

FTZs and trade facilitation: What is the economic evidence?

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Introduction:

- **Proliferation of FTZs** with pro-trade policies mainly in **developing** and **emerging countries**
- **Behind the generic term free zones:** wide variety of terms that reflects a broad diversity, from duty-free airport areas to huge Chinese special economic zones as Shenzhen.
- What implies that impacts and behaviour may be very contrasted, notably concerning the issue of illegal trade

Free Trade zones : Definition and diversity

- **Several definitions of FTZs** by referring their different characteristics
 - Geographic form (concentrated –SEZ- or widespread – Maquiladoras-)
 - Type of business (transit, processing, storage, commercial etc.)
 - Industrial specialization (service, technology, logistics, construction, assembly, etc.)
- **Common characteristics:**
 - **Exemptions** of tariff (imports and exports) and/or tax policy
 - Exceptions to national regulations
 - **Facilities** : ports/airports, infrastructures, logistics, building, warehouses, power supply
 - **custom clearance** : simplified (or no) ; shorter in time

The specific case of Export processing zones

- **Export Processing Zones (EPZs)** imply a transformation of imported inputs before exporting the processed good
- **The type of zone** that has probably increased the most in the last 25 years and had the greatest impacts on world trade (more than half of Chinese exports!) and FDI.
- **Export requirements and restrictions on domestic market sales in counterpart of advantages:**
 - 100% export share requirement : no access to domestic market
 - frequently : 80% export share requirement
 - No requirement (eg. Uruguay, Thailand, Brazil –Manaus- etc.)
 - The requirements or advantages are given to companies located **inside** an area legally constituted or **dispersed in the territory** (Maquiladoras).

EPZ Database: 1083 Zones in 2008

<http://ftz.dauphine.fr/fr/donnees.html>



- **No cross-cutting studies** due to lack of data : ILO database by Singa & Boyange (2007), WEPZA database etc.
 - Different definitions of FTZs
 - Regime opacity
 - Inoperative FTZs
- Original data
 - **158 Countries**
 - Approximately **1083 Zones**
 - **Sources: WTO Trade Policy Reviews** (information about date of creation and legislative details, type of zone(s), activity of zone(s) etc.); **US Department of State** (Number of zones, main activity, legislation) ; **reports from International Organizations; academic papers, published books** etc.

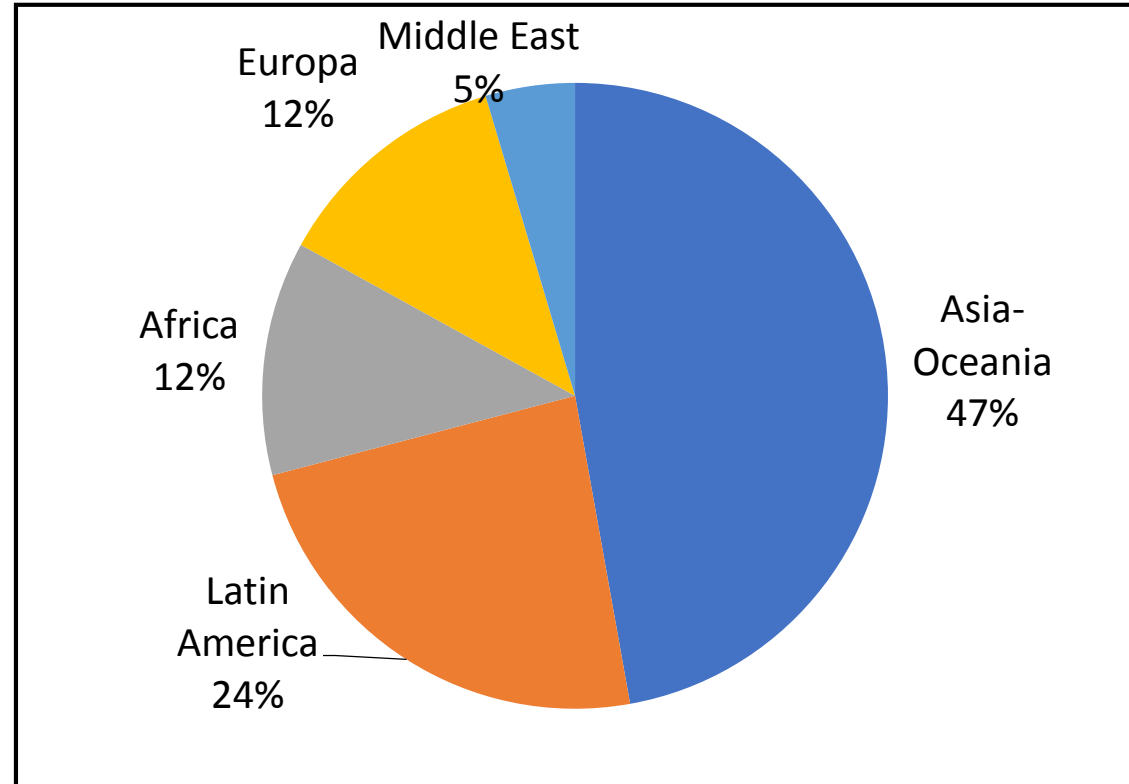
Remark : Less FTZ than more cited references (>3000). Why ?

