



INSTITUTE  
OF EXPORT

& INTERNATIONAL TRADE



# **FREEDPORTS**

## A DISCUSSION PAPER

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## IOE&IT INTRODUCTION

Economies are forever undergoing structural change, driven by continual advances in technology, evolving patterns of demand, and changing patterns of supply, both at home and – importantly – abroad.

In the process, new jobs are created; some existing jobs change their nature; and some disappear. This process of job creation and job destruction is highly dynamic: in advanced economies, for every ten jobs, each year typically around one new job is created; and another is destroyed.

Unfortunately, but inevitably, job creation and job destruction take place somewhat unevenly across the country as a whole. In the UK, as elsewhere, some regions tend to grow and prosper; some stagnate; and some get left badly behind, often with serious economic and social consequences.

To some extent, workers and their families will migrate to the prospering regions. But when change is rapid, or prolonged, it is neither desirable nor practical for such movement to address the entirety of the issue. Not only do people have to move to the jobs: jobs also need to come to the people.

This is not easy to bring about. It requires that capital investment be attracted to the lagging regions; but not at the expense of other regions. And net new investment will be forthcoming only if a number of conditions are met, ranging from a high quality labour force to good transport links; from quality education and training establishments to a constructive town and country planning regime.

Ultimately, in any market economy, it will be the private sector that will undertake

much – though not always all – of the new employment in any region. That said, there is also an important role that only government can fulfil: at a minimum, to provide an appropriate legal and administrative framework within which good private sector firms can prosper.

For many years, and particularly since the EU Referendum of 2016, interest has resurged in Freeports as one potential catalyst for the expansion of UK trade, the economy's broader development, and the redressment of regional imbalances, not least between London and the rest of the UK, including importantly the old industrial north.

Freeports are not a single concept: various versions having evolved dynamically over time, and differently in different parts of the world.

One lesson about Freeports is that the totality of the policy has to extend beyond mere 'fiscal privilege'. A successful policy for Freeports needs both to include a range of other incentives, and to be buttressed by supporting policies.

There is a lot of good infrastructure in the UK's ports already – much of which can be harnessed for more sustainable industries. To the extent therefore that a Freeports initiative can be integrated into a complete package of policies, perhaps in the process extending beyond free ports themselves into more widely conceived 'Enterprise Zones' or 'Special Economic Zones', this is a policy worth exploring further.

This study is offered as a contribution to that end.

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## EXECUTIVE SUMMARY

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1. Since the EU Referendum of 2016, interest in Freeports or Freezones has burgeoned as a potential catalyst for the expansion of UK trade, and the economy's broader development.
2. Freeports have also been proposed as a means to address regional imbalances, not least between London and the rest of the UK, including importantly the old industrial north.
3. The view is that a special import tariff regime, together with various other incentives, will encourage manufacturing output and employment in specified areas.
4. Freeports have an extended, diverse, and geographically extensive lineage, and have already, for decades, formed part of the UK's industrial landscape.
5. Freeports may be operated alongside 'Enterprise Zones', or 'Special Economic Zones': designated areas that provide incentives aimed at increasing new business start-ups and creating new jobs.
6. There are essentially four categories of Freeport: those offering simplified customs processes; those offering duty referral; those taking advantage of tariff inversion; and those based on tax incentives.
7. US use of Freezones has increased significantly over recent years, with the nature of activity largely reflecting the prevalence of a so-called 'inverted tariff' structure.
8. There are around 80 Freezones across the EU, but the rules on the application of anti-competitive state aid heavily circumscribe their activities.
9. Rules on state aid are not confined to the EU, however, although the stipulations under WTO protocols are much less onerous than in the EU.
10. The UK established a number of Freezones and Freeports in the 1980s and 1990s in an effort to regenerate areas of dereliction and decay.
11. There were some successes, of which the Isle of Dogs in London, and Salford in Manchester, are perhaps the most notable.
12. Others are reckoned to have had a mixed record, tending to inspire the substitution of capital for labour, encourage higher rents, and displace labour from other areas.
13. In 2012 the EU changed its rules on Freeports, and the UK decided not to continue with them.
14. However the UK introduced a number of Enterprise Zones, many of which were situated in core cities, and benefit from a range of financial incentives and simplified planning processes. Here too results have been mixed.
15. Recent arguments for the re-establishment of Freeports tend to draw on the UK experience of the 1980s and 1990s and on that of that in the US and Asia.
16. That said US, and for that matter Asian, Freezones are of only limited relevance to the UK.
17. The case for new Freeports, if taken solely by themselves, appears somewhat tenuous, not least when their operation might be fettered by trading agreements.
18. However, the case for Freeports is stronger when conceived as part of a comprehensive policy package that consists not only of fiscal incentives, but also a range of buttressing policies, and linked with other policy initiatives more broadly.
19. The UK already has good port infrastructure: hence bigger economic benefits could probably be obtained by integrating Freeport initiatives with the broad incentives on offer in Enterprise Zones or Special Economic Zones.
20. These in turn would ideally be part of, or at least consistent with, a whole-economy approach to supply-side reform, with a particular focus on education, skills, labour mobility, and infrastructure.
21. Care would have to be taken not to bump up against rules on subsidies and state aid – there have been recent WTO cases on Freezone subsidies.
22. There is a strong case for a national policy review institution in which reforms, of both domestic and trade policy, could be analysed according to their implications for the national interest.
23. A possible model is provided by the Australian Productivity Commission, a well-regarded institution with a constructive record of advising on the connections between trade policy and domestic economic policy.
24. The Commission gives constructive public advice on the liberalisation of trade, implications for particular industries and regions, requirements in education and training, and wider national reform.

