

**Communist Party  
Political Economy  
Commission Briefing**

# **FREE PORTS - STALKING HORSE FOR NEO LIBERALISM**

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This paper was written originally in response to the government's plan to open a number of freeports across Britain. The analysis still applies to the "low tax investment zones" that Kwarteng announced in the mini budget, 23 September 2022.



**TAKE THE ROAD TO  
SOCIALISM**

# FREE PORTS - stalking horse for neo liberalism

## OUR AIM IS

- To assess conservative proposals for eight Freeport's across the UK
- in the light of historical experience
- the likely benefits, and who receives the benefits
- the costs, and who will pay those costs.

**The Communist Party produces essential research and analysis in diverse fields such as Environment and Climate Change, Food Policy and Tax policy. These are written for lay officers of unions and activists, with topics carefully selected, to contribute to wider research and analysis in the union movement.**

## COMMISSION SUMMARY

The eight “freeports” will be created at East Midlands Airport, Felixstowe and Harwich, the Humber region, the Liverpool City Region, Plymouth, Solent, Thames and Teesside.

Freeports are a type of ‘special economic zones’ (SEZs). SEZs areas within a country where business activity is subject to different rules from those prevailing in the rest of the country. SEZs can include tax incentives for investment within the geographical area of the freeports, flexible regulation, and investment in infrastructure. The Government defined freeports as: ‘secure customs zones located at ports where business can be carried out inside a country’s land border, but where different customs rules apply’ in its initial consultation paper on the subject.

### **Jobs: Shifted Rather Than Created**

Freeports will relocate activities rather than generate significant additional business. Embarrassingly for the government, this is also the conclusion of the Treasury Watchdog, The Office for Budget Responsibility, (OBR). They said in an October 2021 report that, ‘We have assumed that the main effect of the freeports will be to alter the location rather than the volume of economic activity. So the costs have been estimated on the basis of activity being displaced from elsewhere.’

In the same report, the OBR referred to an evaluation regarding the extent to which enterprise zones with tax incentives had resulted in job creation.

‘As regards 'additionality', an evaluation of the number of jobs created by enterprise zones carried out by the Centre for Cities found that “jobs growth has been underwhelming”, that a significant number were displaced from local areas and from elsewhere in the UK, and that “the jobs created were mainly in low-skilled local service activities”.’

The OBR report also stated that experience of enterprise zones around the world points to little difference in performance between cities with zones and those without: the main determinants of performance were existing infrastructure and transportation links. ‘This suggests that it is those other factors rather than the enterprise zone reliefs themselves that are key to determining levels of activity and that the reliefs act more as a reward than an incentive.’

A report published in March for UK In A Changing Europe, came to similar conclusions regarding the impact of Freeports: ‘Many economists would argue that the case for freeports is by definition a second best one. If tariffs are too high or regulations too burdensome, they should be lowered for the whole country. If, on the other hand, the level of tariffs or regulation is justifiable, why would they be lowered for one part of the country? In practice, therefore, the real case for freeports is in developing countries where either the customs administration is chaotic or regulation is too high/dysfunctional, and there are political economy reasons why governments cannot change that for the whole country. That isn’t the case for the UK.’

The UK In A Changing Europe report adds: ‘The only groups that are certain to benefit from freeports in the UK are businesses (presuming they decide to relocate operations to the freeports) and high net-worth individuals. The disadvantages of freeports, by contrast, will be experienced more broadly in the UK due to the public cost of maintaining them, which will be exacerbated by the necessity of providing financial incentives for businesses to relocate to UK freeports. Proponents of freeports point to job creation as a justifier for these costs. But the capacity of freeports to create additional jobs is unclear.’

Will the job displacement be a good thing? Some say this is entirely the point to allocate activity to poorer parts of the country. Peter Holmes of the UK Trade Policy Observatory at Sussex University, said it was unlikely to come at the cost of wealthier UK cities.

‘If you take somewhere like Teesside, it’s obviously going to be at the expense of Tyneside,’ he said. “Some of the places they’ve given freeport status to are clearly not going to be drawing away from richer areas. I came to the conclusion that they will be a complete anticlimax.’

