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Improving Governance and Tackling Crime in Free-Trade Zones

Anton Moiseienko, Alexandria Reid and Isabella Chase

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Executive Summary

FREE-TRADE ZONES (FTZS) are designed to attract trade by suspending the collection of customs duties. These incentives are frequently coupled with advantages such as simplified customs inspection procedures, liberalised incorporation regimes and physical infrastructure superior to that available elsewhere in the same country. These features can be attractive to legitimate businesses and criminal groups alike. International organisations such as the OECD, the World Customs Organization, the Financial Action Task Force and the EU have all highlighted criminal risks related to FTZs.

This paper identifies factors that render FTZs vulnerable to illicit trade and financial crime and proposes measures to detect and prevent it. To explore common challenges and responses that transcend countries' individual circumstances, it examines four country case studies: Morocco, Panama, Singapore and the UAE.

Based on 74 interviews, two research workshops and an analysis of publicly available literature, this paper identifies key challenges faced by the case study countries, which are also likely to apply to other countries that host FTZs:

- **The lack of consistent international standards and incentives for the policing of goods that pass through FTZs in transit**. Ensuring that FTZs are not abused for criminal gain tends to be a secondary national objective, especially if the goods transiting or being processed in an FTZ never enter the host jurisdiction. Although this gives rise to illicit trade risks that adversely impact foreign trading partners, the experience of case study countries suggests that they face much more international pressure in relation to tax competition matters, whereas illicit trade prevention has not been nearly as prominent an issue.
- **Inadequate understanding of FTZ-related criminal risks in general and financial crime risks specifically, including at the stage of planning and approving the establishment of an FTZ**. At a universal level, all logistics hubs – including sea and rail terminals and airports – are vulnerable by virtue of facilitating high volumes of trade at the fastest pace possible. What makes FTZs different, however, is that they operate under liberalised conditions, including simplified customs procedures. These risks are not always taken into account at the stage of planning and approving an FTZ. Even once an FTZ is in operation, disagreements may persist in relation to key facts pertinent to its criminal profile, such as the volume of cash transactions in the zone. This patchy understanding of risk impedes risk-based law enforcement efforts, anti-money-laundering/counterterrorist-financing (AML/CTF) supervision and efforts to prevent sanctions and export control evasion.
- **Uncertainty in the division of responsibility for the monitoring, governance and regulation of FTZs, including limited information sharing and failure to involve customs agencies in FTZ-level risks assessment**. Despite the variety of approaches to

FTZ governance, there is in general some degree of reliance by governments on FTZ administrators to operate the zone, who in turn expect FTZ users to abide by the rules. With the multiplicity of other authorities governing the zone in some capacity, from customs agencies to the police, this arrangement requires clarity about responsibilities and effective coordination, including information sharing. Intuitive though they are, these principles are more honoured in the breach than in the observance. For instance, simply because an FTZ administrator is supposed to carry out due diligence on prospective users does not mean that this takes place to a high standard and the administrator has the right staffing, training and IT resources.

- **The absence of credible monitoring of FTZ administrators and users, as well as the resulting gap in enforcement**. With little to no information publicly available on the monitoring of FTZ administrators' security-related performance, it does not appear likely to entail any more robust approach than having an informal conversation with the administrator if the zone's activities reflect poorly on the country's reputation. Similarly, FTZ users frequently operate in the absence of meaningful oversight. In some cases, there is little to oversee to begin with, as FTZ users face no significant obligations to ascertain that they are not facilitating illicit trade when acting on behalf of third parties.
- **The lack of proportionate sanctions and AML/CTF supervision of FTZ-based businesses that would take account of the risk profile and volume of FTZ activities**. Although no less exacting AML/CTF rules tend to apply within FTZs than in the rest of the territory, the volume and diverse nature of activities in FTZs present challenges that compound the usual difficulties of AML/CTF supervision.
- **Limited cooperation with the private sector**. Despite the contribution that logistics companies and intellectual property rights holders can make to FTZ integrity by volunteering information to FTZ administrators and/or state authorities, gaps remain in both incentivising them to do so and providing avenues for regular submission of information. In contrast, the financial sector is both obligated to report suspicious activity and has a formal process for doing so, but regulators do not often tell financial institutions how to recognise suspicious activity relating to FTZs.

These challenges are formidable but not insurmountable. Over the past year, progress has been made, including by the OECD with its Code of Conduct for Clean Free Trade Zones and the World Free Zones Organization – an industry group representing over 600 FTZs around the world – with its Safe Zone certification programme. Advances have also been made at the national level.

To support the implementation of the new international standards, as well as to address other issues identified in the course of the research, this paper makes a range of recommendations in the areas of: policing FTZs; understanding FTZ-related criminal risks; dividing responsibilities in FTZ governance and ensuring coordination; implementing AML/CTF and sanctions measures; and cooperating with the private sector.

Introduction

FREE-TRADE ZONES (FTZs), also known as free zones or freeports, are designed to attract trade by suspending the collection of import duties and taxes. This feature is key to the definition of FTZs in the International Convention on the Simplification and Harmonization of Customs Procedures (the Revised Kyoto Convention):

> 'Free zone' means a part of the territory of a Contracting Party where any goods introduced are generally regarded, *insofar as import duties and taxes are concerned*, as being outside the Customs territory.[1]

FTZs bear resemblance to customs bonded warehouses, where goods can likewise be placed free from customs duties, but FTZs typically permit a broader range of activities beyond storage.[2] Furthermore, other incentives are frequently available in FTZs, including simplified customs inspection procedures, liberalised taxation[3] and physical infrastructure superior to that available elsewhere in the country.[4] Zones that offer some or all of these advantages are sometimes called 'special economic zones' (SEZs).

FTZs have attracted considerable international scrutiny in recent years. The World Customs Organization (WCO) has reported on the adverse effects of 'low-level' customs involvement in FTZs;[5] the Financial Action Task Force (FATF) has called them a 'money laundering and terrorist financing threat';[6] and in 2019, the European Parliament requested that the European Commission prepare a proposal for the 'urgent phasing out' of freeports across the EU.[7] In the

1. World Customs Organization (WCO), 'International Convention on the Simplification and Harmonization of Customs Procedures (as amended)', 3 February 2006, Annex D, Chapter 2. Authors' emphasis.
2. International Chamber of Commerce (ICC) and Business Action to Stop Counterfeiting and Piracy (BASCAP), 'Controlling the Zone: Balancing Facilitation and Control to Combat Illicit Trade in the World's Free Trade Zones', May 2013, p. 8.
3. Michael Fodor and Nada Farid, 'Free Zones: Benefits and Costs', OECD Observer, November 2009, <http://oecdobserver.org/news/archivestory.php/aid/3101/Free_zones:_Benefits_and_costs.html>, accessed 14 September 2020.
4. OECD and EU Intellectual Property Office (EUIPO), *Trade in Counterfeit Goods and Free Trade Zones: Evidence from Recent Trends* (Paris: OECD Publishing, 2018), p. 34.
5. Kenji Omi, '"Extraterritoriality" of Free Zones: The Necessity for Enhanced Customs Involvement', World Customs Organization Research Paper, No. 47, September 2019, p. 26.
6. Financial Action Task Force (FATF), 'Money Laundering Vulnerabilities of Free Trade Zones', March 2010, p. 6.
7. 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 14 September 2020.

US, the Congressional Commission on Security and Cooperation in Europe, known as the US Helsinki Commission, hosted public hearings on illicit trade in FTZs in September 2018.[8]

Despite this, the model remains attractive and many countries – including the UK and China – continue to establish new FTZs. There are reportedly over 3,500 zones in 130 countries today, a dramatic increase from just 79 zones in 25 countries in 1975.[9] Countries that host FTZs are engaged in a legitimate quest to attract commerce and foreign investment. Dubai, for example, relies on FTZs for around 41% of its total trade;[10] the Jebel Ali Free Zone alone accounts for 32% of all foreign direct investment in the UAE.[11] In Morocco, participants of a workshop convened by RUSI spoke eloquently of their country's right to development and the role that FTZs play in that endeavour.[12]

An approach that regards all of these FTZs as generically high risk is unlikely to improve global standards. No two zones are exactly the same and standards can vary considerably across zones within a single country, with certain FTZs presenting a higher risk than others. Nor is this to say that FTZs are uniquely susceptible to crime: all of the illicit trade and financial crime common to FTZs also occurs outside them. All logistics hubs including sea and rail terminals and airports are fundamentally vulnerable to illicit activity by virtue of the fact that they exist to facilitate a high volume of trade at the fastest possible pace. What makes FTZs different, however, is that they operate under liberalised conditions that can reduce monitoring and oversight compared to other logistics facilities.[13]

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8. Commission on Security and Cooperation in Europe, 'Free-Trade Zones', 12 September 2018, <https://www.csce.gov/international-impact/events/free-trade-zones>, accessed 23 September 2020.
9. OECD, 'Free Trade Zones Are Being Used to Traffic Counterfeit Goods', 15 March 2018, <http://www.oecd.org/industry/free-trade-zones-are-being-used-to-traffic-counterfeit-goods.htm>, accessed 14 September 2020.
10. Sarah Townsend, 'Dubai Free Zones Saw 22% Growth This Year, Government Says', *The National*, 22 December 2018, <https://www.thenational.ae/business/economy/dubai-free-zones-saw-22-trade-growth-this-year-government-says-1.805246>, accessed 21 August 2020.
11. Waheed Abbas, 'More Relief as Three UAE Free Zones Are Out of VAT Scope', *Khaleej Times*, 5 July 2018, <https://www.khaleejtimes.com/business/local/More-relief-as-three-UAE-free-zones-are-out-of-VAT-scope>, accessed 23 September 2020.
12. Participant interventions at a workshop hosted by RUSI and the Policy Center for the New South, Rabat, 12 February 2020. See Policy Center for the New South, 'Assessing Free Trade Zone Integrity', <https://www.policycenter.ma/events/conferences/assessing-free-trade-zone-integrity#.XymbOi2ZORs>, accessed 18 August 2020.
13. Omi, '"Extraterritoriality" of Free Zones', p. 3; FATF, 'Money Laundering Vulnerabilities of Free Trade Zones', p. 15; Fodor and Farid, 'Free Zones'; OECD and EUIPO, *Trade in Counterfeit Goods and Free Trade Zones*, p. 34.

Objective

The objective of this paper is to identify factors that render an FTZ vulnerable to illicit trade and financial crime and propose measures for better detection and prevention.[14] It focuses on common challenges and responses that transcend countries' individual circumstances in order to provide recommendations for improving the integrity of FTZs worldwide.

This paper forms part of a two-year study. The next and final step in the project is the development of a manual that private sector companies can use to assess their exposure to the risk of unwittingly facilitating crime when dealing with businesses that are based in or use FTZs. This paper paves the way for the development of the manual by explaining factors that can make FTZs appealing to criminal groups and exploring possible methods of addressing the problem. The provisional list of such risk factors based on research to date is available in the Annex.

Methodology

This paper bases its findings and recommendations on the experiences of four case study countries: Morocco, Panama, Singapore and the UAE.[15] Country selection was based on the authors' evaluation of the international significance of their FTZs and diverse economic, geographic and social profiles. These case studies provided an opportunity to examine the purpose, governance and regulation of FTZs in different contexts and identify common challenges in their administration and oversight.

The project began with a literature review of FTZ-related reports by international organisations, governments and academic experts, court case materials, and news reports. The authors then conducted semi-structured interviews and workshops using an interview protocol that was adjusted as necessary depending on the interlocutor's area of expertise and the context of the conversation. In most cases, conversations covered FTZ-related criminal risks and responses to them in the country in question, including the role of the private sector. Experts interviewed included: government officials; FTZ administrators; financial sector compliance officers; logistics company staff; FTZ users; and academics.

14. The paper does not examine other types of crime or other misconduct in FTZs, such as labour law violations or corruption that does not relate to illicit trade or financial crime.
15. Morocco's largest FTZ, Tangier Free Zone, is a key transhipment hub due to its proximity to Europe. Panama's Colón Free Zone is one of the world's busiest FTZs and has been alleged to play a part in drug-related money laundering. The Port of Singapore is estimated to be the world's biggest transhipment hub. The UAE likewise finds itself at geographical crossroads. It also serves both as a financial centre and a trading hub for high-value commodities, including precious metals and stones.

The following list details the interviews and consultative workshops that have been conducted as part of this research:

- A total of 74 semi-structured interviews, including 19 interviews conducted during fieldwork in Panama City and Colón (Panama) in October–November 2019; 12 interviews conducted during fieldwork in Rabat and Casablanca (Morocco) in February 2020; 13 interviews conducted remotely with Singapore-based experts in June 2020;[16] and 30 interviews with various UK-based and overseas experts conducted remotely from London throughout 2019–2020.
- A research workshop held in Panama City on 30 October 2019 in partnership with Grupo FARO and attended by over 20 participants from Panamanian governmental institutions and private sector companies, including financial institutions.
- A research workshop held in Rabat on 12 February 2020 in partnership with the Policy Center for the New South and attended by over 20 participants from Moroccan governmental institutions, academia and civil society.
- A meeting of the Advisory Board for Developing the Manual on Assessing Free Trade Zone Integrity held remotely on 27 April 2020 as part of the authors' ongoing work on a risk assessment manual due to be published as part of the same project in 2021.

Interviews and workshops were conducted in coordination with local research partners, who played a key role in identifying suitable key informants based on their country-specific expertise and contacts. The research partners are: Grupo FARO, an Ecuadorean think tank with a registered office in Panama; the Policy Center for the New South, a Moroccan think tank; and Henry Gao of Singapore Management University. No local partner was available in the UAE and its experience was explored on the basis of a review of the literature and nine interviews conducted remotely.

Structure

Chapter I discusses common criminal risks in FTZs. Chapter II presents systemic factors that tend to contribute to those risks. Chapter III identifies priorities in addressing FTZ-related criminal risks. The final chapter offers conclusions and recommendations.

16. A research trip to Singapore planned for April 2020 had to be cancelled due to the coronavirus pandemic, which prevented the authors from holding an in-country workshop.

I. Criminal Risks in FTZs

A SOUND ASSESSMENT OF criminal risks in any individual FTZ has to be informed by an understanding of the vulnerabilities and typologies of criminal abuse common to the FTZ model more broadly. This chapter summarises evidence of the use of FTZs for: illicit trade, including the manufacture, transhipment and importation of illicit, counterfeit and contraband goods; financial crime, including money laundering, terrorist financing and sanctions and export control evasion; and tax evasion. It draws on existing literature supplemented with fieldwork findings.

