1. Evolution of Free Trade Zones

The 2017 OECD and EU Intellectual Property Office (EUIPO) report, *Mapping the Real Routes of Trade in Fake Goods* notes that parties that engage in the trade of counterfeit and pirated products tend to ship infringing products via complex routes, with many intermediate stops along the way (OECD/EUIPO, 2017[1]). The transit points are used to i) facilitate falsification of documents in ways that camouflage the original point of departure, ii) establish distribution centres for counterfeit and pirated goods, and iii) repackage or re-label goods. In addition, while imports of counterfeit goods are, in most cases, targeted by local enforcement authorities, goods in transit are often not within their scope, which means they are less likely to be intercepted.[1]

The transhipment operations are generally located in special economic zones that governments have created to stimulate economic activity. The zones, commonly referred to as free trade zones (FTZs), are designated areas that in most cases lie outside the customs jurisdiction of the economies concerned and are not subject to customs duties or most of the other customs procedures that would otherwise apply to imported merchandise (OECD/EUIPO, 2017[2]).[2] The 2017 report concludes that more in-depth analysis is needed in order to develop a clearer picture of the role that FTZs are now playing in facilitating trade in counterfeits.

The aim of this report is to provide further information and insights into FTZs, examining i) their evolution and the international legal framework in which they operate, ii) the reasons that countries have established zones and the benefits that zones provide to businesses, iii) the role they play in fuelling trade in counterfeit and pirated goods.

For hundreds of years, governments have sought ways to facilitate international trade in their ports. The earliest mechanisms were called free ports, which were designated areas open to commercial vessels on equal terms; cargoes destined for re-export were exempt from customs duties (Dictionary.com, 2017[3]). Such zones are still in operation. The first modern-day FTZ is generally considered to be the Shannon Free Zone, in Ireland. In the 1940s, Shannon Airport was an important refuelling station, with as much as 85% of transatlantic traffic stopping there to refuel (Shannon Chamber, 2017[4]). With the development of jet aircraft, however, the need for refuelling at Shannon declined significantly. The government responded by developing a programme that was designed to promote the area for industrial and tourism development; this included a number of tax and other benefits for firms that located there. The efforts succeeded; by 1965, exports of manufactured goods from Shannon accounted for almost one-third of the national total. The zone remains an important economic area, and it is currently home to more than 100 international and Irish companies that employ over 7 000 highly skilled employees and generate over EUR 3.3 billion in trade every year (Shannon Chamber, 2017[4]). The area remains one of the largest recipients of foreign investment in Ireland (Shannon Chamber, 2017[4]).

Zones have since experienced explosive growth worldwide, albeit in different forms. While generally referred to as free trade zones, the World Bank has coined the term "special economic zones" to capture the different forms they can take (FIAS, 2008[5]). These different types range from export processing zones, industrial areas focusing on assembly and manufacturing of intermediate imports aimed primarily, but not exclusively, at foreign markets, through free ports that typically encompass much larger areas and accommodate a broad range of activities, including tourism and retail sales to specially designated storage warehouses that are overseen by customs authorities.

The principal features of the different types of zones are that they:

- are geographically delimited, usually physically secured areas
- offer benefits based upon physical location within the zone
- represent separate, duty-free customs areas.

According to the International Labour Organization (ILO), the number of zones has increased from 79 zones located in 25 economies in 1975 to over 3 500 zones in 130 economies today. At last count, the zones collectively employed 66 million workers, while generating over USD 500 billion in direct trade-related value added (Table 1.1) (ILO, 2014[6]; Boyenge, 2007[7]).[3] Most of the zones in OECD countries were established prior to the 1970s, with a sharp rise occurring in other countries in the 1990s (FIAS, 2008). While the zones have proliferated in all regions worldwide, Asian zones account for some 85% of total zone workers worldwide, with China alone accounting for 40 million workers (ILO, 2014[6]). While there has been widespread growth, less than a dozen countries account for the majority of zone employment and exports (FIAS, 2008[5]).

Table 1.1. Trends in FTZ development. 1975-2006

	1975	1986	1997	2002	2006
Number of economies with zones	25	47	93	116	130
Number of zones	79	176	845	3000	3500
Employment (millions)	(1)	(1)	22.5	43	66

Note: (1) Not available
Source: (ILO, 2014[6])

Most enterprises in zones are engaged in labour-intensive assembly operations, notably in the apparel, textile and electric and electronics industries (Engman, Onodera and Pinali, 2007[8]; FIAS, 2008[5]; Farole and Akinci, 2011[9]; World Bank, 2017[10]). Female workers have traditionally accounted for 60-70% of the zone workforce worldwide, though the percentage has slipped as manufacturing activities in zones have expanded.

The development has varied by region.

- **Americas**: In the Americas, zones in many countries were developed by public sector entities, a situation which over time has given way to private zone development; in the process, a number of public zones were fully or partially privatised. The majority of the zones developed in recent years in South America, and particularly in Colombia and Uruguay, are "high-end" zones, offering state-of-the-art facilities and services.
- **Asia/Pacific**. The Asia/Pacific region has led zone development. Zones in East and South Asia are largely government run, either by central government authorities (e.g. Korea, Singapore and Bangladesh), by state government

corporations (Malaysia and India) or by ministerial departments (Chinese Taipei). Zone activities have focused largely on low-skilled textiles and apparel activities; a few, however, such as Thailand, Malaysia and Chinese Taipei, have expanded their activities into higher-skilled areas such as electronic and automotive assembly and chemical processing. Moreover, some countries have developed specialised zones for financial services, information technology and science-based industries.

