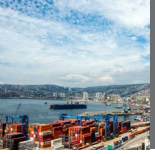
The Economist INTELLIGENCE UNIT

The Global Illicit Trade Environment Index

A report by The Economist Intelligence Unit

Commissioned by TRANSNATIONAL ALLIANCE TO COMBAT ILLICIT TRADE TRACIT.ORG



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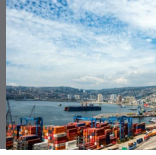

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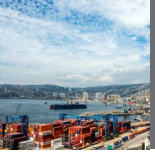

Acknowledgements

The Global Illicit Trade Environment Index is based on a similar index that was devised and constructed in 2016 by Chris Clague. The 2018 update and expansion was conducted by Trisha Suresh, Michael Frank and Chris Clague. David Ramirez and Chris Clague wrote this report, focusing on free trade zones, and Scott Aloysius provided research support. It was edited by Amanda Simms.

During research for the construction of the Index and in writing this report, the EIU interviewed executives and experts from across the world. Their time and insights are greatly appreciated. They are listed below in alphabetic order by affiliation. The EIU takes sole responsibility for the construction of the Index and the findings of this report.

- **Kishore Makhijani**, president, Corozal Free Zone Chamber of Commerce
- **Alejo Campos**,director for Crime Stoppers Caribbean, Bermuda and Latin America CBLA
- **Alvaro Jose Romero Guerrero**, president, Guajira Chamber of Commerce
- **David Luna**, founder, Luna Global Networks
- **Antonio Hernandez**, operations manager, Marinovic y Cia
- **Dr. Piotr Stryszowski**, senior economist, OECD

We would also like to thank the numerous interviewees agreed to provide their time and insight in providing for background.

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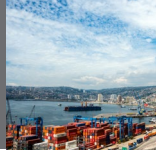

The Global Illicit Trade Environment Index is a measure of the extent to which economies enable (or inhibit) illicit trade through their policies and initiatives to combat illicit trade. The index is built around four main categories, each of which is comprised of a number of indicators. The four categories are government policy, supply and demand, transparency and trade, and the customs environment. This report is focused on the way that five free trade zones across the world are facilitating illicit trade. They are not the only free trade zones doing so, but they are among the most prominent.

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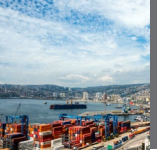

Introduction

Free trade zones (FTZs) are the problem child of global trade. On the one hand they highly valued for their contributions to trade facilitation but on the other they are criticized for vulnerabilities that facilitate many forms of illicit trade and other illegal activities. Though the concept of a "geographically delimited area administered by a single body, offering incentives [to business]" has been around for hundreds of years, it wasn't until the 1980s that countries, mainly in the developing world, truly started creating them.[1] And they were conceived as a means of stimulating economic growth, which in many instances is what they have done, with the most prominent example being the Shenzhen Special Economic Zone (SEZ).

Many of the zones have come at a cost, however. In enticing businesses with the promise of a tax-free environment, with little in the way of regulation, governments across the world have created within their borders unmonitored havens ripe for criminal operations, including those of transnational organised crime networks.[2] Over the past decade, numerous international bodies, non-governmental organisations (NGOs) and consultancies, including the OECD, the International Chamber of Commerce (ICC) and the UN Office on Drugs and Crime, as well as The Economist Intelligence Unit (EIU), have documented the myriad ways that free trade zones are used to facilitate trade in illicit goods.[3] While no one knows for certain the precise volume or value of illicit trade that flows through the zones, it is estimated, by almost everyone, to be substantial and include counterfeits, narcotics, alcohol, tobacco, pharmaceuticals, wildlife and humans. Moreover, FTZs have been exploited by criminals as a means to initiate and facilitate illicit financial transactions, such as traditional money laundering, trade-based money laundering (TBML) and terrorist financing.[4]

Yet, it didn't—and doesn't—have to be this way. Free trade zones don't need to be free of oversight to deliver on their commercial and economic promise, and many governments are grappling with approaches to find the balance between facilitation and control/monitoring. Perhaps what might be concerning are cases where governments appear to be indifferent to the issue, some actively so.

To measure how nations are addressing the issue of illicit trade, the Transnational Alliance to Combat Illicit Trade (TRACIT) has commissioned the Economist Intelligence Unit to produce the Global Illicit Trade Environment Index. The global

1 http://documents.worldbank.org/curated/en/343901468330977533/pdf/458690WP0Box331s0April200801PUBLIC1.pdf
2 To cite one example: https://www.nytimes.com/2010/11/11/world/middleeast/11iht-m11mtrade.html
3 https://iccwbo.org/publication/controlling-the-zone-balancing-facilitation-and-control-to-combat-illicit-trade-in-the-worlds-free-trade-zones-2013/
https://read.oecd-ilibrary.org/trade/trade-in-counterfeit-goods-and-free-trade-zones_9789264289550-en#page7
https://www.unodc.org/documents/data-and-analysis/Studies/TOCTA_EAP_web.pdf
4 http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf

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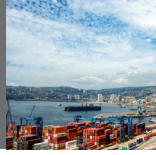

index expands upon an Asia-specific version, originally created by The Economist Intelligence Unit in 2016 to score 17 economies in Asia on the extent to which they enabled or prevented illicit trade. The Asian index generated much-needed attention on the issue of illicit trade within the region. Building upon the success of the Asia index, the global index now includes 84 economies, providing a global perspective and new insights on the social and economic impacts of illicit trade.