# INTRODUCTION

## There has been growing interest in Freeports since 2016

Since the EU referendum of 2016, there has been burgeoning interest in the role that so-called Freezones, or more specifically Freeports (the two terms are interchangeable), could play in the future expansion of UK international trade and the nation's broader development. Championed by, amongst others, Chancellor of the Exchequer Rishi Sunak, and numerous port operators and mayors, the government initiated a consultation process, with a view to inviting bids from different sites (including those situated inland) for Freeport status. The Prime Minister hinted that Teesside, Bristol, Grimsby, Hull, Liverpool and Belfast were being considered. Other possible sites included Tilbury, Grangemouth, and Sunderland.<sup>1</sup>

## The bidding process started end 2020 with winners to be announced Spring 2021

The bidding process was formally launched in November 2020, with proposals due by 5 February 2021, and winners to be determined by Spring 2021. Successful bidders will be granted seed funding to support set-up costs, and will work with the government to develop detailed business cases for their spending plans associated with the regeneration funding offered to Freeports. Commitments have been made to establishing Freeports in each of the four nations, with a target of 10 for the UK as a whole.<sup>2</sup>

## Freeports are seen as a means to boost manufacturing activity and trade ...

The underlying rationale for Freeports is that a special import tariff regime, together with various other regionally-defined financial and other incentives, will encourage positive agglomeration effects, such as economies of scale, specialisation, and network propagation. These in turn will foster cost reductions, stimulate knowledge spillovers and, over time, help to improve the quality of human capital.

## ... create jobs, raise productivity ...

Hence, Freeports are seen as facilitating not just an expansion of manufacturing activity and merchandise trade, but also job creation, investment, including importantly from offshore, and thereby a renaissance in UK productivity performance. The multiplier effects associated with tradeable manufacturing are typically higher than in many other sectors.<sup>3</sup> The message that stands to be sent to the world is that post-Brexit Britain is open, innovative, outward-looking, and dynamic.

## ... and encourage regional regeneration

That said, Freeports are also being proposed as a core element of regional regeneration, as the government seeks to deliver on its commitment to support struggling areas of the country, rebalance the economy away from London and the South East, and generally 'level up' activity, incomes, and wealth. Previously, much of UK regional policy was outsourced to the EU and its structural funds. But, after Brexit, the task of limiting regional inequalities and deprivation has fallen back on the UK government.

FIGURE 1: UK LABOUR PRODUCTIVITY GROWTH



Source: NIESR and Llewellyn Consulting



## 1 BRITAIN'S EXISTING PORT SECTOR

**The UK port sector is large and reasonably efficient ...**

The UK's largely privately-owned ports are already of relatively high quality, with good access to private capital, although they do suffer from some congestion, and they are not perceived to be among the very best among the OECD economies.<sup>4</sup> The nation can boast the third largest such sector in Europe, after the Netherlands and Spain, and, having invested heavily to meet the challenge of large deep-sea container ships, its ports are generally efficient and competitive. They already account for 96% of all trade by weight, and three quarters of trade by value.<sup>5</sup>

**... although many ports are located in depressed regions ...**

Not surprisingly for a small island nation, the UK's ports are widely distributed around the coastline. However, the relatively depressed north of England is disproportionately represented, and a number of larger ports are located in areas that have fallen behind, including Merseyside and Hull.

Of Britain's thirty largest ports, just over half are situated in the bottom quartile of local authorities when ranked by the Office of National

Statistics' index of multiple deprivation, and three quarters are in below-average areas on the basis of this metric of regional inequality.<sup>6</sup>

The UK's regional inequalities are certainly substantial. London has grown significantly faster than other areas of the country over recent decades and, on the basis of gross value added (GVA) per head, is by far the richest region, followed by its South Eastern hinterland. All other regions fall below the national average, with Wales, the North East, Northern Ireland, and Yorkshire at the bottom of the pile.<sup>7</sup>

**... that have fallen behind London on many levels**

Opportunities for social mobility too are higher in the capital. Meanwhile, in Britain's old industrial towns, many of which are located in the North, employment rates lag behind the national average, and 1 in 12 of working-age people receives incapacity benefits for poor health.

**This is having important political consequences**

All this is having political consequences. Resentment of London and the South East is palpable in the UK's poorer regions. And the 2016 EU referendum outcome, while the result of a number of factors, was in part an expression of discontent with the growing divide between metropolitan London and the rest of the country: pro-Brexit voting patterns correlated closely with relative regional poverty.

## 2 THE DIVERSE NATURE OF FREEZONES

Freeports and Freezones are nothing new ...

The concept of Freeports, or Freezones, has an extended, diverse, and geographically-varied lineage. It has been argued that their history can be traced back to the Greek island of Delos, two and half thousand years ago, while they were also to be found in early modern Europe, especially Italy.<sup>8</sup> In the UK, they have been part of the fabric of the industrial landscape since the early 1980s.

... although they are anything but homogeneous

Freeports, or Freezones, may be operated alongside 'Enterprise Zones', or 'special economic zones': designated areas that provide incentives aimed at increasing new business start-ups and creating new jobs.

The nature of Freezones differs considerably from country to country. However, they can generally be defined as specified, secure, areas within the geographical borders of a country that have different customs, and perhaps tax, subsidy, and regulatory arrangements, from the rest of the nation.

Freeports fall into four overlapping categories

They broadly fall into four categories, although some Freezones exhibit elements of more than one.