Illicit Trade

The authors identified several typical characteristics of FTZs that render them attractive for illicit trade purposes, including:

- Their role as common transit locations, which provides the opportunity to: repackage and relabel goods; forge key documents, such as bills of lading or certificates of origin; and co-mingle licit and illicit goods.
- The availability of infrastructure to manufacture or assemble illicit goods, with limited oversight providing an ideal environment for producing and shipping such goods to consumer markets.
- The relaxed tariff regime, which creates incentives for leaking products to the rest of the country's territory in order to evade import duties.

Seizure reports implicate FTZs in the transit of a slew of products. The WCO's analysis of 626 FTZ-related seizures between 2011 and 2018, reproduced in Table 1, identifies the diversity of products seized as a 'notable trend'. Drugs, counterfeits and tobacco accounted for 22%, 20% and 10% of seizures respectively, but seizures of weapons, wildlife and foodstuffs were also recorded in statistically significant quantities.[17] Press reports implicate FTZs in further types of illicit trade, such as the storage and sale of stolen antiquities,[18] and illicit trade in fuel was mentioned during research interviews.[19]

17. Omi, '"Extraterritoriality" of Free Zones', p. 13.
18. UNESCO Intergovernmental Committee for Promoting the Return of Cultural Property to its Countries of Origin or its Restitution in Case of Illicit Appropriation, 'Free Ports and Risks of Illicit Trafficking of Cultural Property', 20th Session, UNESCO Headquarters, 29–30 September 2016, accessed 23 September 2020.
19. Telephone interview with a Singapore-based anti-illicit trade expert, 24 September 2019.

Table 1: WCO Seizure Statistics

Name	Number of Seizures
Drug	148
Intellectual Property Rights	143
Other prohibitions	134
Tax evasion	77
Tobacco	62
Other	26
Beverage	19
Textile, footwear	18
Weapons	17
Machinery	11
Wood, pulp	8
Miscellaneous	8
Other commodities	5
Plastic, rubber	4
Prepared foodstuffs	3
Chemical	3

Source: Taken and adapted from Kenji Omi, '"Extraterritoriality" of Free Zones: The Necessity for Enhanced Customs Involvement', World Customs Organization Research Paper, No. 47, September 2019, p. 13. Seizures classified according to WCO CEN Database recording procedures.

Understanding Illicit Trade in FTZs

In interpreting this evidence, a note of caution is in order. It is possible that FTZs are used for illicit trade not *because* they are subject to distinct regulation but simply because they are high-volume logistical hubs. This is at its most obvious in Singapore, where most (if not all) transhipment activities can only take place via an FTZ. It is uncertain whether designating a port or another logistical hub as an FTZ makes it more attractive for illicit trade purposes. Further, an academic study published in 2020 identified a long-running history of criminal exploitation in the seaports of Genova, Liverpool, Melbourne, Montreal, New York and New Jersey, none of which are FTZs.[20]

Comparing the criminal profile of FTZs with that of other logistical hubs is challenging partly due to the clandestine nature of criminal activity, but also because of the dearth of publicly available data. Although there is an abundance of anecdotal information about FTZ-related criminal risks, there is a lack of regularly published and verifiable statistics on enforcement actions and detected criminal activities in FTZs.

The most relevant data is published on an ad hoc basis, and its format, purpose and target audience vary considerably, as reflected in Table 2.

Table 2: Key Sources of Illicit Trade Statistics for FTZs

Source	Statistics on Illicit Trade in or via FTZs
WCO	• **Database**. The Customs Enforcement Network (CEN) database, which is not open to the public, contains information voluntarily reported by countries on FTZ-related seizures. • **Publications**. A publicly available 2019 policy paper analyses FTZ-related seizures in the CEN database.[21]
OECD	• **Publications**. A 2018 OECD study found that establishing an additional FTZ within an economy was associated with an average 5.9% increase in the value of counterfeit exports from a host economy between 2011 and 2013.[22] The OECD and EU Intellectual Property Office list FTZs among five key factors that make countries attractive to counterfeiters.[23] • **Implementation of the Code of Conduct for Clean Free Trade Zones**. As the OECD works on implementing its Code of Conduct for FTZs, it is unknown whether it will publish information concerning FTZ compliance.[24]

20. Anna Sergi, *The Port-Crime Interface: A Report on Organised Crime and Corruption in Seaports* (Essex: University of Essex, 2020).
21. Omi, '"Extraterritoriality" of Free Zones', 2019.
22. OECD and EUIPO, *Trade in Counterfeit Goods and Free Trade Zones*, p. 13.
23. OECD and EUIPO, *Trends in Trade in Counterfeit and Pirated Goods*, pp. 15–16.
24. OECD, 'OECD Recommendation on Countering Illicit Trade: Enhancing Transparency in Free Trade Zones', 21 October 2019, Article 1(i).

FATF	• **Mutual evaluation reports (MERs)**. FATF and FATF-style regional bodies' MERs sometimes contain information on FTZs in respective countries.[25] • **Typology documents**. In a 2010 publication, the FATF cites case studies of FTZs involved in terrorist financing, money laundering and trade-based money laundering.[26]
Individual countries	• Some governments report information on law enforcement activities on an ad hoc basis. For example, Singapore Customs' magazine, *InSync*, consistently reports on seizures of illicit goods within FTZs.[27] • Governmental publications sometimes feature observations on illicit trade and financial crime vulnerabilities of other countries' FTZs. This is done most consistently in the US Department of State's annual International Narcotics Control Strategy Report.

Source: Author generated

With the exception of the documents listed above, there are few – if any – sources of information on: the rates of seizures of illicit goods; types of (legitimate) goods traded; key trading partners; and known illicit trade and financial crime typologies in FTZs. This may be partly due to restrictions on the sharing of law enforcement data, particularly in relation to ongoing investigations.[28] At the same time, it is unclear why aggregated statistics cannot be published.

Coupled with multiple known examples of criminal exploitation, FTZs therefore maintain a poor reputation as global facilitators of illicit trade even where data proving this abuse is unavailable. In other words, the absence of evidence of law enforcement activity inside FTZs is taken for the absence of proper checks and controls. The notorious difficulty with criminal justice statistics is that more detected crime can mean either more crime or better detection, and vice versa. That said, there should be no significant downsides to publicising FTZ-related law enforcement activities, save for the embarrassment of countries that have no enforcement activity to show.

An alternative approach is to publish statistics on seizures relating to products shipped from other countries' FTZs. Since it originates from the outside, such information would provide a

25. See, for example, FATF, 'Singapore: Mutual Evaluation Report', September 2016, p. 16; FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', 2020; Financial Action Task Force of Latin America (GAFILAT), 'Mutual Evaluation Report of the Republic of Panama', January 2018, p. 83, para. 346; Middle East and North Africa Financial Action Task Force (MENAFATF), 'Kingdom of Morocco: Mutual Evaluation Report', April 2019, p. 19.
26. FATF, 'Money Laundering Vulnerabilities of Free Trade Zones', p. 23.
27. This includes: 'Keeping Singapore's Free Trade Zone in Check' (No. 45, April-June 2017); 'Upholding the Security of Free Trade Zones' (No. 47, October–December 2017); 'Companies Operating in Free Trade Zones: Four Points You Should Know' (No. 48, January–March 2018); 'Transhipment Procedures: Dos and Don'ts' (No. 49, April–June 2018); 'Eye on the Ground: Routine FTZ Checks Result in Arrest of Three Men Involved in Import of Counterfeit Phone Parts' (No. 53, April–June 2019).
28. The authors are grateful to a peer reviewer for pointing this out.

snapshot of higher-risk FTZs. In a 2019 paper, the WCO undertook the analysis of precisely such data in its CEN database, but its availability was limited.[29] Relevant records only included 85 cases of seizures of goods coming from another country's FTZ, compared to 626 seizures within FTZs of member countries. A possible explanation for this disparity is that customs agencies typically record the country from which the shipment has arrived but not whether it comes from a specific FTZ in that country.

Despite these data limitations, however, it is possible to identify several common commodity-focused abuses of FTZs.

Counterfeits

Compared to other types of illicit trade, the abuse of FTZs is best documented in the context of the manufacture and trade of intellectual property infringing products ('counterfeits') and illegal wildlife trade (IWT), discussed below. In 2018, the OECD and EU Intellectual Property Office (EUIPO) published an analysis of global seizure data demonstrating that the value of counterfeit and pirated goods exported from a country rose in parallel with the number and size of FTZs it hosts,[30] with the establishment of an additional FTZ associated with an average 5.9% increase in the value of counterfeit exports from a host economy.[31] A year later, the same organisations listed FTZs among five key factors that make countries attractive to counterfeiters, identifying Panama, Singapore and the UAE among the key transit hubs misused for the trade in counterfeit goods.[32] Some FTZs house facilities for the manufacture of specific counterfeit or illicit goods,[33] especially tobacco products, a criminal industry which reportedly results in global tax losses of $40–50 billion per year.[34]

29. Omi, '"Extraterritoriality" of Free Zones', p. 13.
30. OECD and EUIPO, *Trade in Counterfeit Goods and Free Trade Zone*s, p. 13.
31. *Ibid.* Based on 2011–13 seizure and trade data.
32. OECD and EUIPO, *Trends in Trade in Counterfeit and Pirated Goods*, pp. 15–16.
33. Telephone interview with a retired customs and port security expert, 7 May 2020; video interview with two former law enforcement officers (UK and US), 15 April 2020.
34. Sheila Dutta (ed.), 'Confronting Illicit Tobacco Trade: A Global Review of Country Experiences', Technical Report of the World Bank Group Global Tobacco Control Program, 2019, p. xii.

Box 1: Illicit Tobacco Trafficking

The abuse of FTZs for illicit tobacco trafficking is global and systemic. In Latin and Central America, FTZs in Panama, Belize and Colombia are intra-regional distribution points for illicit tobacco products.* Other commonly implicated FTZs include those in Singapore, the Philippines, Malaysia, China, Greece and Egypt.† In 2016, the WCO-led Operation *GRYPHON II* seized millions of illicit tobacco products connected to FTZs, publicly confirming the 'well-known fact that Free Trade Zones are used for illicit trade'.‡ This led to the identification of several key typologies, including the practice of recording tobacco products as 'lost in transit', enabling a criminal network to either 'leak' the product onto the local market, or repackage and reship the consignment with false documentation.§

* KPMG, 'Project EOS: A Study of Illicit Cigarette Consumption in Latin America and Canada', 2017, p. 12.

† WHO, 'The Protocol to Eliminate Illicit Trade in Tobacco Products: Questions and Answers', <https://www.who.int/fctc/protocol/faq/en/index1.html>, accessed 14 September 2020.

‡ WCO, 'WCO Announces the Results of its First Global Operation Against Illicit Trade in Tobacco', 13 October 2014, <http://www.wcoomd.org/en/media/newsroom/2014/october/wco-announces-the-results-of-its-first-global-operation-against-illicit-trade-in-tobacco.aspx>, accessed 23 September 2020; WCO, 'Millions of Cigarettes Seized During Operation GRYPHON II', 12 July 2016, <http://www.wcoomd.org/en/media/newsroom/2016/july/millions-of-cigarettes-seized-during-operation-gryphon-ii.aspx>, accessed 6 October 2020.

§ WCO, 'WCO Announces the Results of its First Global Operation Against Illicit Trade in Tobacco'.

Interpol highlights the key role of the Jebel Ali Free Zone in Dubai and Port Klang in Malaysia (among others) in the production of 'illicit whites' – defined as cigarette brands produced on an industrial scale primarily for the purposes of smuggling into foreign marketplaces.[35] In 2016, up to 57% of illicit whites in the Maghreb region originated from trademark owners based in UAE FTZs.[36] Illicit whites and counterfeit cigarettes accounted for more than 14.1% of total cigarette consumption in the EU in 2019, according to KPMG.[37] According to the Italian research centre Transcrime, there are at least 10 FTZ-registered factories in the UAE, providing a combined manufacturing capacity of 63 billion cigarettes a year, which creates risks for illicit production of cigarettes in the absence of sufficient oversight.[38]

35. KPMG, 'Project SUN: A Study of the Illicit Cigarette Market in the European Union, Norway and Switzerland', 2017, p. 1.
36. KPMG, 'Illicit Cigarette Trade in the Maghreb Region', 26 July 2017, p. 7.
37. KPMG, 'Illicit Cigarette Consumption in the EU, UK, Norway and Switzerland', 2019, p. 16.
38. Alberto Aziani and Marco Dugato (eds), *ITTP NEXUS in Europe and Beyond* (Milan: Transcrime – Università Cattolica del Sacro Cuore, 2019), p. 152.

Illegal Wildlife Trade

The attraction of FTZs for trade in controlled goods, such as wildlife products, lies in the opportunity to manipulate the origin or final destination of a consignment and thereby confuse risk-based profiling systems that use cargo declarations to determine containers for inspection.[39]

This has been observed in various geographies, including the use of FTZs for waste trafficking from Europe to other parts of the world.[40] However, IWT tends to be most often reported in Asian FTZs, which is a consequence of Asian countries being major destination markets for wildlife products:

- In 2019, UNODC reported that multiple FTZs in Laos and Myanmar had become 'key nodes' in the regional supply chain for drugs, precursor chemicals used to produce methamphetamine and wildlife products.[41] The Golden Triangle Special Economic Zone (GTSEZ) in Laos is a well-known regional hub for the trade and consumption of illegal wildlife products including endangered tigers, pangolins, helmeted hornbills, rhino horn and elephant ivory.[42] In 2018, the US Office of Foreign Assets Control (OFAC) designated as sanctioned the Zhao Wei transnational criminal organisation for their role in operating wildlife and human-trafficking operations based in the GTSEZ.[43]
- Other FTZs in the region have also recorded notable seizures in recent years. In August 2018, Royal Malaysian Customs made the largest seizure to date of rhino horn in Southeast Asia when over 50 pieces valued at an estimated $12 million were intercepted in Kuala Lumpur Airport's Free Commercial Zone.[44] The proximity of Hong Kong's freeport[45] to end consumer markets in China has been further identified as a key vulnerability for illegal timber trade, ivory trafficking and abalone harvested in South

39. OECD, *Governance Frameworks to Counter Illicit Trade* (Paris: OECD Publishing, 2018).
40. *Prothom Alo*, 'Sri Lanka Says Illegal UK Waste Discharged at India, Dubai', 29 July 2019, <https://en.prothomalo.com/environment/Sri-Lanka-says-illegal-UK-waste-discharged-at>, accessed 23 September 2020.
41. UNODC, 'Transnational Organized Crime in Southeast Asia: Evolution, Growth and Impact', 2019, p. 16.
42. Environmental Investigation Agency, 'Sin City: Illegal Wildlife Trade in Laos' Golden Triangle Special Economic Zone', March 2015; Traffic, 'Golden Triangle Under Spotlight as Illegal Wildlife Trade Hub', November 2017.
43. US Department of the Treasury, 'Treasury Sanctions Against the Zhao Wei Transnational Criminal Organization', 30 January 2018.
44. Traffic, 'Malaysia Makes Massive Viet Nam-Bound Rhino Horn Seizure', 20 August 2018, <https://www.traffic.org/news/malaysia-makes-massive-vietnam-bound-rhino-horn-seizure/>, accessed 23 September 2020.
45. The term 'freeport' is often used as either a synonym for FTZ or, in this case, the type of FTZ which specialises in the long-term storage of goods.