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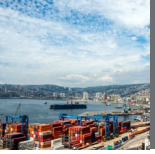

The Global Illicit Trade Environment Index and FTZs

This paper looks at FTZs in five countries: Panama (Colon FZ), Belize (Corozal FZ), Colombia (Maicao Special Customs Regime Zone), United Arab Emirates (Jebel Ali FZ), and Singapore, which has nine free zones in total. They were selected based on a number of factors, including their size, strategic locations, poor FTZ governance, and how each can illustrate the myriad ways FTZs facilitate the flow of illicit goods.

Free trade zones were covered both in the inaugural version of the Index in 2016, which covered 17 countries in Asia-Pacific, and the 2018 expansion, which covers 84 countries across the globe. The two FTZ-specific indicators are contained within the Transparency and Trade category. This category measures an economy's transparency as related to illicit trade, and the degree to which the degree to which it exercises governance over its FTZs and transshipments.

The first FTZ-specific indicator is whether and to what extent a country has adopted Annex D of the Revised Kyoto Convention (RKC), a 1999 agreement reached under the auspices of the World Customs Organisation (WCO), an intergovernmental body focused on customs administration. The RKC, designed to be a "blueprint for modern and efficient Customs procedures in the 21st century,"[5] is an update to the original convention, adopted in 1974. Annex D of the agreement includes two chapters, one covering customs warehouses and one on FTZs. In the index, countries that have adopted RKC and accepted both chapters of Annex D, without reservation, receive the highest score. A country that did not accept Annex D at all receives a score of zero.[6]

The other indicator is FTZ governance. This indicator measures the extent of monitoring and oversight at FTZs and is based on both relevant legislation and expert perception of how that legislation is actually being implemented. Economies that receive the top score of '2' in the indicator have customs operations present in their zones; customs officials and law enforcement agencies also have the legal authority to inspect goods in FTZs and are perceived by experts to be doing so. Conversely, a score of zero is given to economies which have neither customs officials nor legal authorities present in the zones or, in those cases where they are present, are perceived by experts to not be acting.

5 http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/conventions/pf_revised_kyoto_conv.aspx
6 For a full explanation of the Global Illicit Trade Environment Index methodology, please consult the appendix of this paper.

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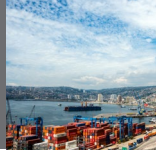

Overall results

The performance in the overall Global Illicit Trade Environment Index of the five countries covered in this report varies. Singapore fares the best, coming in tied with Estonia in 24th place. United Arab Emirates (UAE), at 34th, and Colombia, at 43rd, are also both in the top half of the overall index. Panama follows in 54th and Belize is near the bottom in 77th place.

In three of the four categories in the index, at least two of the five economies place in the top half of the index. But in Transparency and Trade, none of them do, and this is largely because of their scores on the two FTZ-related indicators: Adoption of Annex D of the RKC and FTZ governance. None of the five have adopted Annex D, although in that regard, they are far from alone—only five economies in the index have adopted the annex without reservations and only eight other have adopted parts of it.

That is not the case with the FTZ governance indicator. Sixty one of the 84 economies in the index receive full marks ("two") on this indicator[7] and fourteen receive a score of "one." That leaves nine economies which received a score of "zero." Four of those nine are covered in this report: Singapore, UAE, Panama and Belize. While Colombia received a score of "two" based on the relatively sound governance of the majority of its 103 FTZs, the 104th, Maicao Special Customs

Adoption of Annex D of Revised Kyoto Convention

RANK	COUNTRY	SCORE/ 100
=1	Algeria	100.0
=1	Kazakhstan	100.0
=1	Laos	100.0
=1	Tunisia	100.0
=1	Ukraine	100.0
=6	China	50.0
=6	Hong Kong	50.0
=6	Philippines	50.0
=6	South Korea	50.0
=6	United States	50.0
=11	Australia	25.0
=11	Belarus	25.0
=11	Japan	25.0

COUNTRY	GOVERNMENT POLICY	SUPPLY AND DEMAND	TRANSPARENCY AND TRADE	CUSTOMS ENVIRONMENT	OVERALL
Singapore	=21	2	=56	56	24
UAE	=34	3	58	52	34
Colombia	36	69	=56	=23	43
Panama	52	36	80	=36	54
Belize	69	65	83	=75	77

Note: = where tied with one more countries

7 Economies like Algeria and Australia, which do not have FTZs, were given the highest score because, in the context of illicit trade, not having a FTZ is equivalent to having a well-governed FTZ.