- 1. Those offering simplified customs processes, and in particular duty exemption.** Products are allowed to enter without incurring tariffs or duties, or with tariffs or duties imposed at a discounted rate. These products can be processed, combined with other products, and transformed into finished goods for re-export.
- 2. Those offering duty deferral.** Duty is deferred on goods entering the host country, being payable only when they leave the Freezone. Companies can warehouse and process goods before incurring duties. This serves to improve cash flow dynamics and ease just-in-time inventory management. Such arrangements come into their own around particularly busy periods of consumer demand, such as Christmas.
- 3. Those taking advantage of tariff inversion.** Raw materials and intermediate goods may be subject to higher tariffs than those on finished goods, thereby encouraging the importation of the latter, rather than their manufacture domestically. A Freezone may be established on the basis of tariff-free importation of inputs, thereby

incentivising indigenous producers produce for, and sell into, their own domestic market.

- 4. Those based on tax incentives.** These include lower VAT rates on goods brought into the zone, reduced rates of corporation tax for companies operating in the zone; tax credits for research and development; discounted rates of employment tax for new jobs created; and flexibility in planning processes. (One of the most successful in the UK – London's Docklands – owed not to its being a port, but to revised planning regulations and the provision of infrastructure.)

## 3 FREEZONES AROUND THE WORLD

The number of Freezones has grown dramatically over recent decades

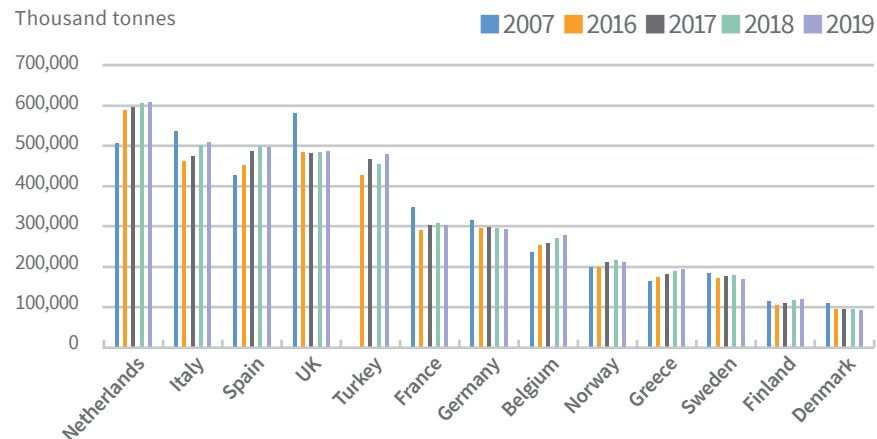
The number of Freezones has expanded rapidly over the past six decades. Globally, there are now some 3,500, in more than 130 countries.<sup>9</sup> Some of the largest are in Asia, including the massive Jebel Ali complex in Dubai; the new high-tech Singapore Freeport, which is dedicated to the storage of, and trade in, art; and the various Special Economic Zones in China. (See various Boxes).

They are especially common where tariffs and regulations are high

Freezones are estimated to account for some \$500bn of direct trade-related value added, and to employ around 66 million people. They are particularly common in high-tariff, high-regulation, emerging market economies, where tariff, tax, and other concessions can be particularly influential in encouraging activities such as warehousing and export processing, as described above, as well as providing a powerful stimulus to foreign direct investment (FDI), and all the managerial expertise it can bring to a developing economy.

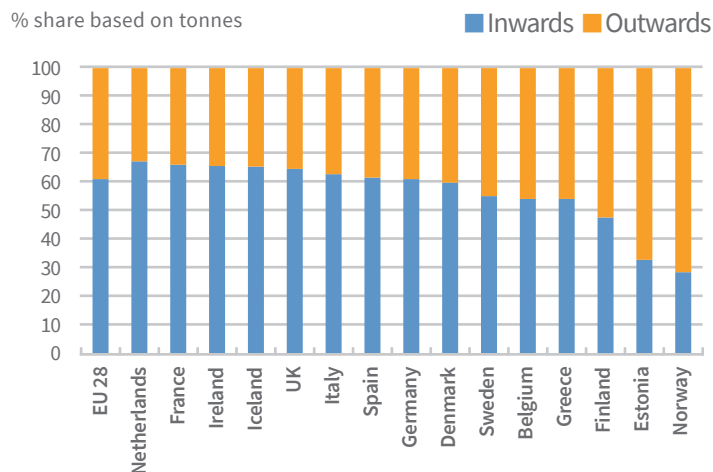


**FIGURE 2: GROSS WEIGHT OF SEABORNE FREIGHT HANDLED IN ALL PORTS**



Source: Eurostat (online code: mar\_mg\_aa\_cwh) Note: No data available in 2007 for Turkey

**FIGURE 3: GROSS WEIGHT OF SEABORNE FREIGHT HANDLED, BY DIRECTION, 2019**



Source: Eurostat (online code: mar\_mg\_aa\_cwhd)

**BOX 1 JEBEL ALI FREEZONE, UAE**

THIS HUGE MAN-MADE PORT COMPLEX AND FREEZONE IN THE UAE WAS ESTABLISHED IN 1985.

**J**UST OUTSIDE DUBAI, this is a manufacturing and processing hub. It is supported by the adjacent Al Maktoum International Airport, which opened in 2010, the world's largest desalination plant, and excellent ground transport connections to rest of the UAE. Jebel Ali offers a 50-year exemption

from corporation tax; zero personal income tax for those working there; a liberalised labour market; and no currency restrictions on repatriation. It is now home to thousands of businesses and 135,000 employees, and accounts for 20% of the UAE's inward foreign direct investment.<sup>1</sup>  
<sup>1</sup> <http://jafza.ae/about-us/>

**THE UNITED STATES EXPERIENCE**

US Freezones focus on manufacturing and production ...

