

Executive Summary

Free trade zones (FTZs) have a long and cherished role in world trade, dating back to at least the early 1700s. They can provide numerous, unequivocal benefits to business and host countries. However, lightly regulated FTZs are also attractive to parties engaged in illegal and criminal activities, such as trade in counterfeit and pirated products or smuggling and money laundering, as these zones offer a relatively safe environment with both good infrastructure and limited oversight.

This study confirms the links between FTZs and trade in counterfeit products. The existence, number and size of FTZs in a country correlate with increases in the value of counterfeit and pirated products exported by that country's economy. An additional FTZ within an economy is associated with a 5.9% increase in the value of these problematic exports on average. The study also led to clear findings with respect to the connections between the value of fake goods exported from an economy on the one hand, and the number of firms operating in FTZs and the total value of exports from these zones on the other.

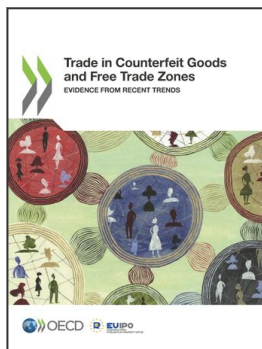
While FTZs were originally established as means to facilitate goods in transit by relieving traders of the need to complete many of the customs formalities that would otherwise apply to goods entering a country for consumption, these zones have evolved over time. They have developed into an important tool for attracting foreign investment and promoting economic development and growth, particularly in developing countries which can use them to leapfrog economic development. However, developed economies have also reaped the benefits of these zones, as evidenced by the several hundred zones operating in the United States alone.

Zones come in many forms, and they are subject to the specific laws and regulations of individual countries. The costs and benefits to businesses and host countries thus vary considerably from one economy to another. For businesses, zones provide numerous benefits, including savings in taxes and customs duties, greater flexibility in terms of labour and immigration rules than in the customs territory of host countries, lighter regulation and oversight of corporate activities, fewer restrictions on corporate activities, and additional opportunities to distribute goods to diverse markets. Furthermore, while there can be costs associated with choosing to locate in a zone, possibly including a range of special zone fees, this burden is often quite light, perhaps with even lower costs than would otherwise be incurred if the business were established in the customs territory of the host country.

For host countries, zones can be beneficial to economies to the extent that they attract foreign investment, create jobs and enhance export performance. The benefits to host countries, however, come at a cost, to the extent that governments are forced to forgo revenue, with any gains stemming from zone activities often failing to offset losses. Moreover, potential benefits to economies only apply to those zone activities that would otherwise not have been established in the customs territory of the given host country.

Beyond the economic costs and benefits to states and businesses, these lightly regulated zones are also attractive to parties engaged in illegal and criminal activities. Some zones may have inadvertently facilitated trade in counterfeit and pirated products, smuggling and money laundering. The problem is aggravated when governments do not police zones adequately. This can occur when zones are deemed to be foreign entities that are outside of the scope of domestic policing activities. When zones are operated by private entities, these entities' main interests are likely to be in finding ways to expand zone occupancy and provide profitable services to zone businesses. They may therefore have little direct interest in and/or capacity for conducting law enforcement activities. They may also lack the capacity or authority to effectively monitor zone operations. Even where government authorities are actively involved in overseeing zone activities, there is evidence that co-ordination between these authorities and zone operators, particularly private operators, can be weak, providing further scope for bad actors to exploit zones for their illicit activities.

More effective actions and co-ordination at the national and international levels are urgently needed to ensure that zones are not undermined by illicit activities. This has come to the attention of the OECD, EUIPO, European Anti-Fraud Office, Europol, the World Customs Organization, the World Trade Organization, Interpol, the United Nations Office on Drugs and Crime and the World Health Organization. The following organisations have made proposals to address the situation: the Caribbean Financial Action Task Force, the Black Market Peso Exchange System Multilateral Experts Working Group, the International Chamber of Commerce and the International Trademark Association. By working together the international community can ensure that FTZs continue to develop as important institutions that promote international trade without facilitating illicit activities. The two goals are not incompatible.



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