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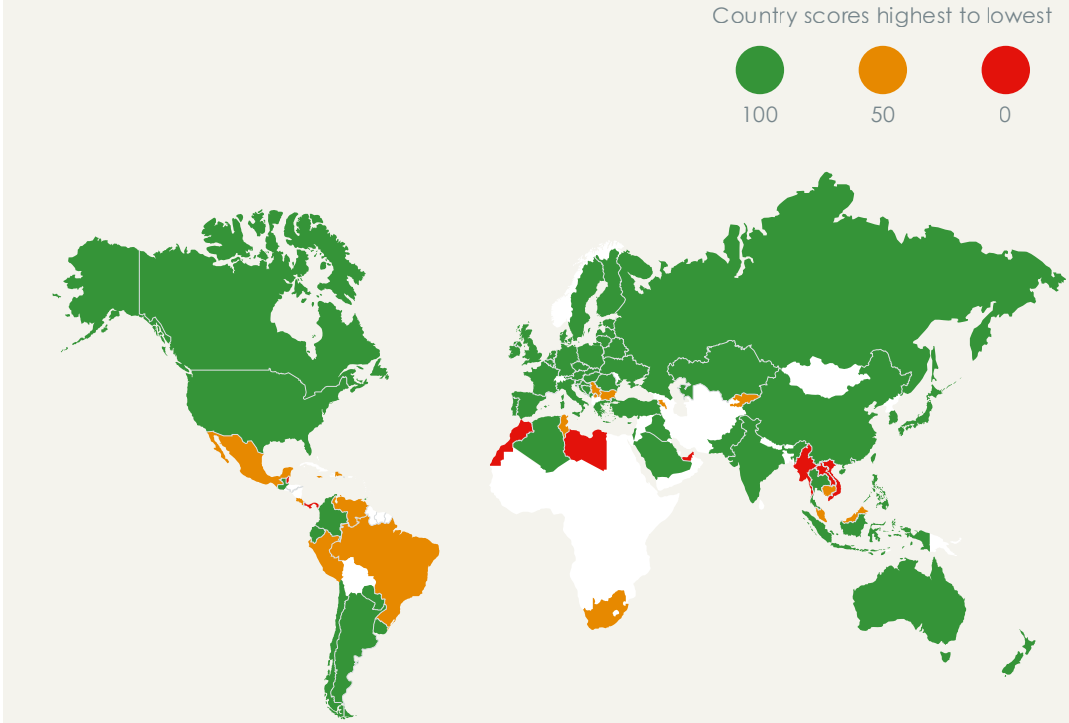
Regime Zone, is a problem and will be discussed in a separate section below.

The rest of this paper discusses why the FTZs in these economies receive the scores that they do on this indicator. David Luna, a former US State Department official and founder of Luna Global Networks, a consultancy, says the zones in these economies "have long been concern for international organisations." We will identify why that is and possible solutions to combating the problem.

Overall results: Free trade zones



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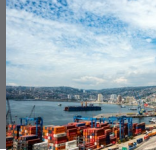

Panama: Colon Free Zone

Panama's Colon Free Zone (CFZ) was created in 1948, making it among the oldest of the FTZs in the post-war era. It is also among the largest, with total trade passing through the zone in 2017 valued at US$19.7bn. That figure, however, represents a significant drop from CFZ's peak in 2012, when total trade reached US$30.8bn.[8] In the years since then, CFZ has been hit by the economic crisis in Venezuela, once a major export market, and an escalating trade dispute between Panama and Colombia over re-exports of footwear and textiles from the zone to Colombia. The woes of CFZ, and other zones in the region and elsewhere, create even more of an incentive for illicit activity, as will be discussed below.

In the overall global index, Panama ranks 54th, or not far outside the bottom third. Its score is pulled down severely by the Transparency and Trade category, where it ranks almost last at 80th. Not only has Panama not accepted either of the chapters in Annex D, it is not even a contracting party to the Revised Kyoto Convention. That results in a score of zero for the indicator. Panama also scores zero on the FTZ governance indicator. Although this reflects policy and legislation at the national level, CFZ was singled out by experts and analysts for lacking effective controls and thus having little in the way of enforcement.

Like many of the world's most notorious free trade zones, smuggling is rampant in CFZ, especially of illicit white cigarettes."[9] According to a local lawyer, the main countries of origin for these cigarettes are China, India, the United Arab Emirates and Paraguay. From CFZ, some cigarettes go direct to their destination, economies like the Colombia, Dominican Republic[10], Ecuador and Costa Rica.[11] According to Antonio Hernandez, operations manager at Marinovic y Cia, a Chilean law firm, they are also shipped to other FTZs, like Iquique in Chile, where they then enter the local market. The reason these cigarettes, and many other forms of illicit trade, pass through one more zones like CFZ is so that their certificate of origin can be altered, a practice often referred to as "origin laundering."

