



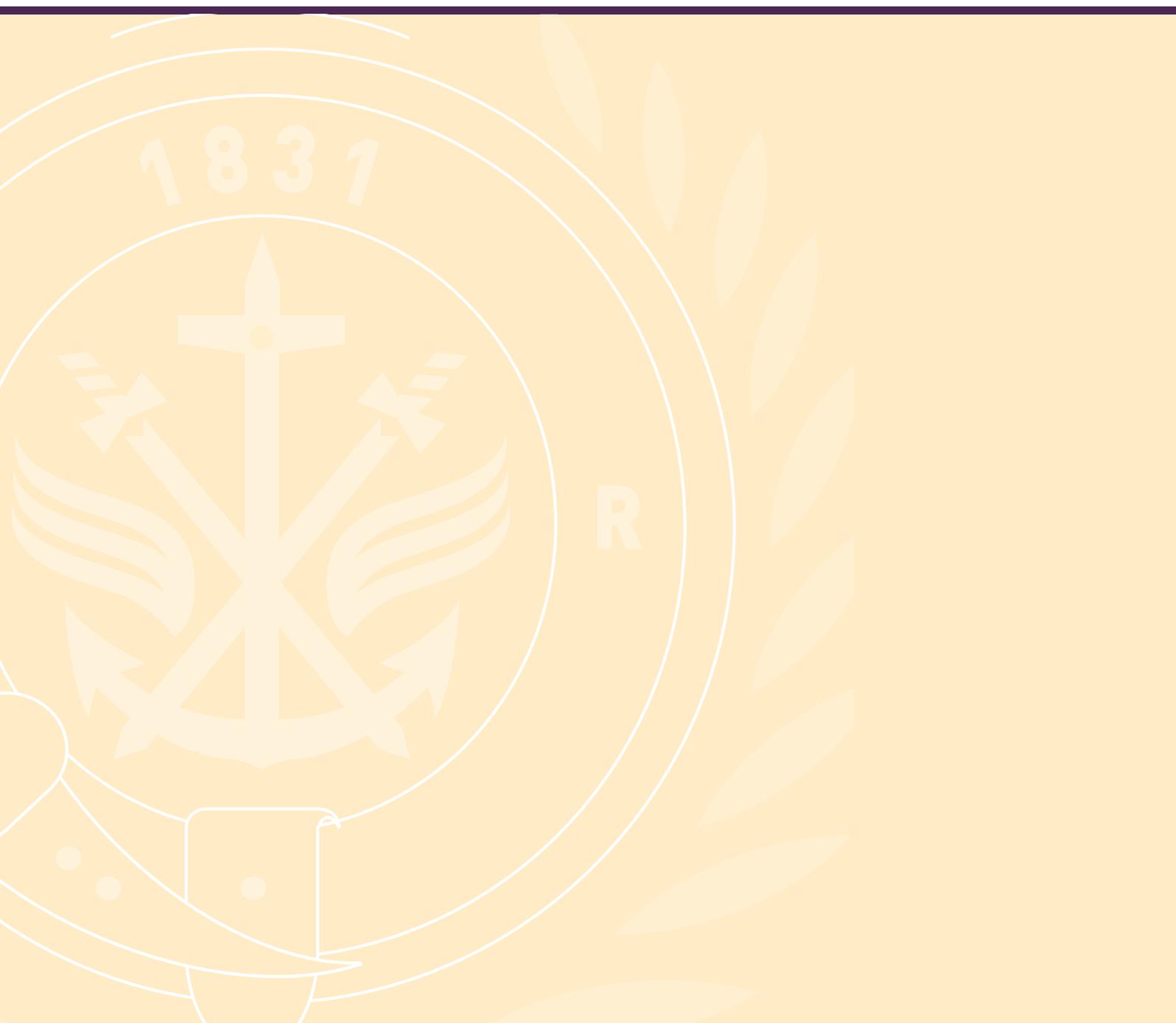
Royal United Services Institute
for Defence and Security Studies

BRIEFING PAPER

Free Ports, Not Safe Havens

Preventing Crime in the UK's Future Freeports

Anton Moiseienko, Alexandria Reid and Isabella Chase



ABOUT THIS PAPER

The authors wish to thank Keith Ditcham, Andrew Grainger, Tom Keatinge, Ron Korver and Phil Lewis for helpful feedback on an earlier draft. The paper was prepared as part of a two-year study on the integrity of free-trade zones funded by PMI Impact.

