Free Trade Zones: A Free Ride for Counterfeiters?

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The ancient Phoenicians invented them. The Romans extended their trade dominance thanks to them. Gibraltar and Singapore were two later examples, established in 1704 and 1819, respectively. But it wasn't until 1959 that the first modern Free Trade Zone was established, in Shannon, Ireland—an aeroplane refuelling stop about to be made superfluous by the advent of long-haul jet travel. The idea: turn an area adjacent to the faltering airport into a booming trade centre with special tax incentives to attract international businesses. It turned out to be a stroke of genius. By 1965, exports of manufactured goods from Shannon accounted for almost one-third of the national total. It was a success that many wished to emulate.

Free Trade Zones (FTZs), Foreign Trade Zones, Special Economic Zones and Export Processing Zones (EPZs) are all names for special, delimited areas where exporters enjoy particularly liberal business conditions not available to those beyond its perimeter. In their least attractive incarnation, FTZs can be ring-fenced enclaves where multi-nationals get tax breaks while employees (between 70% to 90% are women) toil in sweatshops and garment factories in a labour-rights race to the bottom. But FTZs can also be entire cities—indeed, Shenzhen and Hong Kong are both modern-day cities-as-FTZs. And some FTZs are veritable business citadels, complete with childcare, housing, banking, conference centres, bonded warehouses, medical clinics and state-of-the-art digital connections—a kind of business park on steroids powered by breaks on taxes, duties and labour costs.

Attracting the good… and the bad

Unfortunately, what can be alluring about FTZs, particularly to the international businesses that they hope to attract, is also what makes them irresistible to illicit trade, namely, a light touch when it comes to governance, regulation and the enforcement of standards. Some FTZs are considered statutorily to be outside of the purview of domestic policing activities. So, what happens in FTZs tends to stay in FTZs, to paraphrase a popular marketing campaign. And what does happen can go beyond poor labour practices and environmental abuses to include money laundering, narcotics trafficking and counterfeiting.

While illicit trade is difficult to measure by any account, the insular status of FTZs makes measuring their contribution to illicit trade all the more challenging. But, we're not without clues. Analysis of FTZs undertaken by the Financial Action Task Force in 2010 found inadequate safeguards against money laundering and terrorist financing. This gap in vigilance also extends to counterfeiting. Clearly, FTZs have much of what a counterfeiter could hope for: a low-cost foothold in a host territory; concentrated industrial facilities geared to transformation, relabelling and repackaging; low labour costs; a hand's-off approach to oversight and the ability to blend in with legitimate businesses.

Counterfeiters definitely rise to the occasion. There is abundant anecdotal evidence of FTZs being used to "sanitise" shipments, disguise origin, add counterfeit trademarks, manufacture and repackage finished counterfeit goods for export, turning FTZs into gateways for smuggling and transhipping fake products.

FTZs: A factor in the rise of fakes

This anecdotal evidence has been confirmed by a new OECD/EUIPO study, Trade in Counterfeit Goods and Free Trade Zones. A key finding shows that exports of counterfeit and pirated goods from a country or economy rise in parallel with the number and size of free trade zones it hosts. No matter what measure of FTZs you apply—their number, employment, number of firms that operate there—FTZs are a factor in the rise of illicit trade in fakes. To put a number on this effect, a new FTZ is associated with a 5.9% rise in the value of counterfeit exports from the host economy.

Free Trade Zones play an important role in stimulating economic growth in many regions and are central to an integrated global economy. But, as the OECD/EUIPO study shows, this growth goes hand in hand with an increase in the trade of fake goods and intellectual property rights abuses. While some jurisdictions may be willing to "take the hit" and accept the trade-off of increased fakes, they do so at their own peril. The lack of oversight that defines certain FTZs is typically one of the factors that can lead to their failure. For those jurisdictions motivated to act on the growth of trade in fakes, they must find ways to apply good governance to FTZs while maintaining attractive advantages for businesses and host. Many are anxious not to throw the baby out with the bathwater. In the months ahead, the OECD will be working to help hosts to step up their efforts to stop illicit trade, while maintaining their role as facilitators of legal trade.

References:

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- *Government Frameworks to Counter Illicit Trade*, OECD, 2018
- *Money Laundering Vulnerabilities of Free Trade Zones*, FATF, 2010