duty-free shipments each day or about 50,000 requests each year. In addition to these 17 workyears, ACOs (DCMC-wide) expend approximately 10 workyears on input and correspondence for duty-free shipments. The total number of workyears spent on this program is 27.

The system is moving towards becoming paperless, with significant strides in Electronic Data Interchange (EDI) having been taken within the last five years. These EDI initiatives have been introduced into the process continually due to directives from the U.S. Customs Service. DCMC-IC has significantly increased the amount of data it sends and receives electronically. They hope to soon be certified users of the Automated Broker Interface (ABI) system which is a direct electronic interface with U.S. Customs.

The processing of duty-free certificates at DCMCI-I is done by a staff averaging grade GS-6 Step 5. Centralizing the function in one location takes advantage of economies of scale, which helps to keep processing costs low. Without DCMCI-I, the cost per request processed would most likely be higher, assuming ACOs and others at higher grade levels would be assigned these duties.

Expediting the entry of defense goods is one of the most important services provided by the current program. Avoiding delays in getting military items through a port could be critical during a period of mobilization. The current program has proven to be effective in minimizing delays caused by Customs processing of shipments.

The total amount of duty avoided in FY 92 was approximately $41 million. The amount of duty avoided each year varies depending on the level of import activity. The savings are not true savings because the duties are paid to another government entity, U.S. Customs. Even if DLA were to pay these duties, the funds would stay within the Federal government.

The system also provides valuable balance-of-trade information. This shipping data is given to the Maritime Administration, the Census Department, and the Industrial Base Assessment Group. While providing a valuable benefit to these organizations, this data is not directly beneficial to DLA or DoD. Detailed records are kept of types of goods shipped, country of origin, and dollar amounts of shipments. This information is important and may not be easily accessible from any other source. However, if other agencies must have this data, they should be willing to reimburse DLA for it, if providing it were the **only** reason DLA had for continuing the program.

2.2.2 ALTERNATIVE TWO - IMPLEMENTING A THRESHOLD

This alternative would incorporate a threshold into the existing program. The total cost to issue one duty-free certificate is $33 (See Appendix A). Therefore, on any shipments with a duty less than $33, DoD is spending more than it is attempting to save. The DCMCI-I staff strongly supports the use of a threshold due to the prevalence of small dollar amount shipments, some being less than $10.

Shipping data for FY 91 and FY 92 defense imports was compiled and analyzed. This data consists of individual shipments with corresponding item description, tariff code, dollar value of shipment, tariff dollar value, consignee, date of entry, and other information. Frequency counts were taken to determine the most common duty rates and the ranges of shipment dollar values. Along with the analysis of this data, subject matter experts were consulted about common duty rates. As a result, the average duty rate was estimated at 2.9 percent. An average duty rate was derived due to the existence of many actual rates. The actual rates vary by the type of item being imported and the country of origin. It would be impractical to try to use the many actual rates to apply multiple thresholds to the thousands of yearly shipments. Using an average duty rate of 2.9 percent, the breakeven point occurs at a shipment value of $1,160. Below $1,160, issuing certificates is not economical. About 12 percent of the shipments have a value less than $1,160.

Eliminating these low dollar value shipments would mean 6,000 fewer certificates would be issued each year. DLA would save 2.5 workyears by putting this threshold in place. This savings would come from the reduced workload for the DCMCI-I clerical staff and ACOs.

2.2.3 ALTERNATIVE THREE - STOP AVOIDING DUTY PAYMENTS

Another alternative would be to stop avoiding the payment of duties, except on cost-plus contracts. The program in place now expends over $1.6 million in DCMC resources each year to avoid import tariffs. This approach would be radically different from the current system in that most duties would be paid (instead of avoided). In essence, these duties would be payments from one government agency to another because DoD is the ultimate buyer of the goods. Major policy changes would be needed in order to make implementation possible. Contractors would be allowed to build the cost of the duty into the contract price under this scenario. On fixed price contracts only, contractors could be reimbursed for duty payments by including the duty amount as a separate line item. Cost-plus contracts would have to continue to get duty-free status to avoid having contractors build in excess profits on the duty. This option would also require adding the cost of the duties into the DoD budget, so that DoD can pay them. If Customs were willing to reimburse DoD for these payments once each year, DoD would achieve most of the same benefits it does now, but at a much lower cost. Even if Customs were to keep these duties and not reimburse DoD, the Federal government as a whole would not be losing any money paid for duties on a net basis. DoD expenditures for duties would become Customs revenues, and the tariff payments would stay within the government.