The use of Freezones and ports in the US has increased significantly over recent years, and there is now at least one in every state. Almost three quarters of Freezone activity in the US is taken up by production and manufacturing, the remainder being warehousing and distribution.

The intermediate goods processed are mainly of US origin, but they are typically combined with foreign imported inputs to create finished products sold into the domestic market. The nature of the activity in US Freezones reflects the prevalence of inverted tariffs, and the ability to make use of reduced duties on imported raw materials and parts. As much as half of the cost savings accessible by firms in these areas reflect tariff inversion.

... reflecting inverted tariff regimes

A high share of output in US Freezones is taken up by petroleum products, as US tariffs are higher on crude than refined products. The auto sector, including a number of foreign manufacturers, is also well established in these regions.<sup>10</sup>



## THE EU EXPERIENCE

There are many Freezones in the EU ...

There are around 80 Freezones and ports across 21 EU states, many of which were originally established, as a means to attract foreign direct investment, prior to the country in question joining the union.

These fall into two categories: 'Control type I Freezones', that are an enclosed area, where goods are customs-checked upon exit and entry; and 'Control type II Freezones', where physical control of the goods was conducted on the basis of stocktaking and other physical inspections. As of May 2016, these were reclassified as customs warehouses.

The incentives provided to firms to operate in these zones must comply with EU rules on anti-competitive state-aid, whereby it is unlawful for member states to provide financial help to some companies and not others, in a way that would distort competition. Indeed, state aid must be approved by the European Commission. Hence, EU Freezones are heavily constrained.

... but their activities are limited by rules on state aid ...

The General Block Exemption Regulation (GBER) defines categories of aid that are compatible with EU rules, and these depend in turn on the size of the company. For example, medium-sized enterprises are entitled to aid equivalent of 10% of the total investment made, in addition to any regional aid for which they may already have qualified. For small companies the figure is a maximum of 20%.<sup>11</sup>

... notwithstanding some exceptions in poorer regions

There are some exemptions for underdeveloped regions or areas of high unemployment, and in order to promote specific goals such as technological innovation or environmental protection. Many of such exempted operations are in the less developed, newer EU member countries in central and eastern Europe, where per capita incomes are lower.

There are several specified EU Freezone programmes ...

Historically, EU Freezones have been established by applying for incentives under several programmes:

1. **Processing under Customs Control (PCC).** This applies to processed products when they are released into free circulation, rather than when goods are imported.
2. **Businesses operating under PCC** benefit from lower tariffs, the temporary suspension of VAT, agricultural levies, and other charges. Such authorisations can apply anywhere in the EU.

## BOX 2 SHANNON FREEZONE, IRELAND

OBTAINING AND MAINTAINING FREEZONE STATUS WITHIN THE EU IS ILLUSTRATED BY THE EXPERIENCE OF SHANNON IN THE WEST OF THE REPUBLIC OF IRELAND.

**INITIALLY LAUNCHED IN 1958** as a means to compensate for the fact that the local airport was no longer required as a refueling stop for planes crossing the Atlantic, its duty-free, low-tax, high-subsidy status meant that it rapidly developed into an important warehousing and processing centre.

In the 1960s, Shannon attracted numerous multinational companies, came to account for around a third of Ireland's goods exports, and was held up as a model Freezone for

others around the world to copy.

Following Ireland's accession to the EEC in 1973, however, the incentives offered to firms in Shannon were progressively cut back to comply with state aid rules. The agglomeration effects that emerged from its initial development are such that it still represents a vibrant and diverse commercial hub, and an important target of FDI: but there is little doubt that EU membership curtailed Shannon's growth<sup>1</sup>

<sup>1</sup> Sunak, R. 2016. *Op. cit.*

3. **Inward Processing Relief (IPR).** This releases duties and VAT on imported goods to be processed and re-exported to markets outside the EU. Duties are paid only on the finished product. Hamburg is an example.

(In May 2016, these two protocols were combined into the Inward Processing Procedure (IPP).)

4. **Outward Processing.** This programme allows goods temporarily to be exported for processing, without subjecting them to some, or all, import duties when brought back into the EU.

... but it is hard to qualify for them ...

It is not easy for companies to benefit from these programmes. For some, an applicant must explicitly demonstrate that it will not affect the economic interests of other EU firms. In effect, the latter entities can exert a power of veto.<sup>12</sup>

... and latterly EU Freeports have been associated with crime

Furthermore, in April 2019, the European Commission called for a clampdown on Freeports within the EU, citing evidence that they encouraged smuggling, corruption, terrorism finance, money laundering, and tax evasion.<sup>13</sup>



**Inverted tariff regimes are not common in the EU**

Inverted tariffs are much less of a driver of Freezones in the EU (and therefore in the UK when it was in the EU) than they are in the US. The EU has a few cases of raw material tariffs being higher than those on a processed good, including cables and batteries in computers; plastics and glass containers for bottled water or perfume; PVC in film screens; textiles in car seats and sofas; and frozen orange juice and oranges in soft drink concentrate. However, auto-sector tariffs are not inverted, and the sectors of the EU where tariffs are inverted accounted for only around 1% of UK imports. The scope for tariff incentives for increased domestic production in the UK is therefore appears to be much more limited than in the US.