- No all countries
- No Maquiladoras.
- No Us Foreign Trade Zones
- Only « Export Processing Zones » (EPZ): transformation of imported inputs before exporting a processed good.
- No FTZ only devoted to, transit, storage, transshipment

Top 20 of countries with export processing zones (EPZ)



China	236
Dominican Rep.	57
Honduras	39
Malaysia	33
Namibia	31
India	29
Indonesia	23
Cambodia	22
Korea, Rep.	22
Turkey	21
Vietnam	21
Taiwan, China	20
Jordan	18
Colombia	16
Panama	16
Poland	16
Bolivia	14
Guatemala	14
United Arab Emirates	13
Croatia	13
Uruguay	13



Source : FTZ World Database
ftz.dauphine.fr/fr/donnees/world-ftz-database.html

Trade Impact of EPZs: Success Stories?

Expected Impact of EPZ on development

- ❑ « **Catalytic effects** » : Linkages between EPZs and the rest of the economy (e.g. Knowledge spill-overs)
- ❑ **Attracting and Absorbing FDI** with minimum impact on domestic market (Wu, 2009)
- ❑ Insertion in **GVCs** and **export-led growth** policies with higher **employment**
- ❑ EPZs **increase world exports** by participation in Global Value Chain (GVC) : **Backward** (use of foreign goods and services as inputs) and **Foreward** (supply of inputs incorporated in other countries' exports)

EPZ as a second best

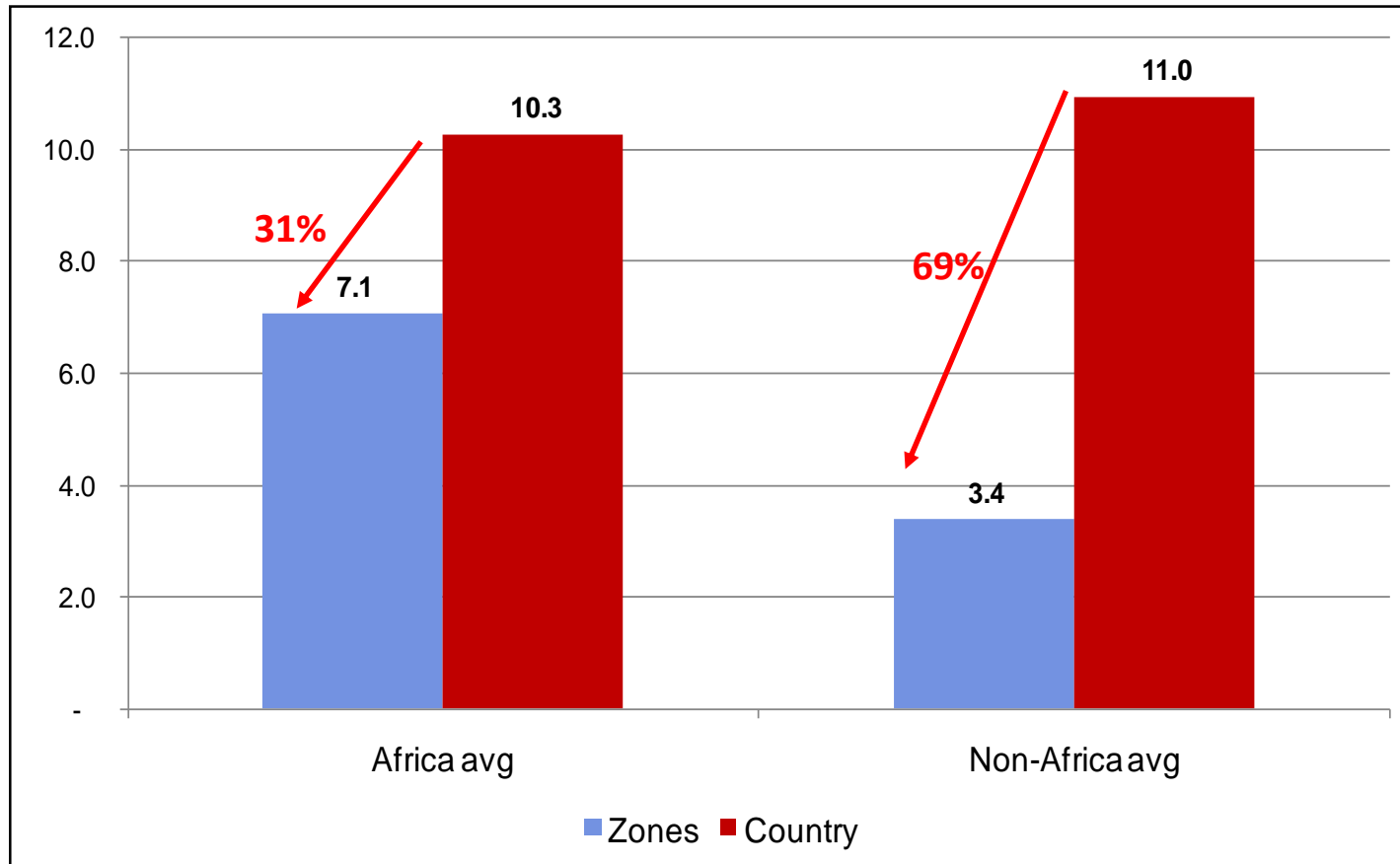
- ❑ EPZ policy is a « mercantilist » strategy...
- ❑ ... which aims to favour imports of duty-free inputs but to maintain tariffs for final goods and to control the activity of multinational firms.
- ❑ In addition to the "cluster" effects, an area with "borders" makes possible to better control operations, particularly customs procedures.
- ❑ Our econometric investigation shows that EPZs raise trade only by partially **easing the negative impact of tariffs.**