Unfortunately, DoD is considered just another customer by Customs. In fact, DoD imports only make up about one percent of all U.S. imports. Customs has complete control of the importation process. Therefore, DoD and DLA must conform to rules set down by Customs. It may not be reasonable to expect Customs to set up a reimbursable account for DLA. Additionally, this approach could only be used on fixed price contracts. (On cost-plus contracts the contractor's profit on the duty would increase the Federal government's overall cost.)

Transportation experts believe that implementing the policy changes required for this approach would not be feasible. Also, with this option, information dealing with the balance-of-trade would no longer be gathered by DCMCI-I for most shipments. The office would no longer track countries of origin and dollar amounts for most shipments coming into this country. Information on DoD shipments is not readily available from any other sources at this time, although possibly it could be acquired directly from Customs. The U.S. Maritime Administration and other organizations would have to find or develop other data sources.

By adopting this alternative, DCMC could save approximately 16 workyears. This calculation of savings assumes that DCMC would still have to devote about 11 workyears to issue duty-free certificates for shipments on cost-plus contracts.

2.2.4 ALTERNATIVE FOUR - STOP AVOIDING COMMERCIAL DUTY PAYMENTS

Under this alternative, DLA would no longer issue duty-free certificates for commercial shipments, but would continue to issue certificates for military consigned shipments. Instead of allowing contractors to import duty-free, contractors would pay these duties. DLA would then reimburse them. As in the previous alternative, this would only apply to fixed price contracts.

Military shipments would continue to get duty-free status. DCMCI acts as the legal representative for shipments that are consigned directly to military activities. Serving as legal representative is an important value that DCMCI adds to the process. If DCMCI were not representing the military activities, each activity would have to have a representative, which would obviously complicate importation activity. For this reason, DLA should continue to issue duty-free certificates for military shipments as they do now.

If this alternative were to be adopted, commercial shipments would be processed more efficiently, with less DLA involvement. If the required DoD and Customs level policy changes could be made, DoD should pay contractors for the duty on commercial shipments and be reimbursed once a year by Customs. The estimated total savings from the use of this alternative is 10 workyears. Seventeen workyears would still have to be used in order to keep military consigned shipments and shipments under cost-plus contracts duty-free.

2.2.5 SYSTEM ENHANCEMENT

The Mechanization of Contract Administration Services (MOCAS) computer system that DCMCI uses should be enhanced to enable access to potentially correct tariff codes when item descriptions, or partial item descriptions, are input. Currently, the system allows users to type in tariff codes to generate a matching item description. When military consigned shipments reach Customs, an entry package, consisting of an invoice and bill of lading, is sent to DCMCI. Quite often, the proper tariff code must be looked-up in a large manual provided by Customs. It would be timesaving to have the system accept the name of an item and generate one or more possible tariff codes. This would greatly narrow down the search for codes and more fully utilize a computer system that already contains this information. The estimated amount of programming work that the Defense Systems Automation Center (DSAC) would have to devote to this program change is 1 workyear. Yearly savings that would result from this system change would be approximately 1.5 workyears.

SECTION 3

CONCLUSIONS

The duty-free certification program effectively ensures free entry of defense goods. However, there is a question about the need to avoid duties that are paid from one government entity to another. The actual savings realized by avoiding duties depends on the basis of comparison. DCMC avoids paying over $40 million each year in import tariffs by issuing duty-free certificates. However, even if DCMC were to pay these duties, this money would stay within the Federal government. How beneficial is it to the Federal government to have DCMC spend $1.6 million each year to avoid paying duties that would stay within the Federal government as Customs revenues?