This is not, however, a problem without any solutions. The same local lawyer explained that there are a number of actions—some simpler than others and some on the private sector side—that can be taken to combat the trade. "The [contraband trade] could be tackled by improving Know Your Customer procedures, " he says, "and inventory control and inspections within CFZ, as well as by unifying labeling requirements [on cigarette packs] across all the countries affected." There could also be improvements in the regulatory framework such as due diligence, audits and meaningful penalties.[12]

8 Zona Libre de Colón (2018), Análisis de la Actividad Comercial Correspondiente al Mes de Diciembre de 2017. http://www.zolicol.gob.pa/sites/default/files/2018-02/MOV%20COMERCIAL%20DE%20DICIEMBRE%202017_0.pdf
9 Illicit whites are cigarettes that are usually manufactured legitimately but are smuggled for the purposes of tax avoidance.
10 https://www.diariolibre.com/noticias/aduanas-se-incauta-de-mas-de-9-millones-700-mil-unidades-de-cigarrillos-en-el-puerto-de-haina-LL9148683
11 https://www.nacion.com/sucesos/seguridad/decomiso-de-cigarros-alcanza-cifra-record-en-solo-3-meses/FMM27TQV7BGFNIE2QMNQAZGEDE/story/
12 http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf

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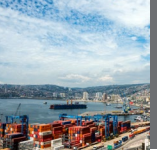

Panama does have a few somewhat unique factors involved, at least as regards free trade zones. Chief among them, according to InSight crime, a foundation focused on studying organised crime in Latin America and the Caribbean, is the way that trade in contraband is mixed in with money laundering in the country. Panama's open banking laws, the dollarisation of the economy and "lax and often corrupt judicial system" make it a natural hub for global money laundering activities.[13] A 2017 report by the Panamanian governments Commission Against Money Laundering, Terrorist Financing, and Financing of the Proliferation of Weapons of Mass Destruction (known by its Spanish-language acronym CBNC) conceded as much, noted that CFZ's "high trade flows" also make it particularly susceptible to money laundering.[14] It admits too that, like many other countries, while it is stepping up efforts to prevent both illicit trade and money laundering in free trade zones, many cases are not prosecuted because the illicit goods don't actually enter Panamanian territory. Another local source confirmed this assessment, saying that authorities have not prioritised enforcement against smuggling and other illicit activities within CFZ because they view it as "other countries' problems."

13 InSight Crime (2018). Panama Profile. https://www.insightcrime.org/panama-organized-crime-news/panama/
14 Comisión Nacional Contra el Blanqueo de Capitales, Financiamiento del Terrorismo y Financiamiento de la Proliferación de Armas de Destrucción Masiva—CNBC (2017), Evaluación nacional de riesgos de blanqueo de capitales y financiamiento al terrorismo de Panamá.

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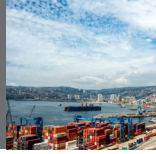

Belize: Corozal Free Zone

Located on the border between Belize and Mexico, the Corozal Free Zone (Corozal FZ) is a regional transshipment hub that, since its inception in 1994, has been taking in goods mainly from the US and re-exporting them principally to Mexico and the rest of Central America. It is far smaller[15], in terms of value of trade, than CFZ in Panama, Jebel Ali in UAE or the various Singapore free trade zones combined, with just US $400mn in annual turnover. Like CFZ in Panama, it has fallen on hard times. Kishore Makhijani, president of the Corozal Free Zone Chamber of Commerce and board member of the Corozal Free Zone, estimates that "40% of businesses within the zone have closed down and 1,600 jobs have been lost due to downsizing and closures over the past few years", all of it mainly due to the depreciation of the Mexican Peso against the US dollar.

In the overall index, Belize ranks 77th, falling between Ukraine and Kyrgyzstan. It doesn't perform well in any of the four categories in the index, but it fares worst in the Transparency and Trade category, where it is second from the bottom, ahead of only Libya. Also like Panama, it is not a party to the Revised Kyoto Convention and so receives a score of zero on that indicator. Likewise, it scores zero on FTZ governance and for similar reasons: while some legislation is in place with regards to free trade zones, enforcement agencies are lax and underfunded.

The "crisis" at Corozal FZ, says Mr Makhijani, is "basically turning the zone into a no-man's land," which is compounding the illicit trade problem. The government in Belize, for its part, appears to have recognised the problem. In March of 2018, it announced a technical cooperation project it is launching with the Inter-American Development Bank (IDB), a development institution, to review and repurpose the Corozal FZ. The output from the project is expected to be a new economic development plan for the zone.[16]

That won't be enough, however, says Alejo Campos, director for Latin America and the Caribbean at Crime Stoppers, an NGO focused on reporting crimes. Some of the fixes are obvious and similar to other economies in Latin America and elsewhere, including providing better funding and training to customs officials. But, Mr Campos says, judges also require better knowledge of how criminal organisations take control of smuggling so that "they [judges] apply asset recovery laws more strictly which would hit hard the economic structure of the criminal networks.