Africa.[46] In Singapore, almost 30,000 logs of internationally protected rosewood were seized in Jurong Port en route from Madagascar to Hong Kong in 2014, which gave rise to a case that ended up in Singapore's highest court.[47]

Financial Crime

In addition to various types of illicit trade, FTZs can be used for: moving or disguising criminal income (money laundering); moving value for the benefit of terrorist groups (terrorist financing); moving cargo for the benefit of or providing funds or resources to sanctioned persons or in support of the proliferation of weapons of mass destruction (sanctions evasion and proliferation); and unlawfully evading tax.

Money Laundering

For convenience, these risks can be divided into: trade-based money laundering (TBML); placement of criminally obtained cash; and misuse of professional enablers.

TBML is the use of trade to disguise and move the proceeds of crime.[48] It is often, though not always, achieved through the misrepresentation of the price, quantity or quality of imports or exports.[49] This misrepresentation can be used to create a pretext for transferring money (in the case of over-invoicing, under-shipment or phantom shipment)[50] or move value through the transfer of goods, which can later be used or resold by the recipient (in the case of under-invoicing or over-shipment).

The difficulty of detecting inaccurately priced goods, which is at the heart of such TBML schemes, can arise regardless of an FTZ's involvement. However, high volumes of trade within and through FTZs, coupled with reduced monitoring due to duty suspension, can be conducive to TBML.

46. UNODC, 'Transnational Organized Crime in East Asia and the Pacific: A Threat Assessment', April 2013, p. 93; Wilson Lau, 'An Assessment of South African Dried Abalone Haliotis Midae Consumption and Trade in Hong Kong', Traffic, February 2018, p. 6; OECD, *Governance Frameworks to Counter Illicit Trade*, p. 133.
47. Kong Hoo (Private) Ltd and Another v Public Prosecutor [2019] SGCA 21, p. 1140.
48. The FATF defines trade-based money laundering as 'the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins'. See FATF, 'Trade Based Money Laundering', June 2006, p. 5.
49. FATF, 'Trade Based Money Laundering', June 2006, p. 5.
50. A 'phantom shipment' refers to ostensible trade in non-existent goods.

Box 2: FTZs and High-Risk Commodities

In one case, the FATF recounts a scheme where a seemingly legitimate company based in the FTZ in Curaçao accepted drug-related US dollars in the course of its trading activities to act as an exchanger and sell the currency to other businesses in need of US dollars. This speaks to vulnerabilities related to insufficient monitoring of high-value cash transactions in FTZs, something also highlighted by multiple cases involving proceeds laundered through the diamond industry. According to another FATF report, the lack of transparency endemic to both FTZs and the diamond trade provides an 'excellent atmosphere to conduct large volume transactions without being detected'.†

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

† FATF, 'Money Laundering and Terrorist Financing Through Trade in Diamonds', October 2013, p. 61.

Commercial activities in an FTZ can also provide an opportunity to use criminal proceeds in cash, for instance by purchasing goods from merchants or placing a cash deposit with a bank that will not perform adequate customer due diligence (CDD). In particular, cash purchases form part of black-market peso exchange (BMPE), which involves using drug proceeds in one country – typically the US – to buy goods that are then resold elsewhere – usually in Latin America – for the drug traffickers' benefit.[51]

In 2016, the US Department of Justice charged the owner and manager of a company based in the Colón Free Zone with laundering the proceeds of drug trafficking, while the Drug Enforcement Agency dubbed him one of the 'world's most significant drug money launderers and criminal facilitators'.[52] The defendant pleaded guilty to one count of money-laundering conspiracy and, although all further charges against him remain unproven, several affiliated companies based in the Colón Free Zone are subject to US sanctions.[53]

51. John A Cassara, *Trade-Based Money Laundering: The Next Frontier in International Money Laundering Enforcement* (Hoboken, NJ: Wiley, 2016), pp. 34–40.
52. US Drug Enforcement Administration, 'Top International Drug Money Launderer Arrested in Colombia', 5 May 2016, <https://www.dea.gov/press-releases/2016/05/05/top-international-drug-money-launderer-arrested-colombia>, accessed 23 September 2020.
53. Parker Asmann, 'All Bark, No Bite: How US Bungled Case of "Major" Money Launderer', InSight Crime, 24 April 2020, <https://www.insightcrime.org/news/analysis/us-panama-nidal-waked/>, accessed 23 September 2020.

Box 3: Mispricing of Services

While TBML typologies focus on tangible goods, intangible goods and services can also be mispriced and thus used as a pretext for moving funds.* This is a persistent concern in the area of transfer pricing, namely the determination of fair price in related-party transactions. While transfer pricing rules aim at preventing the artificial allocation of profits and losses by multinational corporations, the mispricing of intangible goods or services can also be used for the cross-border movement of funds originally derived from criminal activity. Therefore, FTZ-based businesses that engage in the provision of services or intangible goods (such as IP or consultancy services) can also pose money-laundering risks.

* FATF, 'Trade Based Money Laundering', p. 5.

Last but not least, there is a wide range of financial and non-financial professional services that can be abused for money-laundering purposes. If the regulatory or supervisory regime in an FTZ is weaker than in the rest of the country, such services may correspondingly increase an FTZ's appeal to criminals. For example, the UAE's FTZs may be an attractive offering for those who wish to conduct business behind nominee directors.[54]

Regulated non-financial activities that entail present money-laundering vulnerabilities span from the provision of corporate services to less obvious offerings, such as gambling. According to the OECD, the 'implications of FTZs as hosts for online betting and gambling are largely unexplored'.[55] UNODC's 2019 Southeast Asia regional assessment suggests that casinos located in SEZs are commonly used in region-wide money-laundering schemes.[56] Other notable FTZs with gambling facilities include the Philippines' First Cagayan Special Economic Zone and Russia's Primorye Gambling Zone. In 2017, the OECD identified gambling facilities in SEZs as an 'emerging threat', drawing on evidence including the role played by the First Cagayan Special Economic Zone in transferring the proceeds of a $101-million cybercrime against the Bank of Bangladesh into casino accounts.[57]

54. Lakshmi Kumar, 'Dubai: Free Trade or Free-For-All?', Carnegie Endowment for International Peace, 7 July 2020; European Parliament, 'Report on Financial Crimes, Tax Evasion and Tax Avoidance (2018/2121(INI))', p. 5.
55. Michael Morantz, '"Free For All Zone" – Free Trade & Special Economic Zones (FTZ & SEZ) International Online Betting Operators & Gambling', 5th OECD Task Force for Countering Illicit Trade, 28–29 March 2017, p. 3.
56. UNODC, 'Transnational Organized Crime in Southeast Asia', p. 16.
57. Fred Lord, '"Free for All Zone" – Free Trade & Special Economic Zones (FTZ & SEZ) International Online Betting Operators & Gambling', 5th OECD Task Force for Countering Illicit Trade, 27 March 2017, p. 8.

Terrorist Financing

Trade-related vulnerabilities of FTZs can also create opportunities for the generation or movement of funds and goods by terrorist groups and their proxies or supporters. One example of a TBML scheme in the Colón Free Zone in Panama involved monthly transfers of over $15 million by drug trafficking businesses affiliated with Hizbullah, a Shia Lebanese-based political party and militant group proscribed as a terrorist organisation in the US and the UK.[58]

In 2010, the FATF cited a further example from Costa Rica where a business associated with the Basque separatist group Euskadi Ta Askatasuna was able to make large-scale cross-border transfers undetected by exploiting its owner's personal friendship with the managers of a bank branch in Costa Rica's FTZ.[59] As a result, additional requirements for 'banks to rotate employees of FTZ branches every three months' were introduced in the FTZ.[60]

In 2013, a Swiss-led customs inspection discovered looted cultural artefacts from Syria, Libya and Yemen – shipped via Qatar – stored at the Geneva Freeport.[61] Three years later, the Belgian FIU identified the sale of antiquities as a major source of terrorist financing, flagging FTZs as a particular risk.[62]

Sanctions Evasion and Proliferation

The ability to conceal the destination or origin of goods, or their true originators and end users, is also appealing to sanctioned parties or those seeking to evade sanctions or export controls. Such parties can use lax controls in FTZs to move goods including chemical, biological, radiological and nuclear (CBRN) weapons, dual-use components or other goods in violation of export controls. CBRN-related goods, such as subcomponents, nuclear materials and equipment, have reportedly transited FTZs.[63]

Sanctions and proliferation risks are correlated with the geographical location of a country – and, by extension, its FTZs. For instance, there are several US designations of UAE-linked individuals

58. FATF, 'Money Laundering Vulnerabilities of Free Trade Zones', p. 21.
59. FATF, 'Money Laundering Vulnerabilities of Free Trade Zones', p. 24.
60. *Ibid.*
61. Will Gompertz, 'Geneva Free Port: The Greatest Art Collection No-One Can See', *BBC News*, 1 December 2016.
62. Philippe de Koster, 'Session II: Financing of Foreign Terrorist Fighters (FTFs), FTF Returnees and Dormant Cells', 12–13 December 2016, <https://www.un.org/sc/ctc/wp-content/uploads/2016/12/2016-12-12-Session-II-1130-1300-Philippe-de-Koster-CTIF-FI.pdf>, accessed 23 September 2020.
63. Andrea Viski and Quentin Michel, 'Free Zones and Strategic Trade Controls', *Strategic Trade Review* (Vol. 2, No. 3, Autumn 2016), p. 27; David Salisbury, 'Exploring the Use of "Third Countries" in Proliferation Networks: The Case of Malaysia', *European Journal of International Security* (Vol. 4, No. 1, February 2019), p. 106; FATF, 'Money Laundering Vulnerabilities of Free Trade Zones', p. 5.

or entities for Iran-related sanctions evasion.[64] In one long-running operation, controlled vacuum pumps exported to Iran via a UAE-based FTZ were given a fake final destination and systematically relabelled and undervalued as 'spare parts'.[65] North Korea-related sanctions were consistently identified as a concern by interviewees in Singapore.[66] In 2020, an FTZ in China was implicated in the illicit import of beer to North Korea.[67]

On the other hand, geographic distance is not a safeguard against involvement in sanctions evasion or proliferation. The AQ Khan network used Dubai-based FTZs to move dual-use goods from Europe to India, Pakistan, Iran, North Korea and Libya.[68] In July 2020, the US Department of the Treasury published a settlement agreement with Essentra FZE, a Jebel Ali Free Zone-incorporated company, which traded with and accepted payment from North Korea for the illegal export of cigarette filters using deliberately deceptive practices.[69] Another case saw a Shanghai FTZ-based group of Chinese nationals caught exporting relabelled controlled goods to Iran using fraudulent export licences.[70]

Tax Evasion

In recent years, international scrutiny has fallen on the role of so-called 'freeports' – FTZs specialised in the storage of high-value goods – in facilitating tax avoidance by offering storage for objects including art, fine wine and precious metals.[71] The reason for the concern is twofold:

- The owner of an object stored in a freeport could sell it without paying any indirect or capital gains tax in the country where the freeport is located due to the tax regime applicable.

64. See the three instances cited in Jodi Vittori, 'Introduction', in Page and Vittori (eds), 'Dubai's Role in Facilitating Corruption and Global Illicit Financial Flows', p. 7.
65. US Department of Justice, 'Summary of Major U.S. Export Enforcement, Economic Espionage, Trade Secret and Embargo-Related Criminal Cases', June 2016, <https://www.justice.gov/nsd/files/export_case_list_june_2016_2.pdf/download>, accessed 23 September 2020.
66. Video interview with Singaporean customs consultants, 4 June 2020; video interview with a retired Singaporean banker, 10 June 2020; video interview with a Singaporean logistics expert, 11 June 2020.
67. United Nations Security Council, 'Report of the Panel of Experts Established Pursuant to Resolution 1874 (2009)', S/2020/151 (2 March 2020).
68. David Albright and Corey Hinderstein, 'The A.Q. Khan Illicit Nuclear Trade Network and Implications for Nonproliferation Efforts', *Strategic Insights* (Vol. 5, No. 6, July 2006).
69. Federal Register, 'Notice of OFAC Sanctions Actions', 24 August 2020, <https://www.federalregister.gov/documents/2020/08/24/2020-18527/notice-of-ofac-sanctions-actions>, accessed 23 September 2020.
70. Viski and Michel, 'Free Zones and Strategic Trade Controls', pp. 27, 37.
71. *The Economist*, 'Über-Warehouses for the Ultra-Rich', 23 November 2013; Atossa Araxia Abrahamian, 'Tax-Free Storage Wars', Longreads, 29 May 2018, <https://longreads.com/2018/05/29/tax-free-storage-wars/>, accessed 14 September 2020; Graham Bowley and

- Although the seller would ordinarily be obliged to declare their income in their residence country, there would be no way for that country to know that the sale has taken place, which creates incentives for tax evasion.[72]

The perceived connection between FTZs, tax evasion and trafficked cultural artefacts was a significant factor in the European Parliament's call to phase out freeports, identifying them as a 'new emerging threat' for money laundering.[73] This perception is likely to be exacerbated by press reports of the valuable objects stored in freeports. In 2016, the Geneva Freeport was holding an estimated 1 million pieces of fine art, including up to 1,000 works by Picasso.[74]

Box 4: The Introduction of UK Freeports

Less than a year after the European Parliament called for the phasing out of freeports in the EU, the UK government launched a consultation on its intention to introduce 10 freeports after the UK's exit from the EU.* But unlike the freeports in Geneva, Luxembourg and Singapore, the UK government does not intend to 'designate freeports for the purpose of high value luxury storage'.† In essence, the UK proposal is to create 10 traditional FTZs, while the exact nature of benefits on offer – and measures to be put in place to prevent crime – are yet to be determined at the time of writing.‡

* HM Government, *Freeports Consultation: Boosting Trade, Jobs and Investment Across the UK* (London: The Stationery Office, 2020).

† *Ibid.*, p. 10.

‡ For more details, see Anton Moiseienko, Alexandria Reid and Isabella Chase, 'Free Ports, Not Safe Havens: Preventing Crime in the UK's Future Freeports', RUSI Briefing Paper, April 2020.

Doreen Carvajal, 'One of the World's Greatest Art Collections Hides Behind This Fence', *New York Times*, 28 May 2016.