### STATE AID RULES BEYOND THE EU

**State aid regulations are less onerous outside the EU ...**

Rules on state-aid and anti-competitive behaviour are not confined to EU countries. Freezones are also bound by the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures. However, the stipulations within this protocol are less onerous than the EU's rules. The WTO does not, for example, require states to notify aid, or obtain any prior authorisation.

**... but many EU trade deals include rules limiting state aid**

On the other hand, Freezones located in countries that have negotiated preferential trade agreements with the EU often accept EU state aid rules. Indeed, EU trade agreements usually embody provisions on state aid limitations as a condition for access to the EU Single Market. For example, the Western Balkan nations, all signatories of Stabilisation and Association Agreements with the EU, have committed to harmonising their legislative frameworks with the EU. Even though none of these countries has as yet entered formally into negotiations on competition and state aid, they have committed to aligning themselves with EU state aid rules within four years.<sup>14</sup>

Hence, in its periodic negotiations with the EU, the UK will likely face pressure to comply with some EU state aid rules.



### BOX 3 SHENZHEN SPECIAL ECONOMIC ZONE

SHENZHEN SPECIAL ECONOMIC ZONE WAS ESTABLISHED IN MAY 1980, AS THE FIRST SUCH AREA IN CHINA.

**T**HE ZONE HAS GROWN dramatically into a city with a population of some 12 million, many of whom are migrant workers from rural districts, and more than three million businesses.

Built around a much more liberal economic model than most of the rest of the country, it offers low regulation, looser planning arrangements, tax benefits, and strongly preferential treatment for

foreign direct investment and research and development.

It has become an export-orientated technology, innovation, and financial hub, and is recognised as having played an important role in boosting China's economic growth and development over the past 40 years. It can today boast GDP of more than \$350bn, or just under 10% of the total value of the country's output.

## THE UK EXPERIENCE

Freezones have been part of the UK landscape since the 1980s ...

Freezones were initially established in the UK in the 1980s, and parts of Liverpool, Prestwick, Sheerness, Southampton, and Tilbury were still operating as EU control type II zones when the government of the day decided to no longer renew their licenses in July 2012. The Isle of Man, although formally neither a part of the UK, nor of the EU, remains a Freezone.

... operating alongside Enterprise Zones

The UK's Freezones initially operated alongside another more expansive type of special economic area, Enterprise Zones. In contrast to Freezones, these latter areas, where tax breaks and other incentives were provided to encourage business start-ups and create new employment opportunities, were revived in 2012.

## 4 THATCHER/MAJOR UK ENTERPRISE ZONES

UK Enterprise Zones originally targeted urban blight

Enterprise Zones initially emerged during the Thatcher and Major Conservative Administrations of the 1980s and early to mid-1990s, as a means to regenerate distressed urban areas. The original concept, developed by town planner and geographer Peter Hall, hinged on the idea that, by reducing the various barriers faced by business – such as regulation and bureaucracy – enterprise would thrive, increasing the number of companies, level of employment, and incomes in locations that had been devastated by industrial decline and restructuring.<sup>15</sup>

They were built around a range of financial incentives...

The early Enterprise Zones proved rather less true to laissez-faire doctrine than Hall had proposed. Rather, they sought to overcome various market failures through a system of capital-based growth and rebates. Incentives were provided to the developers, investors, and occupiers of industrial and commercial properties in the designated areas, including:

- ◆ 100 percent tax allowances for capital expenditure on constructing, improving, or extending commercial or industrial buildings.
- ◆ Exemption from business rates for industrial and commercial premises.
- ◆ Simplified planning procedures.

- ◆ Exemption from industrial training levies.
- ◆ Faster processing of applications for firms requiring warehousing free of customs duties.

The Isle of Dogs and Salford were notable successes

In some instances, 1980s and 1990s Enterprise Zones provided a remedy for long-standing neglect and environmental decay. For example, areas including the Isle of Dogs in London, (see Box 4), and Salford in Manchester, have been transformed relative to the early 1980s.

Inner city locations generally tended to perform best

In general, it was the zones created within inner cities that were most successful in creating new additional jobs. Of twenty-two Enterprise Zones evaluated by a Department of the Environment-sponsored study in 1995, six inner city zones created more than half of the total employment growth. Only one in 20 jobs was created in the three 'remote' areas examined.<sup>16</sup>

But the overall record was mixed

Overall, Britain's experience of Enterprise Zones in the 1980s was mixed. This is in part because they were located in locales that were always likely to find it difficult to achieve sustained success, whether because of poor transport links, and/or only limited access to large pools of skilled labour, suppliers, and customers.

The substitution of capital for labour was encouraged ...

At the same time, the promised simplification of planning processes rarely materialised. Moreover, the nature of the financial incentives offered tended to encourage the substitution of capital for labour, moderating any impact on job creation. Furthermore, the jobs created tended to be skewed towards low-skilled activities in service occupations.

... they tended to displace activity ...

The Thatcher/Major Enterprise Zones also tended to encourage the displacement of economic activity, rather than the creation of net new activity or jobs – it has been estimated that more than 40% of the net additional 58,000 jobs created in the Enterprise Zones of the 1980s were displaced from elsewhere.<sup>17</sup> The zones also tended to be expensive. Each job created within the zone is estimated, by one study, to have cost the Exchequer some £17,000 over ten years in 1994/95 prices.<sup>18</sup>

... and rental inflation took hold

A further failing was that business rates relief tended to encourage higher rents, which merely swelled the coffers of landlords. The proportion of net rates relief that filtered down to tenants was an estimated 10% to 55% in urban areas, and -25% to +45% in more remote areas.<sup>19</sup>

## BOX 4 THE ISLE OF DOGS ENTERPRISE ZONE

THE ISLE OF DOGS ENTERPRISE ZONE, ESTABLISHED IN THE EARLY 1980S, IS OFTEN HELD UP AS A SUCCESSFUL MODEL FOR A FREEPORT PROGRAMME.