15 www.belizecorozalfreezone.com .
16 http://www.quepasacorozal.com/corozal-free-zone-re-purposed/

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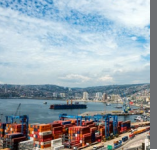

Colombia: Maicao Special Customs Regime Zone

The Maicao Special Customs Regime Zone (Zona de Regimen Aduanero Especial, or ZRAE) was established in 1999 by combining three neighbouring municipalities (Maicao, Urabia and Manaure) on the Guajira Peninsula in northeast Colombia, on the country's border with Venezuela. While it is the source of many the same issues as other zones in Latin America, its operations differ in a number of ways. The importation of automobiles is prohibited, for example, as are any goods deemed a threat to national security, including arms; alcohol is subject to an import quota. Goods can also enter Colombia from ZRAE, but they are subject to normal tariffs and taxes, while individual consumers are allowed to purchase the equivalent of $2,000 worth of merchandise per visit, subject to a 6% duty.[17]

In the overall index, Colombia ranks 43rd, placing it amongst the better performers in the Americas region, which includes Canada and the US, although that is faint praise for a region that generally performs poorly. In the Transparency and Trade category it comes 56th, not far off from a trio of other Latin American countries in 51st (Uruguay) and 52nd (Ecuador and Mexico tied). It is not a contracting party to the Revised Kyoto Convention, but in the FTZ governance indicator, the country's National Tax and Customs Office was deemed competent in analysis conducted for the index and it received a score of two out of two.

The ZRAE is an exception to this, however. For one, it has a different legal status than the majority of the other 103[18] zones in Colombia, as discussed above. The city of Maicao was, on its own, a free port for many years and had a long-standing reputation for being a hub of illicit trade. By folding it into ZRAE, the government appears to have been attempting to hide it within a larger free zone. Another aspect in which makes ZRAE distinct is the poor state of its infrastructure. Alvaro Jose Romero Guerrero, president of the Guajira Chamber of Commerce, says that the customs authority faces difficulties to conduct inspections at Bahia Portete, the only port that services ZRAE, basically "because of lack of an adequate port infrastructure." The only road from Bahia Portete to ZRAE is 120km long and "is deteriorated" and the port itself lacks modern facilities, resulting in all of the cargo being handled manually rather than by machine. Labour conditions at the port are so dire that the government threatened to close it down, but has refrained due to protests from the local community, according to Mr Romero Guerrero.

Separate studies from the *Federacion Nacional de Departamentos* (FND), the association of

17There are additional limits: only 12 articles of the same kind (4 in the case of home appliances) can be carried in a single trip and resale is prohibited. Government of Colombia (1999).
18 United States Department of State, Bureau of International Narcotics and Law Enforcement Affairs (2018)

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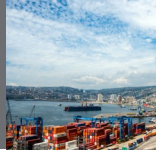

national provinces, and the *Asociacion Nacional de Empesarios de Colombia* (ANDI), a national business association), have shown that, as a result of these factors, ZRAE has become a haven for smugglers. In particular, smugglers of illicit cigarettes, the profits from which the FND study noted are "high."[19] And the situation only appears to be getting worse—a recent report from the Colombian government says that cigarette smuggling appears to be soaring in 2018.[20] [21]

19 Federación Nacioinal de Departamentos (2015). Estudios Regionales, Contrabando. http://www.fnd.org.co/fnd/2015-03-25-22-26-43/anticontrabando/146-la-federacion/centro-de-estudios-regionales/politicas-publicas/1616-contrabando

20 https://canal1.com.co/noticias/incautan-gigantesco-cargamento-de-contrabando-camuflado-en-camion-de-hidrocarburos/

21 https://www.dian.gov.co/Prensa/ComunicadosPrensa/087-DIAN%20realiza%20aprehensiones%20en%20Maicao,%20Tulu%C3%A1%20y%20Pereira%20por%20m%C3%A1s%20de%20$2.000%20millones.pdf

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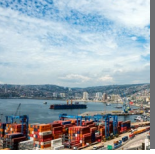

Singapore

Singapore is the world's largest transshipment hub and has nine free trade zones in total, two of which are attached to Changi, the city-state's airport and the Southeast Asian hub for multiple airlines. As we noted in our 2016 report, Singapore's central role in facilitating trade in the Asian region, and the revenue it derives from that role, which is in the billions of US dollars, endows it with especial responsibility when it comes to preventing illicit trade. The results of the 2016 index, as well as interviews with experts, indicated at the time that Singapore was not fulfilling its responsibility in this regard.

The results of the 2018 index, and subsequent research, reveal that little, if anything, has changed since. In the overall index, it does come in 24th, bolstered by high scores in other areas, including the Supply and Demand category, which measures the domestic environment within economies for illicit goods and where it comes in second. Singapore, like many other countries with numerous and large free trade zones, such Panama, appears to be more concerned about what enters the country than what transits through it. In the Transparency and Trade category, however, it ranks 56th out of 84 countries. Singapore is still not a contracting party to the Revised Kyoto Convention, let alone Annex D of the agreement, and on the FTZ governance indicator, it once again receives the lowest score, owing to the gaping, unresolved loopholes in legislation for goods-in-transit that continue to be regularly and widely exploited by traffickers in illicit goods.