The dark face of (some) FTZs

- ❑ Poor transparency of FTZ and incentives
- ❑ Source of new **distortions** and **unfair competition** with domestic firms outside the FTZ (see previously the “second best policy”)
- ❑ **Lawless areas** with **sweatshops** and low Labour standards (major concern for the ILO and Trade Unions))
- ❑ **Money laundering and Illegal trade** : Once introduced into an FTZ, counterfeit goods may undergo a series of economic operations (assembly, manufacturing, processing, warehousing, re-packaging, re-labelling, ...). Once completed, the goods can be imported directly to the national territory of the hosting state or re-exported to another FTZ, where the process is repeated...

Trade facilitation and simplified controls increase trade (WTO agreement). But...

Average time needed for imports (through main seaport) to clear customs (days) *Source: Farole (2011)*



- Simplified controls at customs Goods with the risk of exploiting the FTZ system for fraud.
- The lack of control by Customs raises problems in the fields of intellectual property, security of the supply chain, valuation fraud
- It is simpler for legal entities to set up FTZs and hide the name(s) of the true beneficial owners.
- Most FTZs software systems are not integrated to the Customs IT systems.

(see : FATF Report, Money Laundering vulnerabilities of FTZ, March 2010)

Jebel Ali Free Zone (Jafza), UAE

“In 2008, the UAE was the second largest source of counterfeit goods detained from entering the European Union, accounting for 15% of all seizures made.” (Bascap, 2013)

From Official promotional brochure (2017)

“Over the last 30 years, Jafza has refined its systems to remove all the barriers that businesses face. From formation, licencing, visas, to commercial facilities and staffing. When you establish your company in Jafza, a One Stop Shop will cater to all your needs in the most efficient way possible”

Free zone business incentives :

- 100% foreign ownership
- 0% corporate tax for 50 years (a concession that is renewable)
- 0% personal income tax
- 0% import or re-export duties
- No restriction on capital repatriation
- No currency restrictions
- No restriction on foreign talent or employees
- Ability to mortgage your premises to a bank or financing company

FTZ and WTO

- WTO does not recognize the extra-territoriality of FTZ.
- They have to apply the WTO rules and agreements, especially TRIPs (Trade Related Intellectual Properties) and SCM (Subsidies and Countervailing Measures)
- Failure to apply TRIPS and SCM within an FTZ may be subject to dispute settlement procedure under the WTO
- September 2017 : EU wins WTO dispute with Brazil over tax subsidies in FTZ

Comment 1 – Diversity of governance in FTZ might make difficult to establish general rules

- The FTZ is a single firm (ex. : Mexican Maquiladoras) : The firm must meet a range of requirements to qualify for benefits whatever its location. No specific authority, no autonomous custom.
- The FTZ is a country as a whole (ex : Singapore, Honk Kong,...)
- The FTZ is a delimited area (ex. : Shenzhen or Jebel Ali Free Zone) with its own administration, borders and custom procedures and control.

The issue is mainly on the quasi "extra-territoriality" of the third type FTZs. At the opposite, thanks to concentration and own administration, good practices might be easier to implement.

Comment 2 –Are EPZ the most concerned by illegal trade ?

- What about component (microprocessors, electronic chips, integrated circuits,) which are processed in EPZ?
- A limit to counterfeiting: Production is usually done by sub-contractors or by subsidiaries of multinational companies which sell the final goods under their trademarks. EPZs might not be the main source of illegal trade in fake goods, even they have a specific custom clearance regime.
- Focus on FTZ specialized on transit, storage, transshipment, logistic FTZ ? Jebel Ali Free Zone more than Shenzhen ?

Conclusion

- Some FTZs facilitate illegal trade, but they are not systematically at the source/origin of illegal activities : production of counterfeit goods can be disseminated everywhere in the world although, during shipment, free zones can facilitate the "makeup" of illegal trade.
- EPZs are not necessarily the best location for violation of property rights thanks to the presence of multinational firms that control patents, licenses, copyright,....
- Necessity to target the kind of FTZs the most exposed to illegal trade