**B**Y THE LATE 1970S, this once-busy expanse of dockland and industrial processing situated to the east of the City of London was on the way to becoming an industrial wasteland. The containerisation of the international cargo trade had undermined the operations of much of the Port of London, and the Isle of Dogs in particular. The old shallow docks, and time-worn handling equipment, together with a poor transport network, and a conservative, often militant, labour force, meant that the area could not handle the new, larger ships, and streamlined throughput that had come to dominate the cargo trade.<sup>i</sup>

Port installations migrated downstream towards the Thames estuary, or to other better-equipped, modern locations such as Felixstowe on the south and east coasts, where they could more readily take advantage of the burgeoning trade with the then EEC.<sup>ii</sup> Businesses in the Isle of Dogs went bankrupt or moved out, unemployment soared, deprivation and social problems mounted, and much of the area was left derelict.

In 1982, however, the Isle of Dogs was designated an Enterprise Zone, and a major regeneration effort ensued on land largely owned by the London Docklands Development Corporation (LDDC). Offices, housing, retail enterprises, pubs, and restaurants were encouraged. All this was underpinned by support for retraining and major improvements in infrastructure, including importantly the Docklands



Light Railway, which began operations in 1987, and the extension of the Jubilee Underground line in 1999.

In short, the Isle of Dogs Enterprise Zone addressed a set of market failures in the land, labour, housing, and commercial property markets.

It is considered by far the most fruitful of the 1980s Enterprise Zones. Today it is home to the Canary Wharf complex, which is effectively London's second financial and commercial hub.<sup>iii</sup>

<sup>i</sup> Serwicka, I. and Holmes, P. 2019. *What is the extra mileage in the reintroduction of 'Free Zones' in the UK?* UK Trade Policy Observatory, University of Sussex. Briefing paper 28. February. The authors have also benefitted greatly from direct discussions with Dr. Holmes and his colleagues at the UK Trade Policy Observatory, Sussex University.

<sup>ii</sup> Overman, H. and Winters L.A. 2006. *Trade shocks and industrial location: the impact of EEC accession on the UK.* CEP Discussion Paper dp0588. LSE. London.

<sup>iii</sup> Larkin, K. and Wilcox, Z. 2011. *Op.cit.* and Sissons, A. and Brown, C. 2011. *Do enterprise zones work?* The work foundation. London.

## 5 MODERN UK ENTERPRISE ZONES

Some 24 new Enterprise Zones have been established in the UK since 2012, of which eleven are in so-called 'core cities', including Birmingham, Sheffield, Liverpool, London, and Manchester. Echoing the incentives offered to their 1980s and 1990s counterparts, firms operating in these areas can benefit from:

- ◆ Discounts on business rates of up to 100% over a five-year period, worth up to a total of £275,000.
- ◆ 100% first-year capital allowances for companies investing in plant and equipment.
- ◆ Simplified planning processes.
- ◆ Location specific facilities, such as road and rail links and high-speed broadband.

Simplifying planning processes in particular is considered to have been important, and there is a case for experimenting further with variations.

In addition, Local Enterprise Partnerships (LEP) – voluntary collaborations between local authorities and businesses also established in 2011 to develop local economic priorities – can retain all business rates growth within an Enterprise Zone for 25 years for reinvestment in the area. And Tax Incremental Financing can be utilized to allow local areas to borrow against future increases in business rate receipts to fund infrastructure development.

In total, there are now more than 60 Enterprise Zones in the UK, 48 of them in England. Their operating models vary, and they often concentrate their activities around a particular industrial sector. For example, the four Enterprise Zones set up in Scotland include an area focusing on life sciences, another focusing on general manufacturing, and two focusing on low-carbon/renewables.

**The 60 Enterprise Zones often focus on a single sector**

## 6 THE PERFORMANCE OF POST-2011 ENTERPRISE ZONES

**Job creation in new Enterprise Zones has often disappointed**

As with their forerunners, the number of jobs created in Enterprise Zones since 2011 has generally fallen short of original projections. The hope had been expressed that some 54,000 jobs would be created by 2015, but in 2017 there were only 17,000 more jobs in the 24 new Zones than there had been in 2012. Even if the entire increase in employment in these areas is attributed to Enterprise Zone policies alone, it would amount to less than one-third of the number initially forecast.<sup>20</sup>

Moreover, some 2,000 of these jobs were in publicly-funded activities, rather than in the private sector, and a further 2,000 were in the construction sector, and therefore intrinsically temporary.<sup>21</sup> The jobs created also tended to be relatively low-skilled and service based, rather than high-skilled and export-based positions that could transform the fortunes of a region, or an economy as a whole.<sup>22</sup>

**Again, urban zones have tended to enjoy the most success ...**

It has also become clear that, as with previous incarnations of Enterprise Zones, it has been those situated in urban centres that have performed best. City-centre zones accounted for almost two-thirds of total jobs growth achieved, although they accounted for well under 10% of the total land covered by these Zones.

What is harder to deduce is how many of these urban jobs might have been created anyway. Enterprise Zones certainly brought some previously-moribund land back into use, and addressed a market failure in the commercial property market. But unlike rural and suburban areas, city centres are complex business environments, where there is a great deal of commercial activity; and the record of job creation in Enterprise Zones within these urban districts has been no better than in UK city centres as a whole. Hence, even in areas where they seemed to have the greatest success, this may have been related to broader trends in the economy.