Improvements could be forthcoming. Last year, a consortium of luxury brands, including Louis Vitton, Gucci, Burberry, Hermes and Sanrio, brought a case in Singapore's High Court against Megastar Shipping Pte Ltd, a freight forwarder and, most importantly for the case, the local consignee of what turned out to be—upon inspection by the customs authority—two containers of counterfeit goods being transshipped through Singapore from China and with a suspected final destination of Indonesia. At issue in the case was whether Megastar, as the local consignee, was liable for trademark infringement. Although the court eventually ruled for the defendant[22], and the plaintiffs have appealed, that the case was brought at all has called attention to the fact that Singapore is not in compliance with its obligations from its 2004 free trade agreement (FTA) with the United States, which contains a provision on the seizure of counterfeit and other IP-infringing goods being transshipped through the country. Even if the brands lose their appeal, it seems likely Singapore will still have to change their practices in this area to better comply with the FTA, according to a source with knowledge of the matter.

22 http://www.singaporelaw.sg/sglaw/laws-of-singapore/case-law/free-law/high-court-judgments/23025-louis-vuitton-malletier-v-megastar-shipping-pte-ltd-pt-alvenindo-sukses-ekspress-third-party-and-other-suits

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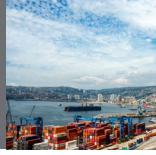

Yet, even if that scenario comes to pass, the timeframe for implementation is likely to be years rather than months. In the interim, Singapore will continue to reap economic benefits from its free trade zones and its role as a transshipment hub while, in many ways, turning a blind eye to many forms of illicit trade, the effects of which reverberate throughout the Asian region and the rest of the world.

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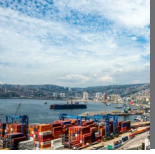

United Arab Emirates: Jebel Ali Free Zone

The Jebel Ali Free Zone, also known as 'JAFZA,' was established in 1985 in the United Arab Emirates (UAE). JAFZA is one of the world's busiest transshipment hubs, with an annual container throughput of more than 15 million twenty-foot equivalent units, or TEUs, the standard measure of port activity in the shipping industry. It is also a massive site for manufacturing. Seventy-five hundred companies have operations within JAFZA, processing, assembling and producing a wide variety of goods for export, primarily to Europe and Sub-Saharan Africa. The volume of commercial activity at JAFZA makes the zone vital to the UAE economy and in particular to Dubai, which lacks the natural resource wealth of its fellow emirates and has thus long been pursuing a strategy to position itself as a regional hub for logistics, as well as financial services. By some estimates, JAFZA accounts for as much as 20% of Dubai's GDP.

In the overall index UAE ranks 34th. As is the case with many countries in the index that have large free trade zones, however, it scores poorly in the Trade and Transparency category, coming in at 58th in the rankings, just behind Singapore and Colombia, which are in a tie for 56th. While it is a signatory to the RKC, it has not accepted either of the chapters in Annex D, earning it a zero in the indicator. For the FTA governance indicator it also receives a score of zero; legislation on the books grant customs the authority to carry out inspections, but local experts consulted say that legislation is honoured more in breach than practice. The quantity and quality of inspections, for one, is considered to be low, when authorities are checking at all. One regional brand manager said that firms have taken to engaging law enforcement to get involved as a means of motivating customs to carry out more inspections, but that that isn't always effective.

For these reasons, and because of the size of the zone's manufacturing base, which produces large volumes of genuine goods, JAFZA has become a major hub for illicit trade, especially trade in counterfeits and other IP-infringing goods. In some cases, the counterfeits are assembled within the zone from parts imported separately; in others, the raw materials are imported and the counterfeiters manufacture the goods from scratch. Once complete, the counterfeit goods are shipped throughout the region and also to Europe. "In terms of counterfeits coming into Europe, Jebel Ali really stands out," says Dr. Piotr Stryszowski, senior economist at the OECD and the co-author of a recent joint report between the OECD and the EU Intellectual Property Office.[23] "If you ask any customs officer where the fakes come from, they will say Hong Kong, China, Singapore and apart from Asia, it's Jebel Ali."

23 https://read.oecd-ilibrary.org/trade/trade-in-counterfeit-goods-and-free-trade-zones_9789264289550-en#page7

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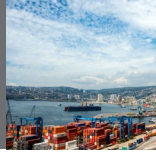

The misuse and exploitation of JAFZA to drive global illicit trade also calls attention to an issue of considerable importance and one with broader, geopolitical implications. In creating free trade zones and failing to properly monitor them, governments around the world have, according to Mr Luna, created enabling environments for a variety of "non-state actors to work together across borders" in ways that would otherwise not be available to them. Mr Luna notes that there is a particular "connectivity" between the world's various free trade zones and that Jebel Ali is just one prominent example. "Payments for [counterfeit] pharmaceuticals being trafficked through Jebel Ali from China and on to Africa eventually wind up in Panama," where they help to fund other types of illegal activity, be it more illicit trade or other forms of criminality. This, he says, means that operators and agencies overseeing see need to cooperate with each other much more closely than they are at present.