Finally, regarding freeports as engines for job creation. Tony Restall, as a British entrepreneur who was involved in setting up several freeports in the United Arab Emirates, has said that ‘anyone looking to establish a manufacturing industry in any tax-free area will look at two things: cost of labour and cost of power,’ these are both areas in which the UK is not competitive internationally, and do we really want to become the low-wage component at the bottom of a global value chain?

## **Costs**

Apart from the tax losses - in a potential sign of their limited scope, Treasury estimates suggest the exchequer will lose just £50m a year as a result of companies taking up freeport tax breaks - freeports require considerable infrastructure to protect their status as extraterritorial zones, though these costs may be mitigated through the use of existing ports.

The government intends to invest in infrastructure, construction and machinery in freeports to ‘raise productivity’ and ‘cut costs associated with processing goods’. Nonetheless, these ongoing costs offset the economic benefit of job creation. For example, Serwick & Holmes reported that ‘final evaluation of the enterprise zones found that the public sector cost per additional job created in the zone amounted to £17,000 per job in 1994- 95 prices.’ That is a significant amount of money, particularly if most of the new jobs created are relatively low-paid. Freeports can force local areas to expand provision of roads, schools, hospitals and homes without any compensating increase in tax revenue to provide these services. Some disadvantaged regions could benefit from this sort of Government investment; however, problems arise if the investment becomes constrained by shocks such as the Global Financial Crisis, COVID and the emerging cost-of-living catastrophe; and home builders may not be interested in building enough affordable homes so rents and property prices may increase in the area. Opportunity costs also need to be considered and the cost implications for supporting and regenerating the areas from which jobs have been relocated to the freeports.

## **Criminal Activities**

There are additional costs, financial and otherwise, associated with the necessary policing of freeports. A written report presented to the International Trade Committee’s Inquiry on UK Freeports in May 2020 suggested the following regarding international evidence of crime in freeports:

**Trade in counterfeit goods.** An OECD study published in 2018 found that establishing an additional freeport within an economy was associated with an average 5.9% increase in the value of counterfeit exports from the host economy in the time period 2011-2013.

**Drug trafficking.** According to the World Customs Organization's (WCO) report published in 2019, the largest number of seizures within freeports reported by member states related to drugs (148 of 626 seizures in 2011- 2018, followed by 143 seizures of counterfeit goods).

**Smuggling of untaxed goods,** such as cigarettes. Seizures of tobacco products were likewise recorded in the data collected by the WCO. Several studies of illicit cigarette trade point to transit and manufacturing in freeports.

**Trade-based money laundering (TBML).** International trade can be exploited to (a) create a pretext for transferring criminally obtained money, such as through misrepresenting the price of goods, or (b) move value in the form of goods being transferred, which can be used or resold by the recipient.

#### **Tax evasion.**

Some freeports specialise in the storage of high-value goods, especially art objects. The European Commission and European Parliament have expressed concerns that ownership of these goods can be transferred without paying tax. This is possible because (a) transactions taking place in a freeport are not taxed by the state where the freeport is located; and (b) the freeport operator is not obliged to notify a customer's state of residence about the objects owned by that customer and stored in the freeport.

#### **Recent History**

The conservatives have claimed freeports as a boost from Brexit, because the UK was constrained as an EU member – even though 7 freeports existed in the UK between the mid-1980s and 2012. The UK in a Changing Europe report referred to above noted that the UK had freeports until 2012, when the government allowed legislation permitting them to lapse, apparently because they were of limited use, made no difference to government revenues and introduced unnecessary customs complexities.

In reality, more than 80 freeports still operate in 20 EU member states – including in Barcelona, Bremerhaven and Venice. However, MEPs have recommended ending freeports within the bloc, warning of the risks of money laundering and tax evasion. In March 2019 MEPs called for freeports to be banned across the union after a damning report on their involvement in tax evasion and money laundering. They encountered resistance from various vested interests such as the then European Commission President, Jean-Claude Juncker who rejected allegations of fraud and irregularities related to the management of Le Freeport Luxembourg, in his home country.

