

## **TRACIT response to OECD public consultation on “Guidance on Countering Illicit Trade: Transparency in Free Trade Zones”**

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### **Endorsement of the OECD work**

- The Transnational Alliance to Combat Illicit Trade ([www.TRACIT.org](http://www.TRACIT.org)) is pleased to have had the opportunity to comment on the OECD Draft *Guidance to Counter Illicit Trade: enhancing transparency in Free Trade Zones*.
- Addressing the risks and vulnerabilities of Free Trade Zones (FTZ) has long been a prominent topic for the international business community in combatting illicit trade. We were therefore pleased with the empirical research produced by OECD Task Force on Countering Illicit Trade (TF-CIT) report: *Trade in Counterfeit Goods and Free Trade Zones: Evidence from recent trends*.
- We consider the draft *Guidance to Counter Illicit Trade: enhancing transparency in Free Trade Zones* to be a critical follow-on to the research findings. TRACIT considers it fundamental that research conducted so far in order to quantify illicit trade in its various manifestations, including in FTZs, is complemented by an equally solid workstream aimed at advising and supporting countries in taking critical policy-making decisions.
- To the extent that governance of FTZ has been weak because of (i) the voluntary nature of governance guidelines, or (ii) poor record of accession to/ implementation of such legal instruments as the WCO Revised Kyoto Convention or WTO TRIPS, or (iii) national governments’ lack of understanding about their duties and responsibilities over activities carried out in FTZ, we very much welcome both the recommendations to governments and the delineation of a Code of Conduct for Free Trade Zones.

### **Consistent with TRACIT research and policy recommendations**

- The draft Guidance echoes many of the key findings from the recent TRACIT / Economist Intelligence Unit (EIU) FTZ report “[Free Trade Zones - Five Case Studies](#)” which uses findings from the 2018 [Global Illicit Trade Environment Index](#) to examine the threat of illicit trade in FTZs in five countries: Panama (Colon FZ), Belize (Corozal FZ), Colombia (Macao Special Customs Regime Zone), United Arab Emirates (Jebel Ali FZ), and Singapore.
- To encourage an effective policy response to the EIU paper, TRACIT has also prepared a set of policy recommendations specific for FTZs. The EIU paper and TRACIT policy recommendations can be found here: [https://www.tracit.org/publications\\_gitei.html](https://www.tracit.org/publications_gitei.html).

- We are pleased to note that the draft *Guidance* is reflective of the concerns raised in the EIU paper and addresses several of TRACIT's policy recommendations. And, we encourage OECD to review the TRACIT recommendations and incorporate additional as appropriate.

## Viewpoints and comments on recommendations to governments

- **Require more robust information on FTZ operators and require licenses for key operations in FTZs.**
  - In many FTZs, the establishment of legal companies requires very little information, which facilitates the establishment of ghost or shell companies.
  - In addition to the recommendations laid out in provision 2.9, governments should require basic information on the economic operators allowed to operate in FTZs, including legal and beneficial ownership information and ownership structure, so as to deter and prevent the misuse of corporate vehicles.<sup>1</sup>
  - Additionally, a competent authority should be established to require and issue licenses to operate in FTZ, e.g., to manufacture, import, export, broker, or ship raw materials and other key inputs necessary for production within manufacturing and packaging facilities in FTZs. Such authority should also be responsible for renewal, suspension, and cancelation of the licenses, in accordance with national law.
- **Give greater attention to data interoperability.** The Draft guidance recognizes the importance of and delineates many requirements for data collection, data sharing and domestic and international cooperation. However, the issue of data interoperability could be further emphasized. In many jurisdictions systems are not integrated and sometimes transactions are recorded in physical and electronic form. The lack of integration in these systems generates great difficulty in analyzing data domestically, and even more so when data is exchanged across different jurisdictions.
- **Promote accession to and full implementation of the WHO Protocol to Eliminate Illicit Trade in Tobacco Products.** One of the Protocol's features, which sets it apart from all other illicit trade related conventions, is that it specifically devotes an article (art.12) to "Free Zones and International Transit" by requiring, among others, that States Parties "implement effective controls on all manufacturing of and transactions in, tobacco and tobacco products, in free zones, *by use of all relevant measures as provided in this Protocol.*" Among such measures are the establishment of a licensing system, due diligence measures, the setting up of track and trace systems, etc. The draft Guidance should provide clear reference to this innovative legal instrument, which is due to enter into force on 25 September 2018, ideally by encouraging countries that have not done so yet to consider acceding to it as a matter of priority.