A related question deals with the value that DLA adds to the importation process by being involved. There *is* an important value that DLA contributes when direct military consigned shipments are involved. DCMCI serves as the legal representative for receipt of these shipments, which is the reason it should continue issuing certificates for this type of entry.

For commercial shipments, however, the DCMC role provides less value added. Brokers act as the legal representatives when these shipments are imported. DCMC adds little value to the process by being involved at this stage. If the necessary policy changes can be made, DCMC should stop issuing certificates for commercial shipments and have contractors pay the duties and be reimbursed, including the duty cost in the contract (fixed price contracts only). The duty reimbursement to the contractor could be a separate line item in the contract; there would not be an added cost to DCMC or DoD to process the reimbursement. The DoD budget would have to be increased in order to reimburse contractors; this increase would be offset by increased Customs revenues. Other agencies that rely on DLA to provide shipment information would have to find another source for information on these commercial shipments if DLA no longer gathered it. (U.S. Customs or other entities may be viable alternative sources for this data.) As stated earlier, DLA does not directly benefit from the collection of this shipping data. Because of the policy changes required this approach is probably not feasible. However, there are smaller changes that can be made to the current program that can help to streamline it, including the use of a threshold.

SECTION 4

RECOMMENDATIONS

If the required DoD/Customs level policy changes could be made, DoD should pay contractors for the duty on commercial shipments and be reimbursed once a year by Customs. The savings would be significant (10 workyears). DCMCI would continue to issue duty-free certificates for military shipments.

If the program cannot be dramatically changed as mentioned above, there are less ambitious steps that should be taken. We also recommend adopting a dollar threshold to eliminate small dollar amount shipments from consideration for duty-free status. Shipments with a value less than $1,160 cost more for DLA to process than the duty amount being avoided. By removing these small dollar value shipments from the program, DLA will have approximately 6,000 fewer requests each year. The total amount of DCMCI and related ACO work saved would be 2.5 workyears. DCMCI has expressed a strong desire for a threshold.

Additionally, we recommend a minor change to the MOCAS system. At the present time, this system allows users to input tariff codes to retrieve item descriptions. This system also should provide a short list of possible tariff codes upon input of an item description. For direct military consigned shipments, the DCMCI staff must often refer to large Customs manuals to look up correct codes that they need. This programming change would help to streamline the process of obtaining proper codes. The estimated amount of programming work needed to accomplish this programming change at the Defense Systems Automation Center (DSAC) is 1 workyear. This programming change would yield annual savings of approximately 1.5 workyears at DCMCI.

Total savings for these last two more modest changes is approximately 3 workyears the first year, 4 workyears after that.

APPENDIX A
COSTS

Approximately 4,200 duty-free requests are processed by DCMCI-I each month or 50,000 per year.

GS-6 Step 5 annual salary*	$ 25,021
Fringe benefits adjustment	X 1.2955
Number of DCMCI-IC positions	X 17
DCMCI-IC annual cost	$ 551,050

$$\frac{\$\ 551{,}050}{50{,}000 \text{ requests}} = \$\ 11.02 \text{ per request}$$

Avail. workdays per year (minus leave, training)	214
Hours per day	X 8
Number of DCMCI-IC positions	X 17
Avail. hours	29,104

$$\frac{50{,}000 \text{ requests}}{29{,}104 \text{ hours}} = 1.72 \text{ requests per hour}$$

$$\text{Time per request} = \frac{1}{1.72} = .58 \text{ hours}$$

ACO initiates request with research and data base input at approximately same rate as DCMCI-I processing, completing 1.72 requests per hour or .58 hours per request; this includes time to research related documentation, and input. ACO also initiates written correspondence with contractors and/or DCMCI.