72. 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; Ron Korver, 'Money Laundering and Tax Evasion Risks in Free Ports', European Parliamentary Research Service, PE 627.114, October 2018, p. 25.
73. European Parliament, 'Report on Financial Crimes, Tax Evasion and Tax Avoidance (2018/2121(INI))', 8 March 2019, para. 211.
74. Bowley and Carvajal, 'The World's Greatest Art Collection Hides Behind This Fence'.

Understanding Financial Crime in FTZs

In order to counteract FTZ-related financial crime vulnerabilities, countries need to understand what those vulnerabilities are in the first place. In doing so, they cannot confidently rely on analysis published by others that is either not specific to their country or dated, or both. For instance, it is now over 10 years since the FATF published its first and only report on FTZ-related anti-money-laundering/counterterrorist-financing (AML/CTF) vulnerabilities.[75] As this research found, in all four countries explored, there are significant deficiencies in the understanding of FTZ-related financial crime risks.

Morocco

In 2019, the mutual evaluation report (MER) for Morocco by the Middle East and North Africa Financial Action Task Force (MENAFATF), a regional group that monitors the implementation of the FATF's anti-financial crime standards, suggested that FTZ-specific criminal risks are understudied and thus poorly understood. According to the MENAFATF, '[t]he absence of supervision and weakness of [money-laundering] risk awareness by supervisors place these zones among the potential risks', with the main risks being cash smuggling and phantom shipments.[76] Although the method for obtaining a licence to operate in a Moroccan FTZ is transparent, the report recommended that Morocco undertake an assessment to better understand the extent to which legal persons (including companies) are being misused in FTZs.[77]

Panama

The Panamanian government reportedly identified the Colón Free Zone as one of the country's greatest AML/CTF vulnerabilities in a national risk assessment.[78] However, there is considerable uncertainty as to the nature of the risk.[79]

There is, for example, a lack of consensus on the extent of cash transactions in the Colón Free Zone. The Financial Action Task Force of Latin America's (GAFILAT) MER of Panama in 2018 referred to the finding in Panama's own national risk assessment that 'large amounts of cash circulate' in the Colón Free Zone.[80] This is in line with the FATF's statement in 2010 that the

75. FATF, 'Money Laundering Vulnerabilities of Free Trade Zones'.
76. Middle East and North Africa Financial Action Task Force (MENAFATF), 'Kingdom of Morocco: Mutual Evaluation Report', April 2019, p. 19.
77. MENAFATF, 'Kingdom of Morocco: Mutual Evaluation Report', p. 14.
78. International Monetary Fund, 'Panama: Selected Issues', IMF Country Report No. 19/12, January 2019, p. 20.
79. Interview with a government official, Colón, 1 November 2019.
80. Financial Action Task Force of Latin America (GAFILAT), 'Mutual Evaluation Report of the Republic of Panama', January 2018, p. 83, para. 346.

Colón Free Zone was a 'central point of delivery for bulk cash proceeds of drugs' and was involved in BMPE.[81]

In 2019, a Panamanian government representative suggested that this finding was outdated and that less than 10% of transactions in the Colón Free Zone involved cash, though no evidence was provided to corroborate the fact.[82] Consistent with this, a longstanding user of the Colón Free Zone suggested that it was no longer possible to pay over $10,000 in cash in the zone but could not recall whether this was the result of any particular scandal or systemic problem.[83]

Relatedly, a workshop in Panama City that brought together experts from the government, financial sector and civil society provided very few financial crime typologies related to FTZs, other than one reference to split payments as part of BMPE schemes.[84] Attendees from all three sectors stressed that a blanket 'high-risk' designation of Panama's FTZs created barriers to access for business users.[85] These two examples demonstrate a mismatch between the overall acknowledgement of criminal risks related to Panama's FTZs and limited awareness of what those are in practice and how to address them.

Singapore

Singapore's position is ambiguous in that FTZ-related risks are generally understood and recognised but no appropriate policy response has been put in place. The FATF's review of Singapore in 2016 limits itself to mentioning that Singapore has FTZs, which 'are generally characterised by relaxed oversight and an absence of trade data and systems integration'.[86] The observation appears to relate to the general state of affairs in FTZs around the world rather than to Singapore specifically. One exception to this is Singapore's freeport, a high-value storage facility that has been identified in Singapore's own risk assessment as posing a medium-high financial crime risk.[87] According to the FATF, 'relevant authorities…did not demonstrate a comprehensive understanding of what activities were being undertaken in the Singapore freeport, which raised concerns with the assessors'.[88]

With the exception of tax evasion risks related to the freeport, interviews suggest that illicit trade risks in Singaporean FTZs are overwhelmingly related to the transhipment of goods, which is a problem universally acknowledged and discussed in Box 6.[89]

81. FATF, 'Money Laundering Vulnerabilities of Free Trade Zones', p. 21.
82. Interview with a government official, Colón, 1 November 2019.
83. Interview with an FTZ user, Colón, 1 November 2019.
84. RUSI/Grupo FARO workshop, Panama City, 30 October 2019.
85. *Ibid.*; interview with an FTZ user, Colón, 1 November 2019.
86. FATF, 'Singapore: Mutual Evaluation Report', September 2016, p. 16.
87. FATF, 'Singapore: Mutual Evaluation Report', p. 29.
88. *Ibid.*
89. Video interview with trade experts, Singapore, 4 June 2020; online focus group with the private sector, Singapore, 17 June 2020.

The UAE

The UAE's MER cites concerns related to the understanding of risk in the country generally and FTZs specifically.[90] The UAE's National Risk Assessment reportedly concluded that 85% of FTZ-based companies were inherently high risk compared to 55.86% of companies across the country (but less so than 93.32% of companies in financial free zones).[91] According to the FATF, this assessment did not enable meaningful prioritisation and failed to identify the precise nature of those risks.[92]

This failing is significant given the UAE's well-documented financial crime and illicit trade vulnerabilities,[93] as well as the fragmented nature of its AML/CTF supervisory regime. The FATF's mutual evaluation of the UAE published in April 2020 notes that 17% of legal entities are set up in FTZs, known as commercial free zones, and states:

> [D]ifferent company formation procedures and compliance requirements within the UAE's different registries [run by the country's different FTZs], along with the competition for business in this area creates unique vulnerabilities and registry arbitrage in relation to information requirements and compliance with AML/CTF obligations. During the course of the on-site, it was not feasible for the assessors to review the laws and meet all registries.[94]

That said, FTZs were one of the two subjects – along with real estate – that were analysed in the UAE FIU's 2019 report, 'Money Laundering Vulnerabilities in the UAE Real Estate Sector and Commercial Free Zones'.[95]

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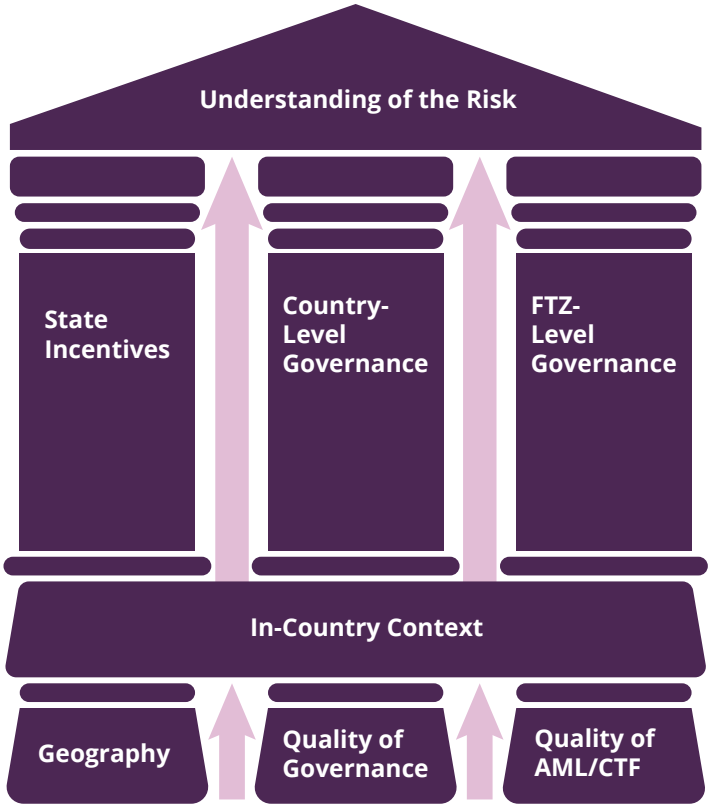
90. FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', 2020.
91. *Ibid.,* p. 173.
92. *Ibid.*
93. See, for example, Page and Vittori (eds), 'Dubai's Role in Facilitating Corruption and Global Illicit Financial Flows'; ICC and BASCAP, 'Controlling the Zone', pp. 7, 12; OECD and EUIPO, *Trends in Trade in Counterfeit and Pirated Goods*, pp. 15–16; Christopher M Davidson, *Dubai: The Vulnerability of Success* (Princeton, NJ: Princeton University Press, 2008), p. 278; telephone interview with academic expert, 17 July 2020.
94. FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', April 2020, pp. 32–33.
95. *Ibid.*, p. 63.

II. Understanding Risk Factors in FTZs

NONE OF THE evidence provided above suggests that all FTZs lack integrity or fall victim to systematic abuse. Although the FTZ model has certain specific vulnerabilities, a generic approach that regards all FTZs as high risk does little to improve global standards or prioritise genuinely high-risk zones. Standards can vary considerably across zones within a single country.

Based on the overview of FTZ-related criminal risks provided in Chapter I, this chapter identifies several categories of risk factors that determine an FTZ's vulnerability to crime. These include: host countries' limited incentives to police FTZs, especially insofar as transit of goods is concerned; country-level risk factors; and FTZ-level risk factors. This is summarised in Figure 1.

Figure 1: Factors that Determine an FTZ's Risk Profile



Source: Author generated.

Incentives to Police FTZs

The vulnerabilities of FTZs to illicit trade and financial crime often stem from their raison d'être, which is to attract commerce through a liberalised regulatory regime. In this sense, FTZs are similar to jurisdictions that seek to appeal to businesses with tax advantages. The primary objective of the stakeholders involved in the running and oversight of FTZs is to facilitate trade. Ensuring that FTZs are not used to enable illicit activity tends to be a secondary objective, especially if the goods that pass through or are processed in an FTZ never enter the host jurisdiction.

The desire to prioritise revenue-generating activities in FTZs may supersede the need to fully understand the risk emanating from them, especially in countries where supervisory resources may be limited. This often leads to the following characteristics of FTZs:

- The lack of clear allocation of responsibility and accountability for crime prevention, monitoring and enforcement.
- The difficulty of holding users of FTZs liable for facilitating illicit trade.
- The unfeasibility of widespread inspections in FTZs without disrupting the flow of goods.

Scale of Priorities

A host country's motivation to understand the risk posed by FTZs may vary depending on the harm caused to it:

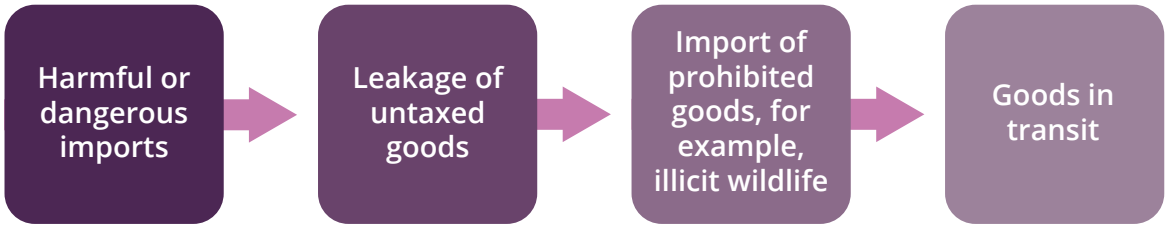
- At one end of the spectrum, the import of harmful or dangerous goods presents a real and present harm to the host country and the FTZ itself.[96]
- Next is the harm caused by a loss of tax revenue if goods are 'leaked' from the FTZ into the host country, thereby bypassing its tariff framework. This could be significant, such as the leakage of tobacco products from Singapore's FTZs into its market, or it could be an acceptable trade-off for the benefits brought by the FTZ.
- Motivations to limit illicit activities will further decrease when goods that are not harmful to the host country but are illegal, such as illegal wildlife products, are moved through a country's FTZs.
- Lastly, countries may have little to no motivation to counter trade through its FTZs where it only acts as a transit point for the trade in any goods. This can be especially harmful to wider global trade integrity when transhipping through a country's FTZ is used to mask the true and potentially high-risk origin of goods.

The spectrum of harm presented by these different activities can, in practice, be weighed against the revenues that FTZs provide, a calculation which likely informs appetite for countering and understanding illegal activity (see Figure 2). All too often, trade facilitation wins out and the

96. See, for example, Jing Yang, 'Concern Raised over Tianjin's Free-Trade Zone', *South China Morning Post*, 18 August 2015.

'transit culture' of turning a blind eye to what does not enter a country's customs jurisdiction regardless of the harm that it may cause in its origin or destination prevails.[97]

Figure 2: Incentives to Police Goods in FTZs (Highest to Lowest)



Source: Author generated.

In the case of the latter two categories, it is important for states to move beyond self-interest and fulfil their responsibility as members of the international community. International regulation sets standards in relation to the trade in various goods, including drugs, firearms, dual-use materials, wildlife products, tobacco and counterfeit products.[98]

Goods in Transit

The transit culture is perhaps the necessary and inevitable evil of FTZs. To remain a competitive port or transhipment hub, FTZs have to offer a 'just-in-time' logistics service with limited friction.[99] Friction – real or perceived – can be created in many ways, from paperwork or record-keeping requirements to the physical inspection of vessels and containers. Although necessary to ensure the integrity of the FTZ and the trade it facilitates, measures to record and control goods in transit take time and even minor delays can make a service or FTZ uncompetitive. Inspecting just 10 additional containers a day would cause considerable disruption to trade,

97. As stated in one interview, 'Why would you police other people's problems?' Video interview with an international organisation expert, 3 June 2020; telephone interview with law enforcement expert, 9 June 2020; telephone interview with foreign law enforcement expert, Singapore, 22 October 2019.
98. A helpful, non-exhaustive list of such treaties is available in Omi, '"Extraterritoriality" of Free Zones', p. 18.
99. Yarin Eski, 'Customer is King: Promoting Port Policing, Supporting Hypercommercialism', *Policing and Society* (Vol. 30, No. 2, 2020), p. 153.

according to one expert.[100] Moreover, the simplified customs procedures offered by FTZs often capture limited data on import and export flows in FTZs, defeating the risk-based profiling systems customs use to target inspections.[101] These problems are often compounded by limited customs resources.[102]

One problem that must be considered when dedicating resources to making a seizure is whether there will be a legal or natural person to prosecute. In Singapore, it is reported that goods are sometimes imported by a newly established shell company, which is dissolved as soon as the shipment is stopped.[103] In some countries, resource constraints mean that investigations are seldom even attempted.[104]

Even if the party involved in illicit trade is an FTZ user and thus subject to obligations that attach to doing business in an FTZ, this may make no difference, as exemplified by the Singaporean case of Burberry Ltd v Megastar Shipping Pte Ltd.[105] In that case, 15,000 counterfeit handbags were seized by Singapore Customs. Burberry took action for violation of their trademark against the freight forwarder, Megastar Ltd, who was transhipping the goods through Singapore from China to Indonesia. Singapore's Court of Appeal, the country's highest judicial instance, ruled that the freight forwarder had not violated the trademark as they were unaware that goods with a trademark were present in the shipment. The documentation listed household goods and generic merchandise.