### **UAE Experience**

The Jebel Ali Freeport in Dubai, has enjoyed success as a hub through its highly liberal approach to taxation: ‘0% corporation tax, no VAT, no income tax, no taxation at all.’

100% foreign ownership is permitted along with no restrictions on repatriation of profits or controls on foreign currency exchange. There are no import or export duties relating to the zone except for sales made into the UAE.

It is also relatively easy to obtain work permits for foreign nationals who are horribly exploited, like many workers in the UAE, and there are guarantees of no corporate or even personal income taxes for between 15 and 50 years from set up.

The UK could not apply such a liberal approach to freeports. A no-tax zone would create huge incentives for existing UK businesses to relocate to within the freeport thereby damaging other areas and exerting downwards pressures on wages and labour protection.

### **Serbian Experience**

The Free Zones Administration of Serbia report that the 15 free trade zones in Serbia have created 35,279 jobs, €3 billion in investments (since 2008), and €5 billion in turnover in 2018. However, the OECD is more sceptical of the benefits of the free zones saying that in Serbia, there are fewer relative advantages from operating in the zones and so it is not as obvious if the zones themselves are really making a difference in attracting FDI into the economy. Serbia has a broad range of tax incentives independent of presence in the zones. Serbia basically attracts FDI because of these incentives and its cheap labour.

Serbia is not exactly an economic success story. The Serbian economy – before the pandemic – was growing below its potential by about two per cent, according to a May 2019 analysis by the Fiscal Council. In terms of economic development and living standards, Serbia trails much of the rest of Europe. Per capita, Serbian GDP is half that of the countries of Central and Eastern Europe and only a third of the level of developed Western European countries; according to Eurostat, it has the highest social inequalities in Europe.

Ljubodrag Savic, an economics professor at the University of Belgrade has said that ‘Growth only makes sense if it spills over into the growth of people’s living standards....We should also not be so optimistic because production is run mostly by foreign investors and they can leave Serbia whenever they want.’

### **The Tariff Inversion Illusion**

Detailed analysis by Sussex university’s UK Trade Policy Observatory (UKTPO) in August 2020 showed that the UK’s new global tariff (UKGT) schedule provided “minimal” opportunity for businesses to take advantage of fundamental aspects of freeports.

In freeports, businesses can import components and ingredients duty free, manufacture goods, and only pay the tariff on finished products when they are exported into the domestic economy – exploiting the difference, or “wedge”, between the two. This is known as tariff inversion. There are several hundred freeports in the US, because opportunities for tariff inversion, particularly in the automotive and petrochemicals sector, make them attractive. But that opportunity will not exist in the UK, the research showed. The UKTPO research, commissioned by the Financial Times, found that under the UKGT only around 1 per cent of UK imports by value could benefit from the arbitrage opportunity.

Researchers calculated that the “weighted average tariff” on intermediate products under the UKGT was 1.6 per cent compared with 8.8 per cent for final goods, pointing to an overall lack of opportunity for inversion.

The UKTPO found that out of the 20 most imported inputs in the UK by value, accounting for around 40 per cent of the UK’s imports of intermediate goods, 12 were duty-free and none had a tariff of more than 4 per cent. They found that a tiny handful of sectors, including dog and cat food inputs, could offer a significant wedge between input and finished products, but in total these accounted for only 0.6 per cent of UK imports of intermediates.

The group found dairy products, starches and starch products, and animal feeds provided the greatest potential for duty savings in these sectors, but even these accounted for only 1.1 per cent of total UK imports. The sectoral analyses to identify potential duty savings ‘all tell the same story’, the research concluded: ‘Introducing freeports in the UK is unlikely to generate any significant benefits to businesses in terms of duty savings.’

This increases the concerns that freeports will just lead to more fraud and tax evasion; and if they only offer laxer regulations and planning laws, they will just encourage businesses to shift operations. Concerns voiced in 2020 by Adam Marshall, head of the British Chambers of Commerce, who said in 2020 that business was nervous that freeports would displace jobs, not create them. He’s not alone.

## **Some Additional References:**

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