**... while job displacement has again been common ...**

Moreover, displacement has been a major consideration in job creation. It has been estimated that more than one-third of the new jobs came either from businesses located elsewhere in the same LEP, or from other areas of the UK. What is more, dividing new businesses in the Enterprise Zones into new start-ups and additional branches of existing firms, demonstrates that more than a third more of the jobs created



**... even if concentration of activity can boost productivity**

were found in a new branch of an existing business. At least some of these jobs are likely to have been the result of transfers from outside.<sup>23</sup>

This begs the question of whether displacement is necessarily unwelcome. The answer is not always. After all, the concentration of previously-dispersed activity in one place can boost productivity by lowering the costs of public service networks to businesses, raising the number of potential workers available to a firm, and making it easier to for businesses and workers to share knowledge.

Also on a more positive note, the more flexible planning rules within the Zones, together with the potential for Tax Incremental Financing to allow local authorities to borrow against the future increase in business rates, does seem to have brought some benefits. This is particularly the case in Birmingham, although neither of these two incentives is exclusive to Enterprise Zones.<sup>24</sup>

# 7 THE CONTEMPORARY CASE FOR FREEPORTS

Support has grown for the creation of new Freeports

In the context of Britain's departure from the EU, a form of Freezone is again being presented as a potential catalyst for the reanimation of British business and trade, and as an arm of regional and industrial policy. This time the focus is specifically on Freeports.

Enthusiasm generally derives from US experience ...

One type of study in favour tends to draw heavily on the US experience with Foreign Trade Zones (FTZs). However, the US model (outlined above) is not a perfect comparator. An assessment by the US General Accounting Office (GAO) concluded that the benefits of US FTZs accrue largely to those importing into the domestic market; and in turn it attributed this to 'tariff inversion', whereby US duties on intermediate goods were higher than on final goods. Thus car firms, to take one example, could achieve significant savings on duties by bringing components into FTZs, assembling them there, and then selling the finished product on into the US, with lower tariffs.<sup>25</sup>

The UK's February 2020 Consultation document suggested that tariff inversion was one of the main sources of potential benefit from UK Freeports. However under the EU CET there were few instances of inverted tariffs; and when the new post-transition UK Global Tariff (UKGT) was announced, one of the main aims was to eliminate tariff inversion to reduce the cost of imported inputs.<sup>26,27</sup>

... but the two cases are far from similar

Hence calculations, based on US experience, that the introduction of Freeports in the UK could, for example, create 86,000 jobs are not based on a like-for-like comparison.<sup>28</sup>

A second type of study focuses more on agglomeration effects. One consultancy report has suggested that, by integrating Enterprise Zones with Freeports, to create a kind of 'supercharged' Freezone, some 150,000 high-value-added new jobs could be created, while adding £9bn per year to UK GDP, boosting trade by £12bn a year, and significantly narrowing regional inequalities between North and South.<sup>29</sup>

This projection is however built around a number of quite strong assumptions, including that there would be few displacement effects, and that the gains of agglomeration in UK Freezones will be equivalent to those in US FTZs. This seems something of a stretch, because

business activities are much closer together in the UK than they are in the US, so that such effects are likely to prove less potent.<sup>30</sup>

FIGURE 4: JOBS AND FIRMS CHANGE, BY LOCATION, 2012-2017

| Area             | Jobs change | Number of firms | Share of total jobs |
|------------------|-------------|-----------------|---------------------|
| City centre      | 8,521       | 349             | 63%                 |
| Suburb           | 1,740       | 218             | 13%                 |
| Area around city | 2,338       | 88              | 17%                 |
| Rural            | 965         | 95              | 7%                  |
| Total            | 13,564      | 750             |                     |

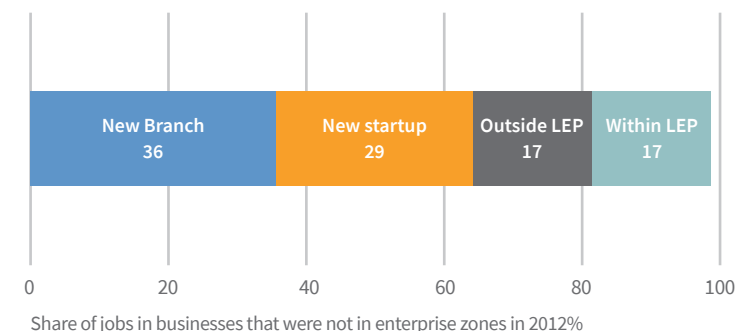
Source: Centre for Cities and ONS Business Structure Database.

Note: This data excludes Construction and publicly-funded services.

A third type of study, a cross-country 'gravity model' analysis of broader types of Freezones, and in particular those specialising in export processing, has concluded that the major effect of the establishment of these Zones would be to reduce the impact of high import duties, and thereby promote imports, rather than exports, as is the case in the US. However, with initial tariffs low, this effect is limited.<sup>31</sup> Other published quantitative analyses have also produced rather equivocal evaluations of Freezones, and found significant displacement effects a recurring theme.<sup>32</sup>

The strongest case for the UK use of Freeports almost certainly rests most comfortably on place-driven levelling-up, as described in this discussion paper, rather than on calculations based on 'fiscal advancement' of non-comparable situations in other countries.

FIGURE 5: BREAKDOWN OF 'NEW' JOBS IN ENTERPRISE ZONES IN 2017, BY ORIGIN OF BUSINESS



Source: Centre for Cities and ONS Business Structure Database.

Note: This data excludes Construction and publicly-funded services.