Box 5: Transiting Goods in Singapore

The presence of FTZs is intended to facilitate transhipment activities, which flourish in Singapore's ports. The Port of Singapore is estimated to be the world's second largest port in terms of the cargo tonnage it processes after Shanghai,* and the world's biggest transhipment hub.† The effective policing of goods transiting through Singapore is impeded by the lack of a consistent legislative framework establishing civil and/or criminal liability for the import of illicit goods.

Instead, there are separate laws that govern trade in various types of products, such as the Trade Marks Act and Endangered Species (Import and Export) Act. Both these laws were interpreted by the Court of Appeal in 2019. In relation to the Trade Marks Act, the Court of Appeal ruled that counterfeit goods in transit in Singapore were 'imported' for the purposes of the Act but declined to hold freight

100. Video interview with a Singaporean logistics expert, 11 June 2020; video interview with a Singaporean IP lawyer, 18 June 2020.
101. Video interview with a Singaporean logistics expert, 11 June 2020.
102. Telephone interview with an engineering expert with experience of Singapore customs controls, 9 September 2019.
103. Video interview with a Singaporean legal expert, 16 June 2020.
104. The authors are grateful to a peer reviewer for pointing this out.
105. Burberry Ltd and Another v Megastar Shipping Pte Ltd [2019] SGCA 1.

forwarders liable due to lack of knowledge.‡ In relation to the Endangered Species (Import and Export) Act, the Court of Appeal held that goods in transit were not 'imported' in Singapore and thus gave no rise to criminal liability on the part of the importer.§

The fragmentation of Singapore's legal regime is evident, although in both cases the outcome was to deny the importer's liability. Interviewees working in IP protection have suggested strict liability for the import of IP-infringing materials as a solution, but it would be preferable for the solution to apply to all types of illicit trade.

* J Müller, 'Container Port Industry in Singapore – Statistics & Facts', Statista, 27 May 2020, <https://www.statista.com/topics/5837/container-port-industry-in-singapore/>, accessed 23 September 2020.

† Christl Li, 'Connecting to the World: Singapore as a Hub Port', Civil Service College Singapore, 6 July 2018, <https://www.csc.gov.sg/articles/connecting-to-the-world-singapore-as-a-hub-port>, accessed 23 September 2020.

‡ Burberry Ltd and Another v Megastar Shipping Pte Ltd [2019] SGCA 1.

§ Kong Hoo (Private) Ltd and Another v Public Prosecutor [2019] SGCA 21.

Other Domestic Threats

FTZ-derived economic benefits aside, some states may be unwilling to invest significant resources to policing FTZs due to their assessment that the country's key illicit trade vulnerabilities lie elsewhere. In countries with substantial informal economies, FTZs in fact may be more highly regulated than other sectors of the national economy. Thus, the Moroccan government considers FTZs to be *more secure* than other national logistics or manufacturing hubs.[106] This was principally attributed to the formal procedures governing FTZs, such as the licensing and incorporation process, which provide greater oversight compared to the informal, decentralised nature of the national marketplace.[107] Likewise, several interviewees in Panama argued that the understanding of AML/CTF standards was higher inside the Colón Free Zone than in other parts of the economy.[108]

At least two North African countries, namely Morocco and Tunisia, have established FTZs in an attempt to formalise border economies, where high volumes of illicit trade have historically

106. Interview with a government official with expertise in customs, Rabat, 10 February 2020; interview with a government official with expertise in trade, Rabat, 12 February 2020; video interview with a Moroccan government official, 24 September 2020.
107. *Ibid.*
108. Interview with a stock market expert, Panama City, 28 October 2019; interview with an FTZ user, Panama City, 28 October 2019.

taken place.[109] For example, in 2018, Morocco began to crack down on smuggling through the Tarajal II corridor between Africa and the EU. According to one official estimate, the value of informal products crossing the border ranges between €550 and €730 million a year, over 10 times the value of legal exports in the same region.[110] By providing jobs and infrastructure, establishing a new FTZ on the border is expected to provide a legal alternative to smuggling.[111]

This is another manifestation of the possible mismatch between domestic priorities – that is, preventing crime that affects the host country – and the international community's interest in preventing the movement of illicit goods. These domestic priorities should be acknowledged and respected while making illicit trade-related issues part and parcel of an overall diplomatic engagement strategy.

Country-Level Factors

A consideration of how country-level risks interact with zone-specific factors is essential to the more effective identification of genuinely suspicious activity within the private sector, and efforts to raise governance standards in FTZs worldwide. It also contributes to the identification of priority areas for enforcement activity.

Geography

Factors such as geography or the broader illicit trade profile of a country are key to contextualising risk. For example, drug-trafficking risks are heightened when an FTZ is geographically close to a country associated with the source, transit or destination market for illegal drugs. Given South America's regional position as a source of multiple illegal drugs, the Organization of American States recommends the establishment of a specialised unit or interdisciplinary group within FTZ administrators devoted to the detection and monitoring of narcotics and precursor chemicals in regional FTZs.[112] In Southeast Asia, meanwhile, UNODC suggests that one reason why FTZs are particularly vulnerable is because they are 'located in areas where government authority and the rule of the law are challenged by criminal influence'.[113]

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109. Jihane Ben Yahia, 'Can a New Free-Trade Zone Remedy Tunisia's Informal Economy?', ENACT, 4 July 2019, <https://enactafrica.org/enact-observer/can-a-new-free-trade-zone-remedy-tunisias-informal-economy>, accessed 23 September 2020.
110. Madeleine Handaji, 'El Espanol: Morocco Exploits COVID-19 to Cut Off Ceuta, Melilla', *Morocco World News*, 23 April 2020, <https://www.moroccoworldnews.com/2020/04/300414/el-espanol-morocco-exploits-covid-19-to-cut-off-ceuta-melilla/>, accessed 23 September 2020.
111. Hamza Guessous, 'Morocco Begins Construction of Economic Zone Near Ceuta', *Morocco World News*, 9 June 2020, <https://www.moroccoworldnews.com/2020/06/305324/morocco-reportedly-begins-construction-of-economic-zone-near-ceuta/>, accessed 23 September 2020.
112. Organization of American States and Inter-American Drug Abuse Control Commission, 'Best Practices to Increase Security in Free Trade Zones in Ports and Tax Free Ports', undated, p. 5.
113. UNODC, 'Transnational Organized Crime in Southeast Asia', p. 16.

Quality of Governance

The country's overall quality of governance is important, including levels of corruption. In 2019, the OECD and EUIPO published data suggesting that manufacturing of counterfeit goods inside FTZs is more prevalent in less developed countries, which are likely to have weaker intellectual property and law enforcement frameworks, as well as fewer law enforcement resources.[114]

Furthermore, the OECD has identified the hallmarks of policy capture in some FTZs, noting that '[t]o ensure that the sector remains under-regulated, key actors utilize their excessive revenues to buy political influence. All forms of authorities within FTZs, including legislators, regulators and law enforcement, are willing participants of bribery and similar corruption'.[115] There are also examples of SEZs that allegedly face similar issues. In July 2020, the US Institute of Peace reported the involvement of Chinese organised crime groups in the development of gambling-orientated SEZs in Myanmar.[116]

Quality of AML/CTF Supervision

Apart from the overall quality of governance, effective AML/CTF oversight is another prerequisite for tackling criminality in FTZs. In 2010, the FATF suggested that many jurisdictions did not 'apply the same AML/CTF regulations in the zone as in the rest of the country'.[117] In other words, the concern was that FTZs were not only carved out from the host country's customs duties regime, but could also be free of meaningful AML/CTF controls.

In all case study countries, no less exacting AML/CTF rules apply within FTZs than in the rest of the territory, apart from company incorporation rules in the UAE's FTZs. That notwithstanding, shortcomings in the AML/CTF supervision of FTZ-based companies are common to all of the countries examined, with the possible exception of Singapore. In all case study countries, the volume and diverse nature of activities in FTZs present challenges that compound the usual difficulties of AML/CTF supervision.

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114. OECD and EUIPO, *Trends in Trade in Counterfeit and Pirated Goods*, p. 16.
115. '"Free for All Zone" – Free Trade & Special Economic Zones (FTZ & SEZ) International Online Betting Operators & Gambling', 5th OECD Task Force for Countering Illicit Trade, 28–29 March 2017. Interviews in Panama suggest that weak institutions in a country will contribute to weaknesses in FTZ governance and AML/CTF measures. Interview with a Panamanian academic, Panama City, 27 October 2019; interview with a civil society group, Panama City, 30 October 2019; interview with a foreign expert, Panama City, 30 October 2019.
116. Jason Tower and Priscilla Clapp, 'Myanmar's Casino Cities: The Role of China and Transnational Criminal Networks', US Institute for Peace, Special Report No. 471, July 2020.
117. FATF, 'Money Laundering Vulnerabilities of Free Trade Zones', p. 15, para. 30.

Morocco

In Morocco, the same AML/CTF regime applies to regulated businesses in FTZs as in the rest of the country. In particular, financial institutions operating in FTZs are supervised by an inter-agency committee under the leadership of the Ministry of Finance.[118] The effectiveness of supervision across Morocco is limited, with the MENAFATF ranking it as 'moderate', the second lowest grade out of four.[119] According to interviewees, this applies to banks in FTZs at least as much as to those elsewhere in the country, which is further exacerbated by the limited focus on or understanding of FTZ-specific risks, as discussed above.[120]

Panama

In Panama, companies operating in the Colón Free Zone are regulated as designated non-financial businesses or professions (DNFBPs).[121] There were over 3,700 such companies as of GAFILAT's evaluation,[122] which assessed the effectiveness of Panama's supervision regime as 'moderate'.[123] The number of businesses in the Colón Free Zone places a significant supervisory burden on the AML/CTF supervisor of DNFBPs, the Intendencia de Supervisión y Regulación de Sujetos Obligados No Financieros (Intendencia), which is not matched by staffing and resourcing levels.[124] There was, however, a perception that the Intendencia had recently intensified its supervision and enforcement efforts in the Colón Free Zone.[125] This was consistent with the statistics provided to GAFILAT by Panamanian government officials confirming that 36% of Intendencia's on-site inspections are related to the Colón Free Zone.[126] After the authors' visit to Panama in November 2019, the Intendencia became a Superintendencia, which endows it with greater political stature, independence, human and technical resources.[127]

118. MENAFATF, 'Kingdom of Morocco: Mutual Evaluation Report', April 2019, p. 19.
119. MENAFATF, 'Kingdom of Morocco: Mutual Evaluation Report', p. 14.
120. Interview with two bank AML/CTF experts, Casablanca, 14 February 2020.
121. GAFILAT, 'Mutual Evaluation Report of the Republic of Panama', January 2018, p. 23, para. 64.
122. GAFILAT, 'Mutual Evaluation Report of the Republic of Panama', p. 27, para. 87.
123. GAFILAT, 'Mutual Evaluation Report of the Republic of Panama', p. 14.
124. Interview with a banking expert, Panama City, 28 October 2019; interview with a stock market expert, Panama City, 28 October 2019.
125. Interview with a government official, Colón, 1 November 2019; interview with an FTZ user, Colón, 1 November 2019.
126. GAFILAT, 'Mutual Evaluation Report of the Republic of Panama', p. 83, para. 346.
127. Intendencia of Supervision and Regulation for Non-Financial Reporting Institutions, 'Mission and Vision', <https://intendencia.gob.pa/index.php/mision-y-vision/>, accessed 23 September 2020; Roberto González Jiménez, 'Crearán Registro de Beneficiarios Finales' ['They Will Make a Report of the Financial Recipients'], *La Prensa*, 16 December 2019, <https://www.prensa.com/impresa/economia/crearan-registro-de-beneficiarios-finales/>, accessed 23 September 2020.

Singapore

In Singapore, AML/CTF supervision has only been assessed as 'moderate' by the FATF[128] despite the world-class reputation of its financial services supervisor, the Monetary Authority of Singapore (MAS). This evaluation reflects perceived weaknesses in the supervision of DNFBPs. In particular, there was evidence that risks of money laundering involving certain high-value commodities, some of which may be stored in Singapore's freeport, had not been addressed at the time:

- The continuity of ownership of the gold between first seller and last buyer is unknown to the authorities (when traded through the Singapore Precious Metals Exchange).
- The high-risk nature of this trade is especially true taking into account of the fact that Singapore is an international commodity trade hub with a free port.[129]

Following the evaluation, the Precious Stones and Precious Metals (Prevention of Money Laundering and Terrorism Financing) Act came into force in April 2019.[130]

The UAE

In the UAE, as in all the other case study countries, AML/CTF supervision was only assessed as 'moderate' by the FATF.[131] This verdict extends to its FTZs. In particular, the FATF found that sanctions levels were not dissuasive across the country, including in FTZs.[132] However, the FATF also made several positive comments about FTZs as compared to the rest of the country's territory, including:

- The existence of at least some market entry controls in FTZs is a welcome addition to the generally ineffective supervision of DNFBPs across the UAE.[133]
- Some FTZ administrators, including the Jebel Ali Free Zone, Ras Al Khaimah Economic Zone (RAKEZ) and Dubai Multi Commodities Centre (DMCC), reportedly have a 'more developed understanding of beneficial ownership and complex structures' than other supervisors.[134]

128. FATF, 'Singapore: Mutual Evaluation Report', September 2016, p. 12.
129. FATF, 'Singapore: Mutual Evaluation Report', p. 109.
130. Precious Stones and Precious Metals (Prevention of Money Laundering and Terrorism Financing) Act 2019, <https://sso.agc.gov.sg/Act/PSPMPMLTFA2019>, accessed 14 September 2020.
131. FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', 2020, p. 16.
132. FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', p. 156.
133. FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', p. 5.
134. FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', pp. 175, 178.