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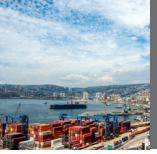

Conclusion

The findings from our research into these five countries show that there is much more that can be done to minimise vulnerabilities to illicit trade occurring in their FTZs and, as a result, achieve a higher score on the Global Illicit Trade Environment Index. These findings are also relevant, to varying to degrees, to zones elsewhere in the world and include:

- **Customs**. Make sure there is a customs office in each zone and that local law enforcement has the legal authority to carry out checks at any time on goods stored in a free zone.

- **Enforcement**. Many countries already have laws in place to combat illicit trade. In many zones, however, there is simply a lack of enforcement.

- **Corruption**. Corruption enables illicit trade. The more it is reduced, both inside and outside of the zones, the more likely illicit trade volumes will fall.

- **Infrastructure**. Strong infrastructure is no guard against illicit trade; JAFZA and Singapore's FTZs have among the best infrastructure in the world. But weak infrastructure creates vulnerabilities easy to exploit.

- **RKC and Annex D**. Sign the RKC, including Annex D, and implement is key provisions, such as refusing goods brought from abroad on the grounds that the goods are subject to prohibition or restrictions on the grounds of public morality, public security, public hygiene or health, or the protection of patents, trademarks and copyrights.

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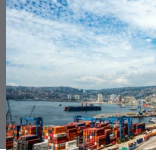

Index methodology

The Global Illicit Trade Environment Index measures the extent to which a country enables illicit trade, either through action or inaction. Based on the findings from an extensive literature, and input from a panel of illicit trade experts, we built the Index around four main categories, each with four to seven indicators. Those categories are:

- Government policy measures the extent to which countries have comprehensive laws targeting illicit trade. The category focuses on legal authority at relevant stakeholders, and considers intellectual property protection, cyber security and money laundering laws.

- Transparency and trade measures the extent to which the government makes itself publicly accountable in its efforts to combat illicit trade. The category also considers best practices in trade governance.

- Supply and demand considers the institutional and economic levers that can stem or amplify illicit trade flows.

- Customs environment measures how effectively a country's customs service manages its dual mandate of trade facilitation while preventing illicit trade.

We constructed the Index in consultation with an expert advisory panel:

- **Julio Bacio Terracino** – deputy head of division at OECD Public Sector Integrity Division, Public Governance Directorate

- **Michael Levi** – professor of criminology at Cardiff University (UK)

- **John M. Sellar** – independent anti-smuggling, fraud, and organised crime consultant

This index follows the illicit trade framework from the OECD Task Force on Countering Illicit Trade (TF-CIT).[1] According to the OECD, illicit trade refers to "trafficking and illegal trades in drugs, arms, persons, toxic waste, natural resources, counterfeit consumer goods, and wildlife." Framework examples transcend industry and geography, including illicit trade's negative impact on health, environment, human vulnerability, terrorism, and government.

Country selection

We selected 84 countries to ensure a representative sample of countries in global supply chains, with particular consideration for illicit trade flows. The selected countries

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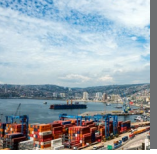

represent 95% of global GDP and 95% of trade flows. When selecting countries, we also made sure to include a balance of countries from all regions and levels of development. Regions are classified primarily based on based on the World Bank's country and lending groups for 2018.[2]

Indicators by type

The Index includes 14 quantitative indicators and six qualitative indicators. There are four broad categories of indicators:

- **EIU country scores**. Our country analysts are expert economists who regularly track the business environment and operational risk for their country of study. Analysts score countries based on answers to a set of specific questions for each topic, ensuring comparability across all 84 countries.

- **International institution scores**. We draw on existing indices or benchmarking exercises from highly reputable international sources, such as the World Bank's Logistics Performance Index and the Organization for Economic Cooperation and Development's Trade Facilitation Indicators.

- **Participation/availability scores**. Countries receive scores for adoption of illicit trade-related international conventions and participation in trade services, such as Authorised Economic Operator ("trusted trade") programmes.

- **Survey of experts**. Ten indicators are scored based on qualitative desk-based research and interviews with in-country illicit trade experts.

Indicator normalisation

In order to compare data points across countries–as well as to construct aggregate scores for each country–the project team normalised collected data on a scale of zero to 100 using a min-max calculation. While both scores and rankings are relative assessments, scores have more absolute weight as they better capture the distribution of actual outcomes.

Other indicators were normalised as a two, three or four-point rating. For example, "4.5) Customs recordal system" was normalised so that countries without such systems scored 0, countries with partially effective systems scored 50, and countries with effective systems scored 100.

While using normalised values (that is, a score of 0–100) allows for direct comparability with other normalised indicator scores in the 2018 Global Index, we cannot directly compare performance of countries in the 2016 APAC Index and this Index. This is because (a) normalised scores change based on performance of other countries in the sample, and (b) some indicator scoring frameworks and data sources have changed.

2 https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups

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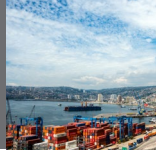

Indicators

Our research team collected data for the Index from December 2017 to February 2018. In addition to scores from The Economist Intelligence Unit, the Index uses publicly available data from international organisations, as well as qualitative analysis based on desk-based research and interviews with in-country experts.