SUMMARY

In July 2019, the UK government announced plans to establish freeports to attract trade and investment following the UK's departure from the EU. Further details were provided in a consultation paper published in February 2020. Among other topics, the consultation solicits views on possible criminal risks posed by freeports.

The misuse of freeports in other countries for drug trafficking, trade in counterfeits, money laundering and a vast array of other crimes has drawn the attention of key international stakeholders, including the Financial Action Task Force (FATF), the Organisation for Economic Co-operation and Development (OECD) and the World Customs Organization (WCO). The European Parliament has gone so far as to call for the abolition of freeports in the EU.

These risks merit a strong response, and the government's consultation signals its intent to deliver precisely that. But there are gaps in the specific measures proposed. Bearing in mind that the government's plans are not yet finalised and thus subject to change, this Briefing Paper makes recommendations that will help strengthen the UK's ability to prevent illicit trade in its future freeports.

These recommendations relate to:

- The need to assess existing criminal risks in the geographical locations where freeports will be established.
 - The need for proportionate responses to the risk profile and volume of activity taking place in freeports.
 - The possibility that the envisaged 'light-touch' authorisation procedures for businesses will make it difficult to assess the risks they pose.
 - The need for regular review of the effectiveness of Freeport Operators in discharging their security-related responsibilities.
-

INTRODUCTION

In his maiden speech as prime minister, Boris Johnson announced the government's intention to establish freeports to boost economic growth in the UK.¹ Further details became available in a consultation released in February 2020, which defines freeports as 'secure customs zones' within the national territory 'where different customs rules apply'.² Freeports will attract trade by offering incentives including simplified customs procedures and the duty-free importation of goods and raw materials – unless those products are then imported into the UK marketplace.

Meanwhile, freeports elsewhere are in the spotlight for all the wrong reasons. The FATF has labelled them a 'money laundering and terrorist financing threat';³ the WCO has reported on the pernicious effects of 'low-level' customs involvement in the running of freeports;⁴ and the European Parliament has even requested that the European Commission prepare a proposal for the 'urgent phasing out' of freeports across the EU.⁵

International experience is a helpful barometer, but it would be wrong to assume that UK freeports will necessarily face the same problems. For instance, the EU's concerns are driven by the use of certain freeports for the storage of high-value goods such as art,⁶ which the UK government does not envisage.⁷

This Briefing Paper therefore analyses factors that could render UK freeports vulnerable to crime, assesses the adequacy of the mitigation measures proposed in the consultation paper and makes recommendations for bolstering the UK's ability to prevent illicit trade in its future freeports.

-
1. Prime Minister's Office, 'Boris Johnson's First Speech as Prime Minister', 24 July 2019, <<https://www.gov.uk/government/speeches/boris-johnsons-first-speech-as-prime-minister-24-july-2019>>, accessed 7 April 2020. The introduction of freeports was first proposed by the current Chancellor of the Exchequer, Rishi Sunak MP. See, See Rishi Sunak, *The Free Ports Opportunity: How Brexit Could Boost Trade, Manufacturing and the North* (London: Centre for Policy Studies, 2016)
 2. HM Government, 'Freeports Consultation: Boosting Trade, Jobs and Investment Across the UK', 10 February 2020, p. 9.
 3. Financial Action Task Force (FATF), 'Money Laundering Vulnerabilities of Free Trade Zones', March 2010, p. 6.
 4. Kenji Omi, "'Extraterritoriality" of Free Zones: The Necessity for Enhanced Customs Involvement', World Customs Organisation (WCO) Research Paper No. 47, September 2019, p. 26.
 5. European Parliament, Report on Financial Crimes, Tax Evasion and Tax Avoidance (2018/2121(INI)), 8 March 2019, para. 211, <https://www.europarl.europa.eu/doceo/document/A-8-2019-0170_EN.html>, accessed 8 April 2020.
 6. Ron Korver, 'Money Laundering and Tax Evasion Risks in Free Ports', European Parliamentary Research Service, October 2018.
 7. HM Government, 'Freeports Consultation', p. 10.

