

Free Ports

This briefing seeks to offer an introductory explainer as to what Free Ports are and what future they have within the United Kingdom. We ask what these special economic zones have to do with Brexit, and look at how Free Ports (including British ones) have functioned within the European Union.

There are many good resources explaining what Free Ports are and how they work. For further reading we recommend checking the references from within this briefing. Full government assessments as to the impact of these Free Ports are not yet available.

April 2021

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What are Free Ports?

Free Ports are special economic zones, usually maritime ports or airports. They are specific geographic areas within a country where goods can be imported from outside without being subject to the usual tax and tariff rules of the country in which they are based.

They allow goods to be imported, stored, manufactured, and re-exported, without being subject to the usual paperwork and tariffs. If the goods move out of the designated Free Ports area into the domestic market, however, they have to go through the full import process, including paying any tariffs.¹ This effectively creates an additional internal border.

The purpose of a Free Port is to encourage businesses that import and re-export goods, rather than for goods where the final destination is that country.

Companies operating in the special economic zone typically pay lower or no tax. Critics argue that Free Ports are used for money laundering and tax evasion, and can lead to a reduction in workers rights. Further criticisms include the fact that the point where import tariffs are paid are merely deferred for later down the line.

History of Free Ports in the UK

The UK operated several Free Ports as recently as 2012 when the government stopped renewing their licenses.² These Free Ports were introduced in the 1980's and included sites in Birmingham, Belfast, Cardiff, Liverpool, Prestwick and Southampton.

Following this, the UK introduced 'Enterprise Zones' in 2012. There are now 48 of these operational across England.³ When introduced, businesses locating to these areas were entitled to a business rate discount of up to 100% over a five year period (worth up to £275,000 per business) as well as Enhanced Capital Allowances for the purchase of machinery and equipment.⁴ Similar policies have been adopted by devolved administrations in Scotland and Wales.

Both these Free Ports and Enterprise Zones were compliant with EU law.

1 Trade: Free Ports and free zones, *Institute for Government*, 10 February 2020, <https://www.instituteforgovernment.org.uk/explainers/trade-FreePorts-free-zones>

2 Trade: Free Ports and free zones, *Institute for Government*, 10 February 2020, <https://www.instituteforgovernment.org.uk/explainers/trade-FreePorts-free-zones>

3 What are Enterprise Zones?, *Enterprise Zones*, <https://enterprisezones.communities.gov.uk/about-enterprise-zones/>

4 Enterprise Zones Research Briefing, *House of Commons Library*, 21 January 2020, <https://commonslibrary.parliament.uk/research-briefings/sn05942/>

Brexit and EU Free Zones

“The EU is the only place where these [free ports] really don’t exist...” - Rishi Sunak MP, 01 August 2019.⁵

“[We can] use that opportunity of Brexit to do the kind of things that we’ve been precluded from doing for decades, including free ports...” - James Cleverly MP, 02 August 2019.⁶

Government Ministers have in the past stated that the EU has stopped the UK from having Free Ports. This is incorrect. There are currently 72 ‘Free Zones’ within 20 EU member states,⁷ and Britain as an EU member has had Free Ports in the past.

However, as a UN report from 2005 found, “The Commission does allow the establishment of free zones within its territory but its definition of free zone is a very narrow one.”⁸

The use of these zones is considered a state subsidy, and as such, they are subject to EU state aid legislation.⁹ This is to ensure fairness of competition within the single market. If a member states Free Ports have particularly aggressive tax rules they can be contested under EU law.¹⁰

Issues have arisen in the past where non-EU countries have free ports and then later join the European Union. Professor Catherine Barnard and Emilije Leinarte of Cambridge University have written:

“The difficulty of obtaining an FZ [Free Zone] status can be illustrated by the Shannon FZ in the Republic of Ireland. The Shannon FZ was successfully launched in 1958 but, upon Ireland’s accession to the EU in 1973, the incentives in the Shannon FZ were limited in order to comply with EU state aid rules (e.g. the 0% corporate income tax was increased to 10%).”¹¹

As there are limits on just how “free” Free Ports can be within the EU, it is correct to state that the UK Government will have more discretion over what form these areas take. With the UK outside of the single market, it is no longer bound by EU trade policies. However, it is not clear how the EU-UK Trade and Cooperation Agreement (TCA), which includes a commitment by both parties to maintain effective

5 Today Programme, 01 August 2019

6 BBC Radio 4 Breakfast Interview, 02 August 2019

7 Free zones which are in operation in the customs territory of the Union, as communicated by the Member States to the Commission, Europa.eu, 06 April 2020, https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/customs/procedural_aspects/imports/free_zones/list_freezones.pdf

8 Free Trade and Port Hinterland Development, *United Nations Economic and Social Commission for Asia and the Pacific*, 2005, https://www.unescap.org/sites/default/files/pub_2377_fulltext.pdf#page=86

9 Research Briefing: Free Ports, *House of Commons Library*, 17 November 2020, <https://commonslibrary.parliament.uk/research-briefings/cbp-8823/>

10 EU State Aid rules and WTO Subsidies Agreement, *House of Commons Library*, 16 September 2020, <https://commonslibrary.parliament.uk/research-briefings/sn06775/>

11 Free Zones, *UK in a Changing Europe*, 07 October 2018, <https://ukandeu.ac.uk/free-zones/>

competition laws, will affect Free Ports. The agreement aims to ensure that “the granting of subsidy does not have detrimental effects on trade” between the EU and the UK.¹²

What’s happening in the UK

In 2016 a relatively unknown MP wrote “The Free Ports Opportunity”, which was published by the Thatcherite think tank the Centre for Policy Studies.¹³ That MP, Rishi Sunak, would go on to become the Chancellor of the Exchequer.

This report proved to be highly influential. Boris Johnson gave his backing to Free Ports in July 2019, prior to him succeeding Theresa May as UK Prime Minister. Mr Johnson called them an “excellent way to boost businesses and trade in regions that Westminster has neglected to pay attention to for far too long.”¹⁴

The 2019 Conservative party Manifesto included a commitment to create up to ten Free Ports.¹⁵ Following the 2019 General Election and subsequent Brexit, bidding for prospective sites in England was opened. The devolved governments in Wales and Scotland are expected to follow at a later date.

In the March 2021 budget it was announced that East Midlands Airport, Felixstowe & Harwich, Humber, Liverpool City Region, Plymouth and South Devon, Solent, Teesside and Thames were successful in their bids to become Free Ports, and that they would begin operations from late 2021.¹⁶

The governments free ports prospectus of November 2020 lays out some details as to how the proposed Free Ports would work, and describes how usual customs and tax rules will not apply.¹⁷ A few of the measures include:

- Goods will be classed as offshore for tax purposes, which would allow for imported materials to be processed and re-exported without customs paperwork or tariffs.
- There is to be Stamp Duty Land Tax (SDLT) relief, along with Enhanced Capital Allowances (ECA), in effect tax breaks, for new plant and machinery assets.

12 UK-EU Trade and cooperation Agreement Summary, *Gov.uk*, December 2020, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/962125/TCA_SUMMARY_PDF_V1-.pdf

13 The Free Ports Opportunity, *The Centre for Policy Studies*, November 2016, <https://www.cps.org.uk/files/reports/original/161109144209-TheFreePortsOpportunity.pdf>

14 Tory leadership race: Members begin voting for next PM, *BBC News*, 05 July 2019, <https://www.bbc.co.uk/news/uk-politics-48881266>

15 2019 Conservative Party Manifesto, <https://www.conservatives.com/our-plan>

16 Budget 2021, pg 58, *HM Treasury*, March 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/966868/BUDGET_2021_-_web.pdf

17 Freeports Bidding Prospectus, *HM Treasury*, November 2020 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/935493/Freeports_Bidding_Prospectus_web_final.pdf

- Employers would not pay national insurance contributions for staff earning less than £25,000 for up to three years.
- Business rates are to be waived for five years.

The March 2021 budget confirmed what was in the prospectus, also announcing that businesses operating in Free Ports “tax sites” would also benefit from an enhanced 10% Structures and Building Allowance.

What’s the benefit?

In a February 2020 consultation document, the Department for International Trade (DIT) states duty inversion as one of the four core benefits of a Freeport:

“If the duty on a finished product is lower than that on the component parts, a company could benefit by importing components duty free, manufacture the final product in the Freeport, and then pay the duty at the rate of the finished product when it enters the UK’s domestic market.”¹⁸

However, academics at the UK Trade Policy Observatory (UKTPO) at the University of Sussex published research into duty inversion, finding that “introducing Freeports in the UK is unlikely to generate any significant benefits to businesses in terms of duty savings.”¹⁹

“The fundamental thing is that the trade benefits of a freeport are almost non-existent,” said Peter Holmes, a UKTPO fellow who co-authored the analysis. “The only benefit might be in some sort of enterprise or urban regeneration zone — but that has nothing to do with the ‘port’ aspect.”²⁰

Rishi Sunak MP’s 2016 paper argued that if the UK’s approach performs as well as that in the USA, Free Ports could create more than 86,000 jobs, reconnecting Britain with its “proud maritime history”, and allowing Britain to capitalise on its new post-EU freedoms.

The Centre for Progressive Policy (CPP) pointed out that

“The 86,000 jobs that are forecast to be created in the CPS report is simply the number of people employed in US free zones (420,000) adjusted to the relative size of the UK population, assuming the agglomeration effects enjoyed in the US would apply equally in the UK.”²¹

18 Freeports Consultation, *HM Government*, February 2020, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/878352/Freeports_Consultation_Extension.pdf

19 Tariff inversion in UK Freeports offers little opportunity for duty savings, *UK Trade Policy Observatory*, 28 July 2020, <https://blogs.sussex.ac.uk/uktpo/2020/07/28/tariff-inversion-in-uk-freeports-offer-little-opportunity-for-duty-savings/>

20 Freeport advantages for business are ‘almost non-existent’, *Financial Times*, 02 August 2020, <https://www.ft.com/content/7ee9e853-bea6-4797-9119-f7e20cdae3c0>

21 Freeport free-for-all should focus on good jobs, *Centre for Progressive Policy*, 11 February 2021, <https://www.progressive-policy.net/publications/freeport-free-for-all-should-focus-on-good-jobs>

Professor Neil Lee from the London School of Economics questions the methodology, pointing out that “The agglomeration literature in the US tends to find relatively large effects. In the UK, everything is closer together so agglomeration is less important”²²

A study by Mace Group, an international consultancy and construction company, went even further in its predictions, estimating that trade could be boosted by £12bn, 150,000 high-quality jobs could be created, and £9bn could be added to the UK economy.²³

The CPP also raise the question of whether it is net job creation, or a result of displacement. Mace’s study assumes that all 150,000 jobs would not exist if it were not for the Free Ports, and does not factor in that many of the jobs will be the result of jobs being moved from one location to another.

The Trade Union Congress (TUC) has warned about fewer protections for employees, warning that Free Ports are a “Trojan Horse to water down employment protections” in a “race to the bottom”.²⁴

Risks: Tax evasion and Money laundering

The European Union published a report in 2018 titled “Money laundering and tax evasion risks in free ports”.²⁵ The report went on to state that Free Ports are “conducive to secrecy”, and that:

“In their preferential treatment, they resemble offshore financial centres, offering both high security and discretion and allowing transactions to be made without attracting attention of regulators and direct tax authorities”

One issue raised that there is often no time limit on how long goods can remain at Free Ports. Goods can be classed as “in transit” for an indefinite period of time, in which they can gain value, and be traded an unlimited number of times without ever having been taxed.

As well as the fact that goods entering Free Ports are not subject to customs duties, those sold are not subject to Value Added Tax, and no withholding tax is collected on capital gains.

22 What is the extra mileage in the reintroduction of ‘free zones’ in the UK?, *UK Trade Policy Observatory*, February 2019, <https://blogs.sussex.ac.uk/uktpo/publications/what-is-the-extra-mileage-in-the-reintroduction-of-free-zones-in-the-uk/#freez28>

23 Freeports are an essential ingredient of levelling-up, *Mace Group*, 05 August 2020, <https://www.macegroup.com/perspectives/200806-freeports-by-paul-kelly>

24 Brexit - why free ports are a race to the bottom on workers' rights, *TUC*, 13 February 2020, <https://www.tuc.org.uk/blogs/brexit-why-free-ports-are-race-bottom-workers-rights>

25 Money laundering and tax evasion risks in free ports, *European Parliament*, 17 October 2018, [https://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_STU\(2018\)627114](https://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_STU(2018)627114)

The European Commission introduced a set of new rules in 2020 in order to clamp down on illicit activity at the Free Ports within the bloc. Member state authorities must now take extra measures to identify and report suspicious activities at Free Ports.²⁶

The Financial Action Task Force on Money Laundering, a Paris based intergovernmental organisation, published a report in 2010, which claimed that free-trade zone, which includes Free Ports, present a “a unique money laundering and terrorist financing threat because of their special status within jurisdictions as areas where certain administrative and oversight procedures are reduced or eliminated”.²⁷

In February 2020 Labour MP Tulip Siddiq raised some of these issues, questioning the Treasury²⁸ :

“To ask the Chancellor of the Exchequer, what recent assessment his Department has made of the correlation between the operation of Free Ports and (a) tax evasion and (b) money laundering.”

The answer given by Steve Barclay MP was:

“The UK plays a key role in tackling cross-border illegal activity and this is not going to change. UK Free Ports will be innovative hubs that boost trade, attract inward investment and drive productive activity across the UK. HMRC have been closely involved in their design to ensure that everyone pays their fair share of tax towards funding our vital public services, while boosting growth in all regions of the UK.”

Conclusions

Free Ports are nothing new. The UK has had them before, and could continue to have them whilst still a member of the European Union. What is new is the ability for the UK to establish Free Ports that deviate further from the European standard, and no longer have to comply with EU State Aid rules.

Assessments as to how much Free Ports can benefit the UK economy vary widely. It is impossible to produce accurate assessments yet, as full details are yet to be revealed.

There are however legitimate concerns that Free Ports will simply cause existing businesses to relocate to Free Ports, rather than stimulate the growth of new business, and that Free Ports can be used to facilitate tax evasion and money laundering. The EU has recently begun clamping down these special economic zones. As to whether UK Free Ports will be susceptible to such abuses we simply don't know, but the risk is very real.

26 EU clamps down on free ports over crime and terrorism links, *The Guardian*, 10 February 2020,

<https://www.theguardian.com/world/2020/feb/10/eu-clamps-down-free-ports-zones-crime-terror-links>

27 Money Laundering vulnerabilities of Free Trade Zones, *Financial Action Task Force*, March 2010, <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf>

28 Free Zones: Money Laundering and Tax Evasion, *UK Parliament*, 27 February 2020, <https://questions-statements.parliament.uk/written-questions/detail/2020-02-27/22013>