- One of the more proactive FTZ administrators 'has undertaken a review of its companies in response to the "Dubai Papers"'.[135]
- The enforcement landscape in the Ras Al Khaimah (RAK) zones is reportedly better than elsewhere in the country:

> RAKEZ blocked 530 companies' accounts in 2018 until CDD information (including BO information) was provided. In RAK ICC the registrar has issued specific penalties for not notifying the Registrar in respect of changes of officers or members. For both RAK free zones, 55 entities were not registered or had their license renewal declined on financial crime grounds.[136]

The regulatory activities of DMCC were cited in the High Court's judgment in April 2020 concerning a dispute between a Big Four accounting firm and its former employee.[137] The former employee alleged that he had been dismissed after he refused to ratify the assurance audit of a DMCC-based gold refinery whose activities bore hallmarks of money laundering, including processing $5.2 billion in cash per annum and disguising gold imports from Morocco as silver. According to Justice Kerr, '[t]he DMCC was and is a Dubai government body and was evidently unconcerned about and keen to help minimise and draw a veil over the evidence connecting [the gold refinery] with suspected money laundering'.[138] That said, one UAE-based legal expert characterised the DMCC's due diligence practices as particularly strong.[139]

FTZ-Level Factors

The diversity of the risk profiles of FTZs is evident in the case study countries:

- In **Morocco**, compared to non-industry-specific export-oriented zones, such as the Tangier Free Zone established in 1999, the country's modern FTZs aim to attract certain manufacturing industries through tailored business incentives and specialised infrastructure.
- In **Panama**, the Colón Free Zone provides high-volume transhipment, manufacturing and retail facilities, while the City of Knowledge Technopark is an office complex.
- In **Singapore**, most imported goods do not incur customs duties. The only exception ('dutiable goods') is some liquors.[140] In addition, tobacco products, motor vehicles and petroleum products are subject to excise duties payable upon import. To most intents

135. FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', p. 38.
136. FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', p. 180.
137. Rihan v Ernst & Young Global Limited et al [2020] EWHC 901 (QB).
138. *Ibid.*, para. 719.
139. Video interview with a UAE-based lawyer, 12 August 2020.
140. Singapore Customs, 'List of Dutiable Goods', <https://www.customs.gov.sg/businesses/valuation-duties-taxes-fees/duties-and-dutiable-goods/list-of-dutiable-goods>, accessed 23 September 2020.

and purposes, therefore, Singapore is one large FTZ. Dutiable goods may be stored in FTZs without paying the duties and the goods and services tax (GST) for up to 30 days.[141]

- In the **UAE**, each of the country's 29 FTZs and two financial free zones are supervised by separate authorities based on a patchwork of legal regimes. They also vary in terms of the activities they aim to facilitate.

Geography

At the local level, too, geography matters. The creation of an FTZ does not magically open a portal to a parallel universe of crime and anarchy. In many ways, there is nothing exceptional about FTZs: all illicit trade and financial crime common to FTZs also occurs outside them. At a universal level, all logistics hubs – including sea and rail terminals and airports – are vulnerable by virtue of facilitating high volumes of trade at the fastest possible pace.[142] What makes FTZs different, however, is that they operate under liberalised conditions, including simplified customs procedures.[143]

For these reasons, FTZs do offer a criminal advantage: the ability to use a comparatively unsupervised environment to assemble, manufacture and tranship illicit goods efficiently, with reduced chances of detection. It is therefore important that, whenever an FTZ is proposed to be established, a risk assessment of existing criminal risks in that location is undertaken and mitigation measures are designed before deciding whether to create the FTZ.

Geopolitics

Geopolitical developments sometimes affect risks in FTZs. For example, in Panama, interviewees stressed that recent economic downturns, principally caused by increased competition from Chinese FTZs and the economic crisis in Venezuela, have made them more vulnerable to illicit activity as a means of compensating for the dwindling legitimate trade.[144] In Belize, it has been reported that the devaluation of the Mexican peso against the US dollar has forced 40% of businesses to close down in the Corozal Free Zone and contributed to a breakdown in the rule of law.[145]

141. Singapore Customs, 'Depositing Goods in the Free Trade Zones', <https://www.customs.gov.sg/businesses/exporting-goods/export-procedures/depositing-goods-in-ftz>, accessed 23 September 2020.
142. An interviewee noted that the FTZ at Changi Airport in Singapore presented challenges for customs authorities because of the rapid turnaround of airfreight. Video interview with Singaporean customs consultants, 4 June 2020.
143. Omi, '"Extraterritoriality" of Free Zones', p. 3; FATF, 'Money Laundering Vulnerabilities of Free Trade Zones', p. 15.
144. Interview with a civil society group, Panama City, 29 October 2019.
145. Economist Intelligence Unit, 'The Global Illicit Trade Environment Index', <https://deliverchange.economist.com/wp-content/uploads/2019/11/EIU-Global-Illicit-Trade-Environment-Index-2018-FTZ-June-6-FINAL.pdf>, accessed 23 September 2020.

Profile of Activities and Users

Geography aside, the nature of activities in an FTZ and the profile of its users also make a difference. In Morocco and Panama, the prevalence of multinational corporations (MNCs) among the users of certain FTZs is considered an effective tool for educating local staff on international standards and practices. The reason is that MNCs have an international reputation to uphold and must, therefore, maintain strong practices across their branches and subsidiaries.[146]

Box 6: Singapore's Experience

There is no reliable evidence of one or more of Singapore's FTZs being more attractive for illicit use than others. However, one interviewee recounted that, in the past, certain logistics service providers in the Changi Airport Logistics Park were engaged in illicit relabelling practices. Singapore's authorities reportedly put an end to this practice in approximately 2010.* According to the same interviewee, the intensity of efforts put into the policing of Singapore's FTZs differs from zone to zone.†

Singapore's 2013 National Money Laundering and Terrorist Financing Risk Assessment does not focus on illicit trade risks at all. It notes, however, in the context of drug trafficking, tax offences and trade-based money laundering, that 'the number of cases investigated, foreign requests for assistance received and seizures related to these offences are very low'.‡

* Video interview with Singaporean customs consultants, 4 June 2020.

† *Ibid*.

‡ Monetary Authority of Singapore, 'National Risk Assessment Report', 2013, p. 36.

Coordination and Effectiveness of Agencies

There is no standard model for the governance framework of FTZs and these can vary even within the same country – although a basic framework will often be created in a country's law for establishing FTZs. Effective governance of FTZs necessitates cooperation between a range of stakeholders, as summarised in Table 3. Where no unambiguous rules or coordinating mechanism exist, responsibility can fall through the cracks. In some cases, public agencies simply do not know that they have a role to play within FTZs or remain confused about their legal right to access to the zone.[147] In others, an inadequate understanding of risk in an FTZ may lead to a lack of prioritisation. A relevant organisation may also lack the right resources and expertise.

146. Interview with an FTZ representative, Panama, 1 November 2019; interview with a foreign logistics expert, Casablanca, 11 February 2020; interview with a Moroccan public official, Rabat, 12 February 2020.
147. Interview with a governmental expert, Panama City, 30 October 2019.

For instance, if an FTZ administrator is required to carry out due diligence on FTZ users, that agency should have the requisite staff and technology (including access to databases), which is not uniformly the case in some countries.[148]

As described above in the context of country-wide governance issues, the prevention of corruption is a vital aspect of effective governance. It also plays a role at the zonal level. Yet, a 2015 UNCTAD survey concluded that very few FTZ administrators took measures aimed at combating corruption in the zone.[149]

Table 3: Agencies Typically Involved in FTZ Governance

Agency	Role
FTZ administrator	FTZ administrators can be solely private entities or partly or wholly owned by the government. Regardless of their ownership, FTZ administrators bear the primary responsibility for overseeing activities within the FTZ and providing support to competent agencies, including customs and law enforcement agencies, as necessary.
Ministry of Trade	Countries typically have an authority responsible for the issuing of licences to FTZ administrators. Countries will have different standards for acquiring and maintaining a licence to run an FTZ. The responsible authority should perform some independent monitoring function to ensure that the conditions of the FTZ administrator's licence are being met.
Customs	Customs have two primary functions, namely revenue collection and the enforcement of the rules governing the cross-border movement of goods.[150] In areas where tariffs are suspended, such as FTZs, the role of customs is to: protect national security; intercept narcotics; protect endangered species; and prevent the smuggling of national treasures and artefacts.[151]
Border police	A country's border police is responsible for protecting its borders from threats including trafficking in illicit or controlled goods.

148. Interview with consultants, Casablanca, 13 February 2020.
149. UNCTAD, 'Enhancing the Contribution of Export Processing Zones to the Sustainable Development Goals: An Analysis of 100 EPZs and a Framework for Sustainable Economic Zones', 2015, p. 15.
150. ICC and BASCAP, 'Controlling the Zone', p. 9.
151. *Ibid*.

Financial intelligence unit (FIU)	A country's FIU is charged with receiving and analysing suspicious activity/transaction reports and other information relevant to the investigation of money laundering and terrorist financing.[152] In the context of FTZs, the FIU plays an oversight role in understanding the level of suspicious activities in an FTZ.
Financial and non-financial AML/CTF supervisors	Financial and non-financial supervisors are responsible for ensuring that their regulated populations comply with a country's AML/CTF legislation. A supervisor may wish to ensure that the level of attention it devotes to FTZ-based businesses is proportionate to the level of risk they pose and the volume of commercial activity they facilitate.
International organisations	International governmental organisations, like the OECD and the WCO, play a vital role in setting standards for the operation of FTZs.

Source: Author generated

152. Egmont Group, 'Financial Intelligence Units (FIUs)', <https://egmontgroup.org/en/content/financial-intelligence-units-fius>, accessed 23 September 2020.

III. Addressing Criminal Risks in FTZs

THIS CHAPTER DISCUSSES opportunities for strengthening the response to criminal risks in FTZs. These themes have been foreshadowed in the previous two chapters, which identify key challenges that need to be addressed to improve the integrity of FTZs. Building on that analysis, this chapter considers: the implementation and clarification of international standards in relation to the policing of FTZs, especially in relation to goods in transit; the improvement of monitoring and oversight; and cooperation with the private sector.

International Standards

The practical challenges of detecting illicit trade are aggravated by the lack of a consistent global set of expectations as to how goods passing FTZs in transit should be policed (although there are emerging standards in relation to FTZ governance, as discussed below). Two international treaties set some rules in respect of policing goods in transit but fall short of providing a comprehensive framework:

- The Revised Kyoto Convention provides that 'the Customs shall have the right to carry out checks at any time on the goods stored in a free zone'.[153]
- The Protocol to Eliminate Illicit Trade in Tobacco Products requires states parties to 'adopt and apply control and verification measures to the international transit or transhipment, within its territory, of tobacco products and manufacturing equipment'.[154]

These provisions provide no guidance to states on how to prevent crime effectively without undermining the efficiency of FTZ operations. Nor is it realistic to expect a separate, more effective regime to be in place for tobacco products compared to all other goods since the policing of illicit tobacco trade is not significantly different from policing any other illegal goods.

153. WCO, 'International Convention on the Simplification and Harmonization of Customs Procedures (as amended)', 3 February 2006, Annex D, Chapter 2.
154. WHO, 'The Protocol to Eliminate Illicit Trade in Tobacco Products: Questions and Answers', <https://www.who.int/fctc/protocol/faq/en/index1.html>, accessed 14 September 2020.

FTZ Integrity Initiatives

There are several international initiatives in place aimed at improving FTZ integrity. With mixed incentives on the part of individual states, international pressure to implement such standards is essential:

- In October 2019, the OECD Council adopted a Recommendation on Enhancing Transparency in Free Trade Zones, which provides a series of commitments to be taken at the state level to enhance the transparency of FTZs while not dissuading trade.
    - Among other things, it reaffirms the need for law enforcement and customs to have direct oversight of trade conducted within an FTZ and stipulates that the administrators and businesses who operate within FTZs must be made aware of their legal obligations. To date, 37 states have signed up to this recommendation, all of them OECD members.[155]
    - The Recommendation contains a Code of Conduct for Clean Free Trade Zones. The Code lays out a series of conditions that administrators must meet in order to be deemed a 'clean free trade zone'. This places an emphasis on both the state authorities and the FTZ administrator taking responsibility for the proper governance of an FTZ.
    - The implementation toolkit and assessment manual are being developed to, respectively, support states in implementing the Recommendation and assessing their compliance.
- In July 2020, the World Free Zones Organization (WFZO), a membership organisation that unites over 600 FTZs around the world,[156] unveiled its Safe Zone certification programme. The programme is voluntary and based on the OECD's Code of Conduct and the WCO's SAFE Framework, discussed below. The programme involves independent certification of an FTZ's compliance with relevant criteria based on the completion of a self-assessment questionnaire subsequently validated through an on-site visit. The current proposal is for verification to be done by 'an independent internationally recognized third-party validator (vetted by the World FZO or one of its key partners)'.[157] The programme's pilot was successfully completed between April 2019 and February 2020 and involved Le Freeport Luxembourg (Luxembourg), Bogota Free Zone (Colombia), Dubai Airport Free Zone (UAE), Klaipėda Free Economic Zone (Lithuania) and El Consorci Zona Franca Barcelona (Spain).[158]
- The WCO has contributed to FTZ integrity in two ways:
    - First, it developed the SAFE Framework of Standards to Secure and Facilitate Global Trade.[159] The SAFE Framework contains a set of recommendations

155. Non-member states can choose to adhere to the OECD's recommendations.
156. World Free Zones Organization, 'Safe Zone Certification Program White Paper', June 2020, p. 7.
157. World Free Zones Organization, 'Safe Zone Certification Program White Paper', p. 21.
158. World Free Zones Organization, 'Safe Zone Certification Program White Paper', p. 13.
159. WCO, 'WCO SAFE Package: WCO Tools to Secure and Facilitate Global Trade', <http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/frameworks-of-standards/safe_package.aspx>, accessed 23 September 2020.

designed to strengthen the effectiveness of customs controls, with emphasis on the threat posed by terrorism and organised crime. As of November 2019, 171 states had signalled their intention to apply the SAFE Framework.[160] It provides for the concept of an Authorised Economic Operator (AEO), a trusted pre-vetted business that enjoys limited customs checks. As noted by the WFZO, the idea of certain certified FTZs as 'safe' or 'clean' follows similar precepts.[161] A weakness of the AEO concept, however, is that it is a status granted by domestic customs authorities, with inevitable differences in standards and approaches across countries.[162] International recognition of a company's AEO status therefore depends on bilateral mutual recognition agreements, of which there were less than 60 as of 2018.[163]

  - Second, the WCO collects information on FTZ-related seizures in its CEN database, as discussed in Chapter I.