A 'BESPOKE' UK FREEPORT MODEL

The government's ambition is to develop a 'bespoke' UK freeport model that draws on international best practices.⁸ Geographical areas where governments do not levy otherwise applicable customs duties are commonly known as 'special economic zones', 'free-trade zones' or 'free zones' (referred to as freeports in this paper for consistency).⁹ A survey conducted by the WCO identified 2,300 freeports in the world in 2018, but as only one-third of WCO members responded, the actual number is probably far higher.¹⁰

Freeports are created to boost economic growth by offering a mixture of liberalised customs and tax incentives. The nature of these incentives is dictated by the type of business activity they hope to attract. In UK freeports, import duties on goods and raw materials will be suspended to stimulate high-quality manufacturing, processing and re-export activities.¹¹ Normal import duties will only be due if finished goods are then imported to the rest of the UK. Under current plans, freeports may be established anywhere in the UK, including existing sea-, rail- and airports.

Businesses operating in freeports will submit simplified import declarations, requiring less data about incoming goods and offering speedier clearances than the HMRC CHIEF (Customs Handling of Import and Export Freight) system which is otherwise used in the UK.¹² Under the current proposal, businesses will still need to complete full Entry Summary Declarations for goods entering from outside the EU. Businesses will keep their own import and export records and be required to submit 'adequate information' to a central record maintained by the Freeport Operator. This inventory system must be available remotely to 'government agencies'.¹³

Potential tax incentives are still subject to consultation. They may include tax benefits that are already in place in 48 Enterprise Zones operating in England, such as Business Rates Discount and Enhanced Capital Allowance.¹⁴

8. *Ibid.*, p. 5.

9. See the definition of a 'free zone' in WCO, 'International Convention on the Simplification and Harmonization of Customs Procedures (As Amended)', 3 February 2006, Annex D, Chapter 2.

10. Omi, "'Extraterritoriality" of Free Zones', p. 5.

11. HM Government, 'Freeports Consultation', pp. 5–10.

12. Under current standard arrangements, an importer or their agent submits a full declaration to HMRC's CHIEF system to release the goods.

13. HM Government, 'Freeports Consultation', p. 11.

14. *Ibid.*, pp. 16–17.

The government's current plans do not provide for an assessment of existing criminal risks in places where freeports will be established.

CRIMINAL RISKS IN FREEPORTS

There is a significant body of evidence concerning criminal risks in freeports and factors that give rise to those risks:

Table 1: Criminal Risk Factors in Freeports

Crime	Key Studies	Risk Factors ¹
Illicit trade in general	<p>According to a survey of 61 WCO members, the types of crime most often observed in freeports include duty fraud, tobacco smuggling, intellectual property rights infringements and drug trafficking.²</p> <p>It is, however, difficult to ascertain whether freeports are, on the whole, more vulnerable to crime than other comparable ports or logistics hubs.</p>	<p>Pre-existing risk profile. If a freeport is established in an area with established organised crime groups or entry points for illicit goods (for example, due to its geographical location), reduced customs oversight can increase these risks.</p> <p>Reduced customs controls compared to the rest of the country. These may stem from the reduced need to collect customs duties.</p>
Trade in counterfeits	<p>A 2018 OECD study found that establishing an additional freeport within an economy was associated with an average 5.9% increase in the value of counterfeit exports from the host economy between 2011–13.³ The OECD and EU Intellectual Property Office list freeports among five key factors that make countries attractive to counterfeiters.⁴</p>	<p>Insufficient oversight of commercial activities in a freeport and inadequate record keeping. This can be due to: (a) the lack of clear division of responsibilities between Freeport Operators and customs; (b) the presence of large numbers of small and medium-size enterprises; and (c) the difficulty of supervising the transformation of manufactured and reprocessed goods.</p>
Money laundering	<p>The FATF cites case studies of businesses in freeports involved in trade-based money laundering – the movement of criminal proceeds through trade.⁵</p>	<p>Prevalence of cash transactions and reduced anti-money laundering/counterterrorist financing (AML/CTF) oversight. These can enable the investment of criminal income.</p>
Tax evasion	<p>A 2019 European Commission staff document and a 2018 study commissioned by the European Parliament suggested that owners of art objects stored in a freeport could sell them without paying any indirect tax or capital gains tax in the country where the freeport was located.⁶</p>	<p>Lack of reliable beneficial ownership records. Obscuring the ownership of high-value objects can hinder tax administrations in identifying individuals and transactions liable to tax.</p>