ACO's GS-11 Step 5 hourly wage**	$ 18.26
Fringe benefits adjustment	X 1.2955
Leave and training adjustment	X 1.22
Time to research, input each request (.58 hours) and complete correspondence (.20 hours)	X .78
	$ 22.51

Therefore, total cost to process certificate is	$ 22.51
	+ 11.02
	$ 33.53

ACO cost per request	$ 22.51
Number of requests per year	X 50,000
ACO cost per year	$ 1,125,500

ACO cost per year	$ 1,125,500
DCMCI-I cost per year	+ 551,050
Total annual cost of program	$ 1,676,550

*Includes 8% locality pay adjustment and 3.7% January 1993 General Schedule pay increase
**Includes 3.7% January 1993 General Schedule pay increase

APPENDIX B
SUMMARY OF ALTERNATIVES

	SAVINGS(1)	COST(2)	FEASIBILITY	ADVANTAGES/ DISADVANTAGES
ALT. 1 STATUS QUO	0; base-line(3)	27	Current program	Avoids duties/But uses substantial resources
ALT. 2 THRESHOLD	2.5	24.5	Requires change to clause	Keeps small value shipments out of process (cost to process > duty)
ALT. 3 STOP AVOIDING DUTY PAYMENTS	16	11	Major policy change; needed policy changes to pay duties probably not feasible	Efficiency; Uses fewer resources to achieve similar goals/But requires buying activity reimbursement
ALT. 4 STOP AVOIDING COMMERCIAL DUTY PAYMENTS	10	17	Significant change; retains many features of current program but policy changes may not be feasible. DCMC should **try** to implement this change.	More efficient for commercial shipments/But less trade info for other agencies

Notes- (1) Recurring annual workyears saved. There also is a recommendation for a system enhancement that could save an additional 1.5 workyears annually that is not shown in the table.

(2) Remaining recurring cost in workyears for both DCMCI and ACOs.

(3) Although $41 million in duties are avoided with the existing program, this is not true savings to the Federal government as a whole, because duties paid by DCMC would stay within the government as Customs revenues.

REPORT DOCUMENTATION PAGE

Form Approved
OMB No. 0704-0188

Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188), Washington, DC 20503.

1. AGENCY USE ONLY (Leave blank)	2. REPORT DATE	3. REPORT TYPE AND DATES COVERED
	November 1992	Final

4. TITLE AND SUBTITLE
Processing Cost for Duty-Free Entry Certificates

5. FUNDING NUMBERS

6. AUTHOR(S)
John S. McKinney

7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES)
HQ Defense Logistics Agency (DLA-LO)
Cameron Station
Alexandria, VA 22304-6100

8. PERFORMING ORGANIZATION REPORT NUMBER
DLA-93-P10198

9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)
HQ Defense Logistics Agency (DLA-AT)
Cameron Station
Alexandria, VA 22304-6100

10. SPONSORING/MONITORING AGENCY REPORT NUMBER

11. SUPPLEMENTARY NOTES

12a. DISTRIBUTION/AVAILABILITY STATEMENT
Public release; unlimited distribution

12b. DISTRIBUTION CODE

13. ABSTRACT *(Maximum 200 words)*

This report documents the costs for the processing of duty-free entry certificates by the Defense Contract Management Command International, International Logistics Office (DCMCI-I) for imported defense goods. It also addresses potential alternative methods for achieving the goals of the program. Since payment of duties by the Defense Logistics Agency to U.S. Customs would be payment from one government agency to another, consideration was given to alternatives that involve paying, rather than avoiding, certain duties. However, the major policy changes that would be required to implement such a program probably are not feasible. At a minimum, a threshold should be used to pay duty on shipments with a value under $1,160. The duty on these shipments is less than the $33 cost to process a duty-free certificate. Also, the Mechanization of Contract Administration Services (MOCAS) computer system should be modified to allow users to input item descriptions and get one or more possible tariff codes. Clerks must often look-up tariff codes for military-consigned shipments in large Customs manuals. Combined savings from a threshold and the system modification would be approximately 4 workyears.

14. SUBJECT TERMS
duty fee costs

15. NUMBER OF PAGES
25

16. PRICE CODE

17. SECURITY CLASSIFICATION OF REPORT	18. SECURITY CLASSIFICATION OF THIS PAGE	19. SECURITY CLASSIFICATION OF ABSTRACT	20. LIMITATION OF ABSTRACT
UNLIMITED	UNLIMITED	UNLIMITED	

NSN 7540-01-280-5500

Standard Form 298 (Rev 2-89)
Prescribed by ANSI Std Z39-18
298-102