- The FATF conducted analysis of FTZ-related financial crime risks in 2010.[164] The FATF and FATF-style regional bodies have also commented on FTZ-related risks in various MERs. The effect of these publications has been varied and depends on a broader set of issues than FTZ-specific comments. For instance, following its evaluation, Panama has formed an executive committee to make the necessary reforms to improve the integrity of the country's FTZs. It is, however, currently on the FATF's list of jurisdictions under increased monitoring, colloquially known as the 'grey list'.[165]
- Civil society organisations also occasionally have a role in improving FTZ governance. In Panama, for instance, the local branch of Crime Stoppers International has established a whistleblowing line allowing those in the Colón Free Zone to report crime.[166]

The adoption of the OECD's Code of Conduct and the rollout of the WFZO's Safe Zone programme are developments that compliant FTZs are likely to take advantage of. In addition to the implementation of these standards, there is merit in setting consistent expectations in

160. WCO, 'Members Who Have Expressed Their Intention to Implement the WCO Framework of Standards to Secure and Facilitate Global Trade', 5 August 2020, <http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/wco-table-intention-to-implement-the-fos.pdf?la=en>, accessed 23 September 2020.
161. World Free Zones Organization, 'Safe Zone Certification Program White Paper', p. 19.
162. Jason Chuah, 'The EU–China Mutual Recognition Agreement of Authorised Economic Operators (AEOs) – A Paradigm of Customs Cooperation?', *International Trade Law and Regulation* (Vol. 4, 2014), p. 86; video interview with three French international trade experts, 10 September 2020.
163. WCO, 'Compendium of Authorized Economic Operator Programmes', 2018, <http://www2.aladi.org/sitioaladi/documentos/facilitacioncomercio/aeo-compendium2018.pdf>, accessed 14 September 2020.
164. FATF, 'Money Laundering Vulnerabilities of Free Trade Zones'.
165. FATF, 'Jurisdictions Under Increased Monitoring – 30 June 2020', <http://www.fatf-gafi.org/countries/a-c/bahamas/documents/increased-monitoring-june-2020.html>, accessed 23 September 2020.
166. Crime Stoppers Panama, <https://panama.tupista.org/en/home/>, accessed 22 Setpember 2020.

relation to how states should police goods that pass them in transit, including through their FTZs. Although it is difficult to state with precision 'what good looks like', the basic principle is that the intensity of controls should be consistent with that of controls in relation to goods entering the country's standard customs territory.

Identification of Problematic FTZs

To further incentivise improvements in countries housing problematic FTZs, voluntary compliance with new international standards could be complemented by an international effort to identify FTZs that serve as major illicit trade hubs. Such an approach has been taken in the area of harmful tax competition with the OECD's list of uncooperative tax havens[167] and the EU's list of uncooperative tax jurisdictions,[168] as well as in the area of AML/CTF with the FATF's list of high-risk jurisdictions and jurisdictions under increased monitoring.[169]

In all of the case study countries, these processes were considered significant levers of international pressure, with special attention being paid to compliance with the OECD's 'economic substance' rules.[170] In particular, Morocco ended up on the EU's grey list of non-cooperative tax jurisdictions in 2018, which was in part due to the tax regime in its FTZs.[171] As Morocco's largest trading partner and the provider of significant funds under the European Neighbourhood Policy,[172] the EU's pressure has induced rapid and notable changes in the regulation of FTZs.

Given its experience of peer review processes and its recent work on FTZs, the OECD appears well placed to engage in a review of individual FTZs. If not, individual states' initiatives to that effect could be valuable, which could resemble the practice of the US Department of State in issuing the annual International Narcotics Control Strategy Report and Trafficking in Persons Report.

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167. OECD, 'List of Unco-operative Tax Havens', <https://www.oecd.org/countries/monaco/list-of-unco-operative-tax-havens.htm>, accessed 23 September 2020.
168. European Commission, 'Evolution of the EU List of Tax Havens', 2020, <https://ec.europa.eu/taxation_customs/sites/taxation/files/eu_list_update_18_02_2020_en.pdf>, accessed 23 September 2020.
169. FATF, 'High-Risk Jurisdictions Subject to a Call for Action – 30 June 2020', <http://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/call-for-action-june-2020.html>, accessed 23 September 2020; FATF, 'Jurisdictions Under Increased Monitoring – 30 June 2020'.
170. Interview with an FTZ employee, Panama, 1 November 2019; interview with an accountant, Rabat, 12 February 2020; participant intervention at the RUSI/Policy Center for the New South workshop, Rabat, 12 February 2020; video interview with Singaporean customs consultants, 4 June 2020; video interview with a UAE-based lawyer, 12 August 2020.
171. European Commission, 'Evolution of the EU List of Tax Havens'.
172. European Commission, 'Morocco', 23 April 2020, <https://ec.europa.eu/trade/policy/countries-and-regions/countries/morocco/index_en.htm>, accessed 14 September 2020.

Box 7: Morocco's Tax Changes in Response to International Pressure

Morocco has until the end of 2020 to implement amendments requested by the EU. Accordingly, the government has principally reacted by enacting the 2020 Finance Law, which reforms its taxation regime and rebrands FTZs as 'Industrial Acceleration Zones' (IAZs).* Historically, FTZ-authorised companies have benefited from a five-year corporate income tax (CIT) exemption and a CIT rate of 8.75% on all export turnover 20 years thereafter.† Under the new law, IAZ-authorised businesses registered after 31 December 2020 will benefit from the same five-year exemption, followed by a standard 15% CIT rate on both local and export turnover thereafter.

Prior to the 2020 Finance Law, only companies realising 85% of their turnover through export were eligible to operate from FTZs. Now, however, companies established in IAZs will be allowed to realise more than 15% of their profits in the local market as long as all duties, taxes and CIT are paid. This may conceivably create an elevated risk of leakage into the national economy, although a one-year trial period allowing FTZ-registered companies to sell up to 15% of their export turnover as finished products on the local market was considered successful and extended into 2019.

* Finance Law No. 70-19 (FL 2020) was enacted by Dahir No. 1-19-125 on 13 December 2019. This summary continues to refer to IAZs as FTZs for consistency across case studies.

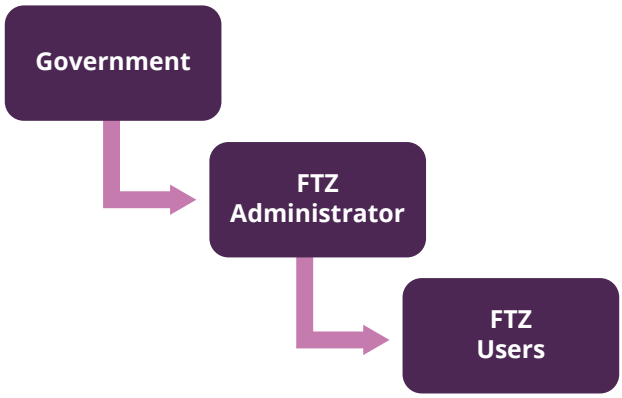
† Oxford Business Group, 'Morocco's New Finance Law Updates Tax Rates and Exemptions', 2020, <https://oxfordbusinessgroup.com/overview/new-landscape-finance-law-2020-has-brought-significant-changes-tax-rates-and-exemptions-variety>, accessed 23 September 2020.

Oversight of FTZs

Despite variations between countries and FTZs as discussed in Chapter II, the typical allocation of responsibilities for policing an FTZ can be visualised as a chain whose links include government agencies, FTZ administrators and FTZ users. Each of these actors sets rules for the next link in the chain, namely the government regulates FTZ administrators who, in turn, control the operations of FTZ users. Interviewees in Morocco characterised this approach as 'the chain of responsibility', which offers a useful analytical framework both in Morocco and elsewhere (Figure 3).[173]

173. The same term is also used in multiple unrelated contexts, including Australian transport legislation and software development.

Figure 3: The Chain of Responsibility



Source: Author generated.

This three-prong structure provides an additional layer of controls over activities within an FTZ beyond regular customs controls. As customs controls are complicated by the volume of trade and exigencies of trade facilitation, this additional layer of controls over who operates in an FTZ assumes particular prominence. The issues that need addressing to ensure it is fit for purpose include: the division of responsibilities; information sharing; monitoring and enforcement; and the role of the customs agency.

Division of Responsibilities

The running of an FTZ involves the performance of several key responsibilities, including:

- Ensuring physical security of the FTZ.
- Coordinating crime prevention and detection activities in the FTZ, including the performance and regular updates of the risk assessment.
- Reporting suspicious activities and/or monitoring FTZ users' compliance with their obligation to report suspicious activities.
- Training FTZ users on their responsibilities.
- Conducting due diligence on prospective FTZ users.

Some of these responsibilities, such as ensuring the FTZ's security and record keeping, naturally pertain to FTZ administrators. In the words of a Singaporean government official, FTZ administrators 'serve as the first line of defence in detecting and deterring illicit trade'.[174]

174. Written reply from a Singaporean governmental authority, 16 July 2020.

Other responsibilities can be fulfilled by FTZ administrators, other governmental agencies such as the customs authority, or other competent organisations or associations. For instance, in Panama's Colón Free Zone, the user association conducts training on AML/CTF rules applicable to FTZ users and encourages the adoption of a 'know-your-customer' application to streamline the onboarding of new customers and screen large transactions.[175]

The OECD recommends that FTZs must enhance domestic inter-agency cooperation, including obligations to report suspicions of illegal behaviour to the competent public authorities, and information sharing between agencies and other cooperation mechanisms, such as joint investigations and joint intelligence centres.[176]

Information Sharing

With clear oversight and coordination comes the ability to better share information between stakeholders within an FTZ, including FTZ users and other private sector companies as discussed below. At present, poor information sharing both domestically within FTZs and internationally between FTZs undermines the integrity and tarnishes the reputation of FTZs. It also impedes proper risk assessment, without which supervisory and law enforcement resources are unlikely to be deployed in the most efficient and effective way.

Conversely, improving information sharing between FTZ administrators and domestic authorities can create a more secure trading environment, primarily because such data is a prerequisite for customs' ability to effectively fulfil their security mandate through targeted inspections and other risk-based procedures. For instance, in Singapore, FTZ administrators are required to report to customs any security-related incidents and suspicious activities on a monthly basis.[177]

To date, examples of effective information sharing in FTZs are few and far between. However, a recent development that can foster greater transparency in FTZs is the shift towards digitisation. In Panama, the 'Ventanilla Única' (single window) is being trialled in the country's FTZs as a way of streamlining reporting.[178] It is a portal where businesses that operate within the FTZ can submit their required information instead of having to go to each government agency. In doing so, information is collected and processed at once. It was also reported that this approach reduces the opportunity to take bribes.[179]

175. Interview with an FTZ user, Colón, 1 November 2019.
176. OECD Legal Instruments, 'Recommendation of the Council on Countering Illicit Trade: Enhancing Transparency in Free Trade Zones', OECD/LEGAL/0454, adopted on 21 October 2019, <https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0454>, accessed 23 September 2020.
177. Written reply from a Singaporean governmental authority, 16 July 2020.
178. Mayrolis Parnther, 'Panama Adopts System for Electronic Commercial Entry/Exit in Colon Free Zone', Lexology, 31 May 2019, <https://www.lexology.com/library/detail.aspx?g=ac75cbe3-34ef-46d0-953a-1effc7bbcf2b>, accessed 14 September 2020.
179. Participant feedback at a workshop in Panama City, October 2019.

In Singapore, similar information portals have the potential to streamline information sharing but are yet to be fully realised. The electronic platform used by customs for declarations, TradeNet, is not currently integrated with PORTNET, a system run by ports managed by the PSA to deal with bills of lading, manifests and other relevant documents. Currently, customs are granted access to FTZ administrators' systems such as PORTNET, and share risk profiling and red flag indicators with them and other government agencies.[180] That said, a single integrated system could further enhance the abilities of FTZ administrators and customs to cross-check information submitted by the importer and identify discrepancies. Separately to that, in September 2019, Singapore Customs launched the Trade Finance Compliance e-service in partnership with MAS and six financial institutions. The e-service enables the sharing of information on the prices of goods to detect mispricing and thereby identify TBML.[181]

In Panama and Singapore in particular, there is political will to improve information sharing to address criminal risks in FTZs. In the case of Singapore, it was reported that the coronavirus pandemic had created an urgency to more rapidly digitise information sharing and reporting to minimise the need for physical interaction at the ports.[182] That said, care should be taken that innovations in digitisation are not treated as an alternative to physical inspections of goods and security controls in FTZs unless and until they are proven to be equally effective.

Monitoring and Enforcement

For the 'chain of responsibility' to work as presented at the outset of this chapter, the performance of each category of stakeholders must be subject to independent monitoring and enforcement.

Most obviously, the compliance of FTZ users with their obligations must be secured. As discussed in Chapter II in the context of Singaporean court cases involving the transit of goods through FTZs, those obligations should provide a meaningful assurance against the involvement of FTZ users in illicit trade. In other words, states should avoid a situation where an FTZ user can do no wrong simply because they never have to enquire into the nature of the trade they facilitate. Furthermore, dissuasive sanctions have to underpin the monitoring arrangements.

A related concern is the widespread lack of monitoring and enforcement in relation to FTZ administrators' performance of their functions. In none of the countries examined was there any evidence of meaningful and consistent monitoring. For instance, in Singapore, where all three FTZ administrators are state owned, other government agencies reportedly rely on informal

180. Written reply from a Singaporean governmental authority, 16 July 2020.
181. Singapore Customs, 'Singapore Customs Makes Available Trade Data via the Networked Trade Platform to Augment Trade Finance Compliance Efforts Against Money Laundering and Terrorism Financing', 5 September 2019, <https://www.customs.gov.sg/news-and-media/media-releases/2019-09-05-Media-Release.pdf>, accessed 14 September 2020.
182. Video interview with an international organisation expert, 3 June 2020.

communications with the administrator if they feel that activities within the zone reflect poorly on Singapore's reputation or jeopardise its security.[183]

In the UAE, FTZ administrators are likewise constituted by respective governments.[184] The presence of multiple FTZs in the country[185] creates incentives for competition among FTZs, which has until recently wholly consisted of generating revenue, but is now tempered by the need to safeguard the zone's reputation by ensuring compliance with AML/CTF standards.[186] Since the business imperative of attracting users can run counter to the reputational benefits of compliance, the path that any given FTZ decides to take is not a foregone conclusion. A formal system of monitoring FTZ administrators could help clarify expectations and shape their decisions.

In the other case study countries, no detailed information appears to be publicly available on the monitoring of FTZ administrators' performance, nor did the authors obtain any insight on that during the fieldwork.