1. These are identified based on the authors' analysis of publicly available literature as well as a series of 47 interviews conducted as part of an ongoing project on free-trade zone integrity.

2. Omi, "Extraterritoriality" of Free Zones', p. 12.

3. OECD, 'Trade in Counterfeit Goods and Free Trade Zones: Evidence from Recent Trends', 2018, p. 13.

4. OECD and EU Intellectual Property Office, 'Trends in Trade in Counterfeit and Pirated Goods', 2019, pp. 15–16.

5. FATF, 'Money Laundering Vulnerabilities of Free Trade Zones', 2010, p. 23.

6. European Commission, 'Commission Staff Working Document Accompanying the Document Report from the Commission to the European Parliament and the Council on the Assessment of the Risk of Money Laundering and Terrorist Financing Affecting the Internal Market and Relating to Cross-Border Activities', 24 July 2019, SWD/2019/650, p. 244; Korver, 'Money Laundering and Tax Evasion Risks in Free Ports'.

Crime	Key Studies	Risk Factors ¹
Tax evasion	It is also possible, in practice, to avoid paying income taxes in the art owner’s country of residence due to the limitations of information exchange between tax authorities. ⁷	
Customs duties evasion	A workshop held by the WCO identified that imported goods are ‘frequently’ missing and diverted for sale in the host country. ⁸	Inadequate physical security. This can enable uncontrolled movement of goods in and out of a freeport. The lack of clearly defined freeport boundaries can contribute to this vulnerability.

7. Korver, ‘Money Laundering and Tax Evasion Risks in Free Ports’, p. 25.

8. Omi, “‘Extraterritoriality’ of Free Zones”, p. 14.

THE UK’S PROPOSED RESPONSE

The government states that no compromise is intended insofar as ‘security, safety, workers’ rights and the environment’ in freeports are concerned.¹⁵ However, the plans laid out in the current consultation, read together with the existing legal framework, only address some of the risk factors explored above.

Table 2: Analysis of the Planned UK Response to Identified Criminal Risk Factors

Risk Factors	Planned UK Response
Pre-existing risk profile	Not addressed. The proposed criteria for designating freeports include a general reference to their ‘geographic location’ but not to these locations’ existing criminal risk profiles. This is a significant omission.
Reduced customs controls	Addressed in principle but requires effective implementation, especially if Border Force and/or HMRC are not present on site. The designation of a freeport may be revoked if HMRC is ‘satisfied that there has been a failure to comply with any condition or restriction’. ¹ HMRC also has the powers to: <ul style="list-style-type: none"> • Inspect buildings and goods within a freeport.² • Search any ship or vehicle entering or leaving a freeport.³ • Impose conditions and restrictions on the movement of goods between a freeport and the place where the goods undergo customs procedures.⁴

1. Customs and Excise Management Act, 1979, Section 100A(3)(e).

2. *Ibid.*, Section 100(F)(3).

3. *Ibid.*, Section 27(1)(e).

4. *Ibid.*, Section 31(1)(aa).