- **Middle East and North Africa**: Although manufacturing is permitted in many zones in this area, trading and associated activities (such as packaging and repackaging) dominate. The Jebel Ali Free Zone in Dubai is a major regional distribution and logistics hub which serves as a model for other zones in the region.
- **Western Europe**: EU regulations restrict manufacturing and processing in zones, with few exceptions. The zones are largely located at ports and are publicly developed and managed.
- **Central and Eastern Europe and Central Asia**: In recent decades, many countries in this region have developed zones as a means of attracting foreign investment and integrating their economies into the global economy through expanded exports.
- **Sub-Saharan Africa**: Most zones in this region (with the exception of Ghana and Kenya) were developed and are run by governments. The dominant industries in the zones involve apparel/textiles and food processing.

The framework in which zones operate has changed markedly over time. Traditionally, zones were fairly isolated institutions, sealed off both in term of policy and in their geographic locations (FIAS, 2008[5]; Farole and Akinci, 2011[9]; World Bank, 2017[10]). Incentives and privileges were tightly controlled and qualifying firms typically had to be 80-100% export-oriented, engaged in recognised manufacturing activities and, at times, foreign-owned. Moreover, zone locations were found mainly in relatively remote areas or near transport hubs. Most were considered, like Shannon, to be instruments for the promotion of regional development. Moreover, they were developed and operated exclusively by governments.

This focus has undergone striking changes. Zone development is now largely viewed from a countrywide perspective. Indeed, each state in the United States have at least one FTZ (Bolle and Williams, 2013[11]). The role that zones can play in development has also changed (FIAS, 2008[5]). Zones in developing countries were previously viewed as a way to work around trade-restricted or closed economies. They were expected to increase exports, create jobs and transfer technology. Currently, zones are seen as broader mechanisms to promote two-way trade and facilitate liberalisation and modernisation in their host countries. An increased emphasis has been placed on encouraging linkages with domestic economies and promoting spill-over effects. As in the United States, the number of zones established in the inland areas of other countries has also increased.

Growth in the number of zones has been further spurred on by the expansion and liberalisation of the policies governing their use (FIAS, 2008[5]; Farole and Akinci, 2011[9]; World Bank, 2017[10]). These policy changes have included:

- an expansion of activities to include commercial and professional services
- equal treatment of foreign and domestic investors
- granting of incentives for private zone development
- relaxation or elimination of minimum export requirements.

Another notable change in zones over time has been the increasing role of privately run entities. In 1975, all zones were government-owned and government-operated (FIAS, 2008[5]; Farole and Akinci, 2011[9]; World Bank, 2017[10]). By the mid-2000s, some 62% of zones in developing and transition economies had been developed and were being operated by private entities (Table 1.2). The proliferation of private actors in zone development and management stems, in part, from the tendency for private zones to be more efficient. It is also due to the potential cost savings for governments. When zones are privately developed, less government funding is often needed, as private developers finance onsite infrastructure and facilities, with governments focusing on building offsite infrastructure and facilities which may represent only 25% of onsite costs. Moreover, most private zone operators are required to take on the expense of constructing onsite facilities for the use of the government authorities involved with zone operations. They may also assume certain regulatory functions on behalf of customs agencies, thereby reducing customs costs for governments.

Table 1.2. Private and public sector zones, by region, circa 2007(1)

Region	Public	Private	Percent private
Americas	146	394	73
Asia/Pacific	435	556	56
Sub-Saharan Africa	49	65	57
Middle East and North Africa	173	40	19
Central and Eastern Europe and Central Asia	69	374	84
Total	872	1,429	62

Note: (1) Excludes single factory programmes.
Source: (FIAS, 2008[5]).

The FIAS (2008)[5] assessment concludes that the growth in private involvement has been beneficial, as privately-run zones tend to offer better facilities and amenities, command higher prices from tenants and attract higher-end tenants. Many public sector zones, in contrast, have crowded, poorly designed and inadequately maintained facilities, reflecting the budgetary and operational constraints that they face. Moreover, privately-run zones tend to be more responsive to tenant needs, providing a wider range of property management services and amenities (Box 1.1). Many private zones also appear to achieve better economic outcomes with respect to exports, employment, foreign direct investment, and social and environmental impact.

Box 1.1. Free trade zone facilities and services

Free trade zone facilities and services have expanded over time, due to the interest on the part of private zone operators in providing tenants with attractive options, including:

- childcare facilities
- medical clinics
- conference centres
- product exhibition areas
- commercial centres
- training facilities
- shelter plans
- repair and maintenance centres
- shared bonded warehouse facilities
- incubator facilities
- on-site banking facilities
- on-site housing
- on-site customs clearance and trade logistics facilities
- high-speed telecommunications and Internet services, networked buildings

Source : (FIAS, 2008[5]).

Notes

1 The analysis in this report refers to goods that are placed in free trade zones, and does not refer to “goods in transit”, as referred to Article 5 of GATT.

2 It should be noted some hosting economies do have customs controls in the FTZ.

3 UNCTAD (2015) indicates that the number of zones now exceeds 4 000.

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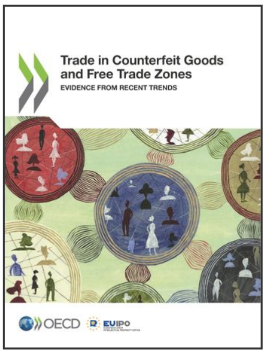

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