The Role of Customs Agencies

The role that customs agencies should play in FTZs is a source of controversy. On the one hand, it is widely accepted that goods entering FTZs are not immune from customs control. The claim that FTZs are 'extraterritorial' and thus beyond the purview of customs agencies is repeated mostly to debunk it. Customs checks aside, there are multiple other functions customs agencies could contribute to, alone or together with other state agencies:

- Undertaking the risk assessment of activities taking place in an FTZ.
- Authorising the establishment of FTZs or the appointment of FTZ administrators.
- Monitoring the compliance by FTZ administrators and FTZ users with their responsibilities.

All of these functions should be performed by the most relevant and competent authority, which may or may not be the customs agency, depending on the country. But given the institutional experience that customs agencies are likely to accumulate in detecting and understanding illicit trade, there should be a presumption in favour of their involvement, including when FTZs are created. The WCO specifically notes the frequent failure of countries to involve customs agencies during the design of FTZs.[187]

183. Video interview with Singaporean customs consultants, 4 June 2020.
184. Video interview with a UAE-based lawyer, 12 August 2020.
185. 29 FTZs and two financial free zones, according to the FATF's 2020 mutual evaluation review. See FATF, 'Anti-Money Laundering and Counter-Terrorist Financing Measures – United Arab Emirates, Fourth Round Mutual Evaluation Report', p. 22.
186. Video interview with a UAE-based lawyer, 12 August 2020.
187. Omi, '"Extraterritoriality" of Free Zones', p. 21.

In contrast, customs involvement – and the involvement of broader domestic authorities – are central to the certification of a compliant FTZ, including those codes adopted by the OECD and WFZO. Nonetheless, to be credible and consistent, such certification should be undertaken independent of domestic authorities.

Working with the Private Sector

Private sector companies are the main participants in international trade and its financing. They can make a significant contribution to detecting and reporting criminal activity, including by monitoring and reporting suspicious activity to FTZ administrators and/or state authorities through appropriate information-sharing mechanisms.

Financial Institutions

In addition to the overall improvements in AML/CTF supervision of FTZ-related activities, greater education of financial institutions on FTZ-related financial crime risks is essential to creating relevant typologies and 'red flags'. This applies to both financial institutions that finance FTZ users and are thus likely to be based in the FTZ's host country and those that finance businesses trading through FTZs.

For example, trading through an FTZ without an apparent business rationale can be a red flag, but so can any other counterintuitive trading pattern. According to an AML/CTF analyst working for a global bank in the UK, the treatment of situations involving FTZs is complicated by the lack of understanding of what they are, why they are used and how to assess the risk inherent in dealing with a specific one.[188] In all countries considered, there is a lack of understanding among banks of red flags and typologies related to FTZs, which hinders the submission of high-quality suspicious activity reports.[189] In Panama, however, some owners of FTZ-based companies profess an understanding of red flags based on their own experience and informal interactions with law enforcement agencies.[190]

Box 8: Singapore's Experience

Singapore Customs shares red flag indicators with FTZ administrators to raise awareness and for improved detection and reporting of suspicious transaction reports.* Following the introduction of AML/CTF regulation surrounding precious stones, for instance, the Suspicious Transaction Reporting Office has provided inputs on red flags to Anti-Money Laundering/Countering the Financing of

188. Interview with a compliance analyst, London, 29 November 2019.
189. Interview with two bank AML/CTF experts, Casablanca, 14 February 2020; comment from a participant, RUSI/Grupo FARO workshop, Panama City, 30 October 2019; video interview with a retired Singaporean banker, 10 June 2020.
190. Interview with a precious metal trader, Panama City, 28 October 2019.

Terrorism Division's circular on precious stones and precious metal-related trade. This circular is not publicly available but was distributed to Zero-GST Warehouse licencees by customs in May 2020. In addition to the financial sector, other key stakeholders using FTZs include logistics companies and businesses affected by illicit trade, such as IP rights holders.

* Written reply from a Singaporean governmental authority, 16 July 2020.

Logistics Companies

Logistics companies are in the ambiguous position of, on the one hand, directly dealing with customers and their goods and thus being best placed to identify them while, on the other hand, facing commercial pressures and contractual obligations that preclude systematic checks of goods being transported.

One compromise is for logistics companies to conduct due diligence on their customers short of checking the goods they handle, for instance by verifying the customer's identity and identifying unusual or suspicious patterns of shipment. This could happen at two levels:

- First, as a voluntary initiative by the industry. This could build on the Declaration of Intent signed by several major shipping companies and the International Federation of Freight Forwarders Association in 2016 to prevent the maritime transportation of counterfeit goods by applying due diligence measures and committing to efforts to identify high-risk shipments of counterfeits.[191]
- Second, those logistics companies that directly operate in FTZs – as do, for example, many Singaporean logistics companies – should be required to undertake such measures as a condition of being admitted to the FTZ.

Businesses Affected by Illicit Trade

Last but not least, businesses affected by illicit trade, ranging from clothes manufacturers to tobacco companies, often have in-house capabilities to investigate illicit trade that jeopardises their interests. The information they obtain can be of value for risk-based, intelligence-led law enforcement activities, including targeted enforcement operations.

The opportunities they have to bring this information to the attention of competent authorities vary dramatically across countries from the working group run by the Colón Free Zone Administration in Panama that encompasses governmental and non-governmental actors to ad-hoc interaction between the private sector and customs in Singapore. While the risk of 'capture' of law enforcement by private interests must be acknowledged and mitigated, governments that lack a constant, formal arrangement for reporting potentially valuable intelligence should consider remedying this omission.

191. ICC and BASCAP, 'Declaration of Intent to Prevent the Maritime Transportation of Counterfeit Goods', 30 November 2016.

Conclusions and Recommendations

ASSESSING CRIMINAL RISKS of FTZs is similar to evaluating the criminal profile of a city neighbourhood. Almost all depends on the neighbourhood. The only characteristic that all FTZs share is that customs duties do not apply in the same way as in the rest of the country's territory. Beyond this, everything else can differ from zone to zone, including: the non-customs-related business incentives on offer; governance arrangements; geographical location; and the profile of users and activities.

While there are some country-wide factors at play, such as the quality of governance and corruption, context remains vital. In some countries, high volumes of trade and reduced incentives for customs oversight may create a uniquely enabling environment compared to the rest of the national territory. In others, such as Morocco, FTZs pose lesser criminal risks than many of the country's other border crossings by virtue of being subject to at least some level of control and security arrangements. Yet, in other countries, like Singapore, the country's tariff regime is so liberal that the distinction between FTZs and the country's customs territory is all but obliterated, which reduces incentives for smuggling goods from an FTZ into Singapore's domestic market but does not affect its position as a prime transhipment node for illicit goods.

But, not everything is relative, and some generalisations are possible. The spotlight on FTZs in recent years has disclosed common vulnerabilities, and the research for this paper has added further depth to the understanding of crime-related challenges that beset multiple FTZs around the world. Of these, the following areas are especially problematic:

- The lack of consistent international standards and incentives in relation to the policing of goods that pass through FTZs in transit.
- Inadequate understanding of FTZ-related criminal risks in general and financial crime risks specifically, including at the stage of planning and approving the establishment of an FTZ.
- Insufficient clarity of FTZ-related responsibilities and lacking coordination among various agencies involved, including limited information sharing and failure to involve customs agencies in FTZ-level risks assessment.
- The absence of credible monitoring of FTZ administrators and users, as well as the resulting gap in enforcement.
- The lack of proportionate AML/CTF supervision of FTZ-based businesses that would take account of the risk profile and volume of FTZ activities.
- Limited cooperation with the private sector.

In a positive development, however, the international conversation on FTZs has now moved beyond cataloguing a litany of real or perceived failings. The OECD's Code of Conduct for Clean

Free Trade Zones and the WFZO's Safe Zone certification programme hold out the promise of both promoting good governance in FTZs and enabling compliant FTZs to distinguish themselves from those that are not.

These are commendable initiatives with the potential to make a difference. However, voluntary certification programmes for the best in class are not sufficient to address a host of FTZ-related vulnerabilities. This requires a concerted effort from governments, FTZ administrators, users and other private sector actors. Voluntary actions are especially unlikely to succeed in preventing criminal misconduct in those FTZs that are neither alive to criminal risks nor face any tangible pressure to raise their game.

With that in mind, this paper offers the recommendations summarised below as a means of advancing the global effort to strengthen FTZ integrity and further advance the useful work already done in this area.

Recommendations

Policing FTZs

1. Governments should commit to ensuring that they police goods passing in transit through their territory, including their FTZs, as effectively as they police goods imported into their customs territory. In FTZs with significant transhipment volumes, that would require either ensuring additional customs capacity or placing crime detection responsibilities on FTZ administrators or users.
2. Assessments of illicit trade risks in FTZs serving as major hubs for illicit trade should be published by either individual states or a relevant international organisation, such as the OECD.
3. When dealing with countries that host FTZs serving as major hubs for illicit trade, governments should incorporate illicit-trade-related considerations into their diplomatic engagement strategy. However, they should recognise that FTZs may not be the highest illicit-trade-related domestic priority for the host country.

Understanding FTZ-Related Risks

4. Governments should publish statistics on seizures of illicit goods in FTZs and related criminal prosecutions and/or non-conviction-based forfeiture actions.
5. Whenever possible, governments should publish statistics on seizures of illicit goods arriving from other states' FTZs, including naming FTZs and the categories of goods in question.
6. Governments and/or FTZ administrators should publish information on respective FTZs' key trading partners and the types of goods being traded.
7. Governments should consider exchanging trade data with key foreign trading partners and relevant international organisations, including through Trade Transparency Units or similar mechanisms.

8. Governments should endeavour to collect reliable information on the extent of the use of cash in FTZs and consider its implications in respective FTZs' risk assessments.
9. Governments should ensure that a risk assessment is in place for each FTZ in their country's territory.

Responsibility Sharing and Coordination

10. Governments should formally delineate FTZ-related responsibilities between respective government agencies and FTZ administrators. Respective agencies should have appropriate resources and expertise to carry out those responsibilities, which at a minimum include:
    - Ensuring the physical security of the FTZs.
    - Coordinating crime prevention and detection activities in the FTZs, including the performance and regular updates of the risk assessment.
    - Reporting suspicious activities and/or monitoring FTZ administrators' and users' compliance with their obligation to report suspicious activities.
    - Training FTZ users on their responsibilities.
    - Conducting due diligence on prospective FTZ users and administrators.
11. If multiple agencies are involved in the governance of an FTZ, a coordination and/or information-sharing mechanism should be put in place.
12. Customs agencies should have access to IT systems operated by FTZ administrators for the purpose of tracking the movement and value of goods.
13. FTZ administrators should be required to report security-related incidents and suspicious activities to the customs agency.
14. In view of their institutional experience, customs agencies should, as a matter of course, be involved in discharging the following responsibilities, unless there is a reason to exclude their involvement:
    - Undertaking the risk assessment of activities taking place in FTZs.
    - Authorising the establishment of FTZs or the appointment of FTZ administrators.
    - Monitoring the compliance by FTZ administrators and users with their responsibilities.

Monitoring and Enforcement

15. To ensure FTZ administrators and users comply with their responsibilities, this should be subject to independent monitoring.
16. There should be dissuasive sanctions for the failure of FTZ administrators and FTZ users to fulfil their responsibilities.
17. Countries should consider introducing the presumption that an FTZ user is liable for the import of illicit goods (including for transit purposes) unless imposing liability would be clearly unjust in the circumstances, for instance when the importer has no means to ascertain the nature of the cargo and has no prior history of importing illicit goods.

AML/CTF and Sanctions Measures

18. AML/CTF supervisors should participate in the assessment of FTZ-related criminal risks as per Recommendation 9.

19. AML/CTF supervisors should ensure that their supervisory activity in relation to FTZ-based regulated entities is proportionate to the level of risk they pose and the volume of commercial activity they facilitate, in line with the FATF standards on supervision.
20. Competent authorities should collect intelligence on high-value goods stored in FTZs and ensure that this information is taken into account in the country's AML/CTF risk assessment.
21. FIUs should cooperate with customs agencies and other relevant authorities to identify red flags and typologies that could be shared with financial institutions and the logistics sector for better detection of possible money laundering and sanctions evasion involving FTZs.
22. Financial institutions engaged in financing businesses that trade through FTZs should consider incorporating FTZ risk into their AML/CTF risk assessment in addition to or instead of the broader country risk.

Cooperation with the Private Sector

23. Governments should consider the feasibility of requiring logistics companies that are authorised FTZ users to conduct due diligence on their customers whose goods pass through respective FTZs. At a minimum, due diligence requirements should be in place that enable logistics companies to comply with UN-mandated sanctions and export controls.
24. FTZ administrators or competent state authorities should make available a formal channel for reporting unusual or suspicious behaviour. Training on due diligence and reporting should be made available to them.
25. Governments should create formal arrangements enabling private sector companies, such as IP rights holders, to submit information on trends and typologies relating to illicit trade and financial crime in FTZs. Credible information contained in such submissions should be considered by relevant authorities, including customs agencies, in carrying out risk-based and intelligence-led policing of FTZs.

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Annex: Risk Factors for FTZ Integrity

Risk Factor	Rationale
1. High levels of illicit trade	Self-evidently, high levels of illicit trade affecting a given FTZ (as demonstrated, for example, by credible governmental or non-governmental reporting) are a risk factor.
2. Reduced customs controls	Reduced stringency of customs controls compared to the rest of the country creates the incentives to use FTZs for illicit purposes.
3. Lack of due diligence on FTZ users	Due diligence conducted on FTZ users is the first line of defence to exclude criminal actors from operating in an FTZ, which is why its absence is a risk factor.
4. Insufficient oversight within the FTZ	If customs officers do not regularly inspect goods with the FTZ, this creates opportunities for illicit trade.
5. Inadequate record-keeping	Inadequate record-keeping makes it difficult for relevant authorities to monitor the movement of goods in and out of the FTZ.
6. Profile of activities	Different activities present different risks, for example, manufacturing may create opportunities for manipulating the goods to conceal their value or for the production or assembly of counterfeits.
7. Prevalence of cash transactions	The prevalence of cash transactions may increase opportunities for purchasing goods with criminally obtained funds or bulk cash smuggling.
8. Reduced AML/CTF oversight	If AML/CTF oversight of FTZ-based reporting entities is relaxed compared to the rest of the country, this creates incentives to use them for money laundering.
9. Lack of beneficial ownership records	Some FTZs are used for storing high-value objects. The absence of adequate beneficial ownership records can facilitate tax evasion.
10. Inadequate physical security	Inadequate physical security makes it possible for untaxed goods to 'leak' from FTZs into the country's customs territory.
11. Corruption level in the country	High corruption levels in a country are a prima facie indicator of corruption risks within that country's FTZs.
12. Non-compliance with the OECD Code of Conduct	Non-compliance with the OECD Code of Conduct signals a lack of commitment to address possible criminal exploitation of an FTZ.