15. HM Government, ‘Freeports Consultation’, p. 9.

Risk Factors	Planned UK Response
<p>Insufficient oversight over commercial activities in a freeport</p> <p>Inadequate record-keeping</p>	<p>Insufficiently addressed.</p> <p>The government’s intention is for freeports to become ‘humming hubs of high-quality manufacturing’.⁵ If fulfilled, this will qualitatively distinguish freeports from existing customs-bonded warehouses, where customs duty and/or import VAT payments are also suspended until the goods leave the warehouse.⁶ To mitigate criminal risks, the following shortcomings should be addressed:</p> <p>a. No assessment of the risk profile of freeport businesses and activities. There is no explicit commitment to ensuring that anti-illicit trade efforts in freeports are proportionate to the risk profile of their businesses (for example, large numbers of small traders versus several multi-national corporations) and activities (for example, manufacturing or reprocessing of goods amenable to counterfeiting).</p> <p>b. ‘Light-touch’ authorisation of businesses. Businesses wishing to operate in a freeport are expected to be authorised by the government in a ‘light-touch process’ focused on a basic history of compliance and solvency.⁷ Contrary to the OECD Recommendation on Free Trade Zones,⁸ there is no commitment to identifying the person on whose behalf businesses in a freeport act, for instance, if they trade as someone’s agents. This can make it more difficult for Border Force and HMRC to identify higher-risk shipments and businesses.</p> <p>c. No review of Freeport Operators’ security-related effectiveness. In designating a freeport, HM Treasury must appoint a Freeport Operator.⁹ There is, however, no commitment to a regular review of the Freeport Operator’s effectiveness in discharging their responsibilities as regards security.</p> <p>In addressing these shortcomings, the government can learn from the experience of US foreign trade zones:</p> <ul style="list-style-type: none"> • In 2007, the Customs and Border Protection accepted the recommendation from the Government Accountability Office to conduct analysis on patterns of shipment involving foreign trade zones for risk-management purposes.¹⁰ • Foreign trade zone operators are reviewed on the basis of the Compliance Review Handbook for Foreign Trade Zones. The Handbook includes ‘a standard checklist of questions meant to identify and assess risks such as the physical security of the FTZ merchandise and the appropriateness of systems and procedures for inventory management’.¹¹

5. HM Government, ‘Freeports Consultation’, p. 5.

6. HMRC, ‘Customs Special Procedures for the Union Customs Code (Notice 3001): Annex A: Customs Warehousing’, updated 21 January 2020, <<https://www.gov.uk/government/publications/notice-3001-special-procedures-for-the-union-customs-code/annex-a>>, accessed 7 April 2020.

7. HM Government, ‘Freeports Consultation’, pp. 11–12.

8. OECD, ‘OECD Recommendation on Countering Illicit Trade: Enhancing Transparency in Free Trade Zones’, Article 1(i), 21 October 2019.

9. Customs and Excise Management Act, 1979, Section 100A(3)(c).

10. US Government Accountability Office, ‘Persistent Weaknesses in the In-Bond Cargo System Impede Customs and Border Protection’s Ability to Address Revenue, Trade, and Security Concerns’, GAO-07-561, April 2007, pp. 40–41.

11. US Government Accountability Office, ‘Foreign Trade Zones: CBP Should Strengthen its Ability to Assess and Respond to Compliance Risks Across the Program’, GAO-17-649, August 2017, p. 22.

Risk Factors	Planned UK Response
<p>Prevalence of cash transactions</p> <p>Reduced AML/CTF oversight</p>	<p>Not applicable.</p> <p>There are no plans for the AML/CTF regime in freeports to differ from that in the rest of the country. The prevalence of cash in freeports could create opportunities for the investment of criminal proceeds and should therefore be addressed as part of each freeport's risk assessment. There is currently no reason to believe that cash transactions will be widespread in UK freeports.</p>
<p>Lack of reliable beneficial ownership records</p>	<p>Addressed.</p> <p>The government has announced that it does not intend to 'designate Freeports for the purpose of High Value Luxury Storage'.¹² It has also extended AML/CTF obligations to anyone who 'by way of business stores works of art in the freeport and the value of the works of art so stored for a person, or a series of linked persons, amounts to 10,000 euros or more'.¹³</p>
<p>Inadequate physical security</p>	<p>Addressed in principle but requires effective implementation, especially if Border Force and/or HMRC are not present on site.</p> <p>The government has committed to freeports being 'secure areas' but is exploring whether a perimeter fence is essential to that.¹⁴ Border Force and HMRC will provide input to ensure that proposed boundaries of freeports are 'compatible with maintaining border security'.¹⁵</p> <p>It is important that security measures are proportionate to risks and that the government fulfils its promise to 'learn from existing ports',¹⁶ which requires taking account of the existing criminal risks in locations where freeports will be established.</p>

12. HM Government, 'Freeports Consultation', p. 10.

13. Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer of Funds) Regulations, 14(1)(d)(ii), June 2017.