- **Ensure the adoption and full enforcement of anti-money laundering (AML) regulations in FTZs.** It is important to stress that all FTZ operators that can be regarded as "reporting entities" (e.g. financial institutions) according to the FATF Recommendations, shall indeed comply with all requirements set forth in the Recommendations in terms of client identification, record-keeping and reporting of suspicious authorities to the competent Financial Intelligence Unit. Such entities should be supervised and subject to the same sanctions for failing to comply with AML regulations as any other body performing similar functions in the territory of the State.
- **Consider illicit trade in FTZs from the prevention angle, not just remedial action.** While most of the proposed recommendations encourage countries to react to illicit trade, they are less focused on prevention, i.e. how to ensure that illicit trade does not occur in FTZs in the first place. TRACIT considers it a critical responsibility of OECD to also promote policies to OECD member states to mitigate illicit trade prior to exploitation of supply chain nodes such as FTZs. This work would include addressing the drivers of illicit activity and promoting implementation of, for example, sound tax & tariff policies that can remove incentives for smuggling. By way of example, in Jordan imported distilled spirits are subject to an import duty of 180-200% depending on the specific category. This import duty is halved to 90-100% for products intended for the Aqaba FTZ. Preferential duty does not apply to products that are ultimately sold on domestic market, outside of the FTZ. However, there is significant leakage from the FTZ to the domestic market, undermining the business activities of the legitimate suppliers in the domestic market and eroding government revenue. The fundamental reason why the FTZ is being used to foster illicit activity is the astronomical duty levied on legitimate products. Similarly, in Colombia, the La Guajira FTZ serves as a major platform for duty-free imports that are then smuggled into the domestic market and sold through illegal shops. Industry estimates that 60% of imported whisky sold in Colombia is smuggled into the country, mostly through FTZs. With a bottle of premium whisky taxed at such high levels that it retails at 40\$ (vs 30\$ in New York, Paris or Berlin...), the price differential of illicit market vs legal market acts as a powerful incentive for misusing the FTZ.

In view of the above, we suggest that the list of recommendations in Section I of the Draft Guidance be complemented with text encouraging countries to:

"Undertake a thorough analysis of their existing tax and tariff structures by sector, to examine where high levels of overall tax & tariff burden may incentivize illicit trade through FTZs".

- **Other remarks on language used in the draft Guidance**
  - We agree on the general principle set forth in Provision 2.6 about excluding convicted persons from operating in FTZs. However, as it is currently drafted, the provision seems to be excessively broad. It should be fine-tuned, first of all by specifying that convictions must be of a criminal nature. Also, the scope of

the "illegal activity" concept needs to be fleshed out more accurately, perhaps by referring to a minimum penalty threshold and/ or specific types of criminal conduct. TRACIT stands ready to further assist in the drafting phase upon request.

- We fully agree on the inclusion of a provision on the need for States to make greater use of international agreements to address illicit trade in FTZs. However, the current formulation of Provision 5 is overly complicated and may lead to confusion. We suggest to streamline it to read that States should ensure that all relevant international agreements, whether trade-, customs or criminal justice related, are considered to be fully applicable in FTZs, except where their applicability to FTZs is explicitly excluded. TRACIT stands ready to further assist in the drafting phase upon request.
- Provision 7 could be usefully drafted to read as follows: "Promote awareness amongst the business community (e.g., major intermediaries including shipping agents, freight forwarders, customs brokers and logistics companies) to understand the major risks related to FTZs, including by leveraging the connecting role played by relevant business-driven initiatives/NGOs active on illicit trade issues.
- We very much appreciate the inclusion of Provision 8 on fostering public private partnerships (PPPs). At the same time, PPPs should not be limited, as the current version suggests, to FTZs that have not adopted the Code of Conduct. One cannot assume that States that have adopted such Code will be illicit trade free by definition. Also, PPPs may well serve the purpose of encouraging Code-abiding FTZs to continue performing according to high standards and as a source of best practices to less virtuous FTZs.

### Areas of collaboration

- TRACIT is willing and able to support the implementation of provisions 1 and 2, by echoing these recommendations to authorities (e.g., Trade Ministers, Customs Officials) in national governments including but not limited to OECD governments.
- TRACIT is willing and able to support the implementation of provision 7, by holding meetings with or producing materials for key intermediaries and cargo owners using FTZ.
- TRACIT is willing and able to support the implementation of provision 8, by fostering public private partnerships on countering illicit trade in FTZs.
- **With regard to the motive to improve transparency on the extent to which FTZs enable or prevent illicit trade.** TRACIT is willing to support the efforts of the TF-CIT to improve transparency by producing an "Index" evaluating and ranking the largest FTZs against a series of performance criteria to highlight specific areas where FTZs are weak or strong. Inclusion in such an Index of several or more of the TF-CIT's proposed

recommendations to governments and several or more of the criteria in the Code of Conduct could serve as an informal "litmus test" of the relevance and coverage of the OECD provisions, in advance of implementation, training and certification. While the work could be done independently of the TF-CIT, we believe that it would benefit from input, joint research and analyses by the TF-CIT and specifically the Secretariat's research team. *(We propose that this work could be undertaken between TRACIT, the Economist Intelligence Unit and OECD).*

- **With regard to objectives for certification.** Any efforts to certify FTZ compliance with the code of conduct should be preceded by sufficient awareness of and training on implementation of the provisions of the code of conduct. Lack of resources and deficiency in the training of human resources is already insufficient within FTZs, even to perform the brief controls that a National Customs Authority is allowed. Moreover, current training of existing workers is deficient in light of the dynamism in the methods of illicit trade in different products. Elements of such training could include:
  - Initial audit review of current internal systems and procedures for compliance with the code of conduct and consulting support to set up the required internal procedures and processes to be compliant;
  - Develop a training package to be delivered to FTZ operators and employees. This could also be tied to ISO 17024 certification for Trade Regulation and Compliance and Trade Management of employees within the FTZ;
  - Develop a training programme to promote awareness amongst the business community operating within FTZs. This can also tie to the development of a training programme as part of ISO 17065 certification of consulting service providers and global trading businesses.
  - Further down the track, work could be undertaken to develop an ISO standard for supply chain certification, with a focus on FTZs.

*(We propose that this work could be undertaken between TRACIT, the Global Trade Professionals Alliance (<https://www.gtpalliance.com/>), the World Free Zones Organization (<https://www.worldfzo.org>) and OECD).*

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<sup>1</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf>