

TWEAKING THE UK FREEPORT MODEL

1. In his Centre for Policy Studies pamphlet, the Chancellor of the Exchequer argued that “an extensive and ambitious network of UK Freeports would not only provide domestic manufacturers with a wealth of tangible benefits, but also send a clear message to international markets that Britain’s new global role will be open, innovative, and outward looking... Another great advantage of a Freeports policy is that its fundamental simplicity and the wealth of international precedent make its implementation possible over a short time scale”.
2. These assessments mesh with authoritative international assessments of the factors which make Freeports successful.
3. This note looks at how the UK Freeport model may be tweaked to achieve maximum effect, and developed over the medium term. It is designed to complement the input of The Infrastructure Forum’s Taxation Working Group members on their reaction to the programme so far.

World Bank view

4. According to the World Bank two factors stand out in the success of special economic zones: “zone size and technological components. Larger zones have performed better than smaller ones. Moreover, and contrary to the expectations of policymakers and zone designers, lower tech, labour intensive zones have been more economically dynamic than their more high-tech counterparts”.
5. The World Bank analysis also noted that Special Economic Zones positively affect the economic performance of surrounding areas: “areas in the immediate vicinity of SEZs have benefitted from spillovers emanating from the zone. However, this positive effect on neighbouring areas suffers from steep distance decay. The effect declined sharply beyond 20km and is barely evident beyond 50km from the centre of the zone”.¹
6. The UK Freeport initiative fits well with this analysis. Among the UK Freeports are a number of relatively large sites. The design of the initiative is intended to minimise economic distortion and promote spillover benefits by a careful design of incentives and benefits.

¹ *Special Economic Zones - An Operational Review of their Impacts*, World Bank Competitive Industries and innovation program, 2017

Spillovers

7. The spillover issue merits consideration because the OBR Budget assessment has been reported as claiming that freeports “offer no economic benefit” or in the OBR’s terms that “We have assumed that the main effects of the freeports will be to alter the location rather than the volume of economic activity... the costs have been estimated on the basis of activity being displaced from elsewhere”.
8. In fact the literature from studies of free zones around the world supports the World Bank assessment rather than the approach taken by OBR.
9. A study analysing the economic growth spillovers generated by 346 special economic zones in 22 emerging countries concludes that SEZs “have a positive impact on the economic performance of the areas surrounding the zones. However, the growth spillovers are limited in area and display a strong distance decay effect: the magnitude of the impact decreases continuously up to 50km.”²
10. An examination of export processing zones in 42 Chinese cities found that “EPZs improve the performance of surrounding firms near the zone, with the impact being larger for firms in the pillar industries that the EPZs particularly favor. We also find that the magnitude of spillovers depends on the distance between a firm and the nearest EPZ.”³
11. An examination of SEZ policy notes studies on the positive externalities of zones.
 - a. “Hyun and Ravi (2018) show that SEZs in India significantly increased economic activity in areas around the zones, promoting structural change by encouraging movement into a larger and more productive formal sector”.
 - b. “Duranton and Venables (2018) discuss the agglomeration effects of SEZs, which promote knowledge spillovers between firms by clustering investors in specific areas”.
12. The authors draw the conclusion that “effectively running an SEZ requires understanding and encouraging its indirect benefits. To do this policymakers

² Susanne Frick and Andres Rodriguez-Pose, *Are special economic zones in emerging countries a catalyst for the growth of surrounding areas?*, *Transnational Corporations* Vol 26 2019 Number 2

³ Weixao Wu, Chang Hong, Andrew Muhammad *The Spillover effect of export processing zones* China Economic review 63, October 2020

need to monitor key performance metrics of the zone and regularly evaluate these to determine which policies work best”.⁴

13. Against this background there is an opportunity to align UK Freeports still more closely with the regimes which apply in the leading global examples. In particular the enthusiasm from locations and public authorities to acquire the Freeport brand shows the very powerful marketing effect of Freeports or Special Economic Zones, especially when compared with traditional customs benefits such as “inward processing reliefs” which customs authorities have often claimed makes the concept of Freeports redundant or negligible.
14. Although there are many different types and sizes of Freeports and other Special Economic Zones around the world, the leading and most successful examples include these elements:
 - A. Scale;
 - B. Streamlined and simplified procedures;
 - C. One stop shop service for companies;
 - D. Explicitly piloting approaches for future rollout elsewhere in the economy.
15. The UK Freeport initiative meets some of these criteria but not yet all. There is an opportunity to tweak its design to align more closely with the international pace setters. Examining the issues in turn:

Scale

16. In Dubai, the Jebel Ali Free Trade Zone and its associated sectoral zones covering airports, health, media and other industries are large scale. Rather than covering small patches of land they cover the whole city or a significant area within it.
17. China’s eleven Pilot Free Trade Zones are also of large scale although differing among themselves in their economic focus.
18. Egypt’s Public Free Trade Zones are also large sites in nine cities and regions.
19. The UK’s Freeports have a maximum outer boundary, which is not a physical boundary, of 45km. The primary customs site and related subzones where

⁴ Marei Alexianu, Moussa Saab, Matthieu Techout and Amit Khandelwai, *Doing Special Economic Zones right: A policy framework*, International growth centre Synthesis brief November 2019.

customs benefits arise, and tax sites where tax benefits are applied, have to be contained within this boundary.

20. This approach offers scale and future flexibility. **It may well be desirable to assess the take-up of sites with tax benefits at an early stage and consider increasing the boundaries of tax sites quickly if take-up does not meet expectations.**

Simplification

21. In terms of customs procedures, the Dubai Airport Freezone, Jebel Ali Freezone and Sharjah Airport International Freezone have customs offices on site, airport access for easy transfer of goods, warehousing facilities and many business infrastructure support services. Free Zone companies are allowed to import goods without the payment of customs duties and can store goods for an unlimited period. Against delivery notes, bills of lading, import permits where required, sales invoices to importers, certificates of origin, packing lists and goods declaration forms, bills of entry will be issued for the clearance of goods into Freezones.
22. Trading companies in the zones have to maintain a computerised and auditable and accountable inventory control system. Export declaration procedures are simplified requiring an export permit, sales invoice and declaration of customs clearance.
23. In China, careful study was made of the Dubai system before developing their Free Trade Zone Programme. In Shanghai as a result, the Shanghai Zone has a new “enter first, declare later” clearance procedure for goods arriving in the zone which means that enterprises can ship goods directly to their warehouses.
24. In the UK HMRC published guidance on operating a Freeport customs site on 31 August 2021. It lists 12 general conditions with which operators must comply, 11 security-related requirements and pre-employment checks for all staff with employment histories evidenced for three years for general staff and five years for agents or consignors. Some of these appear fairly onerous requirements.
25. Each consignment of goods arriving must comply with 12 detailed requirements.

26. It may be worth revisiting these requirements against a test of are they all necessary if operators consider them not to meet criteria of simplicity and minimum red tape.

One-stop shop

27. At first sight the UK Freeport model seems to face some challenges in delivering a one-stop shop which makes it easy for potential investors and users of freeport facilities to identify a central source of guidance and fast track procedures to maximise the use of freeport benefits.

28. First, there is no national Freeport 'hub' fulfilling this role, which is closely linked to the promotion of inward investment and requires skills of identifying and attracting potential users and problem solving for them.

29. It would seem highly desirable to set up a Freeport Centre within government to fulfil this role, work to secure maximum take-up of Freeport benefits, assist in solving problems with other agencies, and monitor and report on the development of the programme.

30. Such a Centre would seem best located in an area already active in investment promotion and project delivery. The Office for Investment or the Infrastructure & Projects Authority might be considered as a platform from which a Freeport centre could be built.

31. Each UK Freeport has its own operating authority and will no doubt seek to maximise its competitive appeal for inward investment and location.
Government might usefully consider, however encouraging operating authorities to set up one-stop shops to streamline procedures especially in relation to HMRC requirements on freeport sites themselves. It may also prove desirable in the light of experience to establish units in the Freeports and/or nationally in HMT to speed and promote use of the tax sites and address any challenges faced in taking up the tax benefits.

Pilots for the future

32. There could be important benefits to be secured by explicitly treating UK Freeports as pilots or testbeds for the development of future policies on taxation, inward investment, simplification of procedures and so on.

33. China for example has put this approach at the centre of her Free Trade Zone policy to the extent of naming the zones Pilot Free Trade Zones, aware that different zones fulfil somewhat different purposes, have individual patterns of trade and function and that future development of the programme should be informed by careful monitoring and study of the most effective and successful approaches.

34. It would be desirable for the UK to treat its Freeports as pilots from which to learn in any future expansion of the initiative. To assess and secure the resulting benefits a central hub in government dedicated to the programme would be needed - the Freeport Centre, identified earlier in this note, could serve working alongside policy officials in HM Treasury.

35. Treating freeports as pilots provides several complementary opportunities. It maintains focus on them so that they do not disappear into any policy backwater. It reduces potential distortion problems because it provides an opportunity to extend successful approaches to the national level. Equally when policymakers are contemplating innovation in adjusting taxation or reducing red-tape at national level it may be of use to pilot the initiative in existing freeports.

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