INDICATOR	UNITS	SOURCE	DESCRIPTION	WEIGHTS[3]
1. Government policy				**35%**
1.1 Commitment to illicit trade-related treaties	# of conventions (out of 14)	Various	Extent to which a jurisdiction has entered into 14 different international conventions related to illicit trade.	12%
1.2 Compliance to FATF standards	0-10 score	Basel Institute on Governance AML Index	Extent to which a jurisdiction engages in international judicial cooperation on money laundering and other criminal issues, based on FATF assessments and Basel Institute on Governance analysis.	8%
1.3 Intellectual property protection	1-5 score	EIU Business Environment Ratings/Risk Briefing	Extent to which a high standard of comprehensive IP laws are enforced. (Note: proxy indicator used for 18 countries: Protection of intellectual property rights from EIU Risk briefing.)	12%
1.4 Corruption	1-5 score	EIU Risk Briefing	Extent of corruption among public officials.	28%
1.5 Law enforcement techniques	0-3 score	EIU custom score	The extent to which there is specific legislation empowering authorities use special investigative techniques under UNTOC and UNCAC guidelines: controlled deliveries, intercepting communications and undercover operations	14%
1.6 Interagency collaboration	0-2 score	EIU custom score	The extent to which law enforcement and customs authorities cooperate on efforts to counter illicit trade.	14%
1.7 Cybersecurity preparedness[4]	0-1 score	International Telecommunication Union	The extent to which governments are committed to cybersecurity across five main pillars: legal, technical, organisational, capacity building, and cooperation.	12%
2. Supply and demand				**20%**
2.1 Tax and social security burdens	2-10 score	EIU/US Social Security Administration	Extent of corporate tax and social security contributions of companies.	10%

3 Category weights represent that category's share of the index. Indicator weights represent that indicator's share of its category.
4 ITU does not score Hong Kong or Taiwan. Hong Kong has therefore received China's score. Taiwan has received an average of the scores for four developed East Asian economies: Hong Kong, Japan, Singapore and South Korea.

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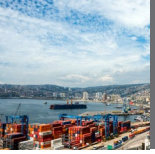

2.2 Quality of state institutions	1-5 score	EIU Business Environment Ratings/Risk Briefing	Effectiveness of country's public institutions. (Note: proxy indicator used for 18 countries: Quality of bureaucracy from EIU Risk briefing.)	40%
2.3 Labour market regulations	1-5 score	EIU Business Environment Ratings/Risk Briefing	Our restrictiveness of labour laws rating scores countries between 1 and 5 on the degree of restrictiveness on hiring and firing, with 1 being "very high" and 5 being "very low". (Note: proxy indicator used for 18 countries: Restrictiveness of labour laws from EIU Risk briefing.)	15%
2.4 Perception of organised crime[5]	0-7 score	World Economic Forum/EIU	Perception of the extent to which organised crime (mafia-oriented racketeering, extortion) imposes costs on business.	35%
3. Transparency and trade				**20%**
3.1 Track and trace services[6]	0-5 score	World Bank LPI	Ability to track and trace consignments.	35%
3.2 Adoption of Annex D of Revised Kyoto Convention	0-4 score	World Customs Organization	Adoption of Annex D of Revised Kyoto Convention.	25%
3.3 FTZ governance	0-2 score	EIU custom score	Extent to which countries establish customs offices and authorise inspections of goods in transit in all FTZs.	25%
3.4 International reporting	0-6 score	EIU custom score	The extent to which the government reports on its efforts to counter human trafficking, IP infringement, and drug trafficking.	15%
4. Customs environment				**25%**
4.1 Percentage of shipments physically inspected[7]	% of shipments	World Bank LPI	Percentage of shipments physically inspected.	10%
4.2 Customs clearance and inspection	# of hours	World Bank Doing Business	Number of hours, on average, for customs clearance and inspection.	10%
4.3 Automation[8]	0-2 score	OECD Trade Facilitation Indicators	Assessment of electronic exchange of data, automated border procedures, and use of risk management.	32%
4.4 Authorised Economic Operator programme	0-2 score	World Customs Organisation	Assessment of operational or planned AEO programmes.	28%
4.5 Customs recordal system	0-2 score	EIU custom score	Assessment of existence and effectiveness of customs recordal systems.	20%

5 WEF does not rate five of the countries in the index: Belarus, Belize, Iraq, Libya and Myanmar. For these countries, EIU country analysts applied WEF's scoring framework to assign a custom score.

6 World Bank LPI does not score Belize for Track and Trace Services. We have assigned Belize an average of Costa Rica, Guatemala and Panama.

7 World Bank LPI does not score Armenia or Belize for physical inspection of shipments. For Armenia, we have assigned an average of CIS lower middle income economies (Georgia, Kyrgyzstan, Moldova, Ukraine, and Uzbekistan). For Belize, we have assigned an average of Costa Rica, Guatemala and Panama.

8 OECD's Trade Facilitation Indicators do not include scores for Iraq or Libya. We have assigned both countries the lowest score based on our research.

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