14. HM Government, 'Freeports Consultation', p. 13.

15. *Ibid.*, p. 36.

16. *Ibid.*, p. 30.

CONCLUSIONS

In its present iteration, the government's plan to create freeports in the UK sends mixed signals.

On the one hand, it should be commended for consulting on optimal ways to prevent criminal misuse of freeports and committing to the safety and security of freeports.

On the other hand, the government should beware of its rhetoric of 'cutting red tape' being misinterpreted as downplaying the value of proper customs controls.¹⁶ On a practical level, its current plans do not provide for an assessment of existing criminal risks in places where freeports will be established; do not commit to anti-illicit trade efforts being proportionate to the risk profile and volume of activity taking place in freeports; envisage light-touch authorisation of businesses in freeports that may come at the expense of reliable risk assessment; and do not establish a mechanism for the review of Freeport Operators' effectiveness in discharging their security-related responsibilities.

Of course, the criminal risks inherent in freeports may never materialise if no one uses them, which could happen if they fail to offer more attractive conditions compared to existing customs processes. The UK's past freeports seem to have had little impact either for good or for bad. But if new freeports are as successful as the government hopes, they will appeal to legitimate businesses and criminals alike, and the UK's reputation will depend upon the strength of its response.

The following recommendations are aimed at bolstering this response:

1. The establishment of a freeport should involve an assessment of illicit trade and security risks specific to that location. This assessment should be undertaken with participation of Border Force, HMRC and other law enforcement agencies as appropriate. It should take into account the existing organised crime landscape in the location in question and propose measures to mitigate these threats if a freeport is established.
2. Once freeports are established, the government should: (a) publish annual statistics on their overall activity; and (b) publish law enforcement and customs seizures statistics related to freeports. This would be consistent with the government's commitment to 'facilitate greater sharing and analysis of data' on the operation of freeports.¹⁷

16. *Ibid.*, p. 5.

17. *Ibid.*, p. 28.

If new freeports are as successful as the government hopes, they will appeal to legitimate businesses and criminals alike, and the UK's reputation will depend upon the strength of its response

3. Border Force and HMRC should conduct regular analysis of the patterns of trade involving freeports to identify anomalies and support risk-management efforts.
4. The efforts taken by Border Force and HMRC to prevent and detect illicit trade in freeports, including the frequency of physical inspections of goods, should be proportionate to: (a) the risk profile of businesses and activities; and (b) the volume of trade. Random physical inspections should be conducted to ensure compliance. Effective information sharing between Border Force, HMRC and other law enforcement agencies will be key to ensuring the effectiveness of these efforts.
5. Due diligence conducted on businesses operating in freeports should enable robust assessment of the risks they pose. In particular, if a business operating in a freeport trades on someone else's behalf, it should be required to disclose that person's identity. Further thought should be given to which agency can conduct checks most effectively and which should be responsible for doing so.
6. The effectiveness of Freeport Operators in discharging their security-related responsibilities should be subject to periodic review.
7. The government should require Freeport Operators to comply with the OECD Code of Conduct for Clean Free Trade Zones, including: appointing a dedicated point of contact for law enforcement liaison activities; incentivising electronic payments and ensuring the traceability of cash transactions; and participating in peer learning with other UK and international freeport administrators.
8. As part of its commitment to challenge-based initiatives aimed at developing technology that facilitates the operation of freeports, the government should consider trialling such initiatives for the purposes of better illicit trade detection.

ABOUT THE AUTHORS

Anton Moiseienko is a Research Fellow at RUSI's Centre for Financial Crime and Security Studies.

Alexandria Reid is a Research Analyst in the Organised Crime and Policing research group at RUSI.

Isabella Chase is a Research Analyst at RUSI's Centre for Financial Crime and Security Studies.