## CONCLUSIONS

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### There is renewed interest in Freeports

Renewed interest in Freezones or Freeports, of one form or another, stems in significant part from the wish to improve economic performance and social fortunes in the economy. This includes tackling the UK's lagging productivity, expanding the UK's position as a global trade hub, and addressing inequalities of various sorts,<sup>33</sup> including importantly between the regions, which are wider in the UK than in some other European and Nordic countries.

In seeking solutions it is natural and appropriate to seek to formulate policies that are the most economically efficient and, to the extent possible, come at low budgetary cost. And never more so than now. The UK government, like many, has recently been obliged by the circumstance of the COVID-19 pandemic to commit to spending huge sums – many percentage points of GDP – on preventing what would otherwise have been a truly dreadful economic and social outcome.

### This is understandable in present circumstances

Looking ahead, it is therefore natural to consider the extent to which, inadvertently or otherwise, regulations of various sorts might be holding back economic growth and development: and hence what potential there may be for relatively low-cost innovations such as Freeports or Freezones, to enhance output, employment, international trade, productivity, and regional rebalancing.

### Freezones have proved effective in the US ...

Here there is a paradox, however. Freeports or Freezones are generally most effective in regimes that are heavily distorted by tariffs or other taxes. Even in the US, which is widely – and with some justification – regarded as an essentially free-trading nation, it is distortions in its tariff regime that created much of the potential for Freeports or Freezones. In the UK, however, tariffs are already low, distortions comparatively few, and customs procedures relatively efficient – although they have become more onerous in some areas as a result of the UK leaving the EU.

### ... although mainly because it has a distorted tariff regime

The search therefore stands to be redoubled for the best, most cost-efficient, ways to achieve sought-after regional and broader economic gains and benefits.

Freeports, and in particular broader forms of Freezone, such as Enterprise Zones, can to some extent help to frame export-orientated and place-based regional development programmes. They could also perhaps provide potential focal points, in the context of the post

COVID-19 crisis, for greater on-shoring and related adjustments to just-in-time supply chains to establish more localised warehouse and storage capacity.

They might also, through Authorised Economic Operator (AEO) and related ISO models,<sup>34</sup> be joined to activities elsewhere in the country, including selected small and medium-sized enterprises.

That said, they stand to do little directly for the services sector, which now makes up nearly 80% of the economy;<sup>35</sup> although there could be scope for some services being brought in through an AEO-type arrangement.

Importantly, to avoid the risk of business and employment diversion/displacement – boosting Teesside at the expense of Tyneside, for example – any new Freeports or Freezones would need to dovetail with the wider infrastructure and other needs of the regions.

Here the government has indicated its intention, working closely with the National Infrastructure Commission, and budget constraints notwithstanding, to address widely a number of the UK's pressing infrastructure issues. Clearly it would make sense for ports, and in particular ports located in those areas that are struggling economically, to figure prominently in this process. Having efficient, state of the art, entry and exit points for trade can only be good for the country's longer-term economic performance; and to the extent that ports in struggling areas can ultimately be connected more widely to the country at large, so much the better.

### A broader approach to reform offers greater mileage ...

There remains, however, one other major area of considerable importance, not least regionally: the education, training, skills, and mobility of the workforce. The UK currently spends proportionately well under half the OECD average amount on Active Labour Market Policies (ALMPs), and a fraction of the sums spent in the more successful Nordic economies, Germany, Austria, Switzerland, and Australia. Moreover, the UK's many attempts to develop new training and apprenticeship schemes over recent decades have been dogged by poor quality and a lack of support from employers and labour unions.<sup>36</sup>

Today, especially in the light of all that has happened in the past several months, the most rewarding approach to industrial, trade, and regional policy stands to be a truly holistic, data-driven, focus on supply side reform and improvement, that recognises the role of services, good infrastructure networks, education and skills, the importance of young, fast-growing firms; the relatively high failure rate of companies in the UK; and the relative lack of successful mid-sized firms.<sup>37</sup>

A feature of so-called ‘hot spots’ seems to be the comparatively high degree of connectivity of different, but related, activities, and a commensurately varied labour force.

It is perhaps in the context of a broad policy package that fosters such developments that Freeports or Freezones, linked to Enterprise Zones, could best find their appropriate place, and maximise their influence at both at macro and regional level, and there is a growing number of protagonists for this broad, holistic view.<sup>38</sup>

In this regard there seems to be a pressing need for a national policy review institution in which reforms, of both domestic and trade policy, and in particular of education, skills and infrastructure networks, could be analysed according to their implications for the UK at all levels – that is to say, macro plus micro. At present the UK does not have any such institution in which these issues can be clearly considered: they go far beyond the matters considered by, for example, the Competition and Markets Authority.

... especially if driven by a new policy institution

A possible model is provided by the Australian Productivity Commission, an institution with a history of considering the connections between trade policy and domestic economic policy.<sup>39</sup> The Commission gave constructive public advice on the liberalisation of trade in Australia in the 1980s and 1990s, considering implications for particular industries and regions, investigating the associated changes that were required in education and training, and later for wider national reform.<sup>40</sup>

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<sup>1</sup> See Giles, C., 2019. Experts sceptical on Johnson's plans for regional freeports. Financial Times, 5 July. Available at <https://www.ft.com/content/f9c41a54-9f1b-11e9-9c06-a4640c9feebb>

<sup>2</sup> Further awards may be made if bids are particularly strong.

<sup>3</sup> A multiplier in the region of 1.5 is a reasonable average.

<sup>4</sup> Pisu, M., Pels. B. and Bottini. N. 2015. *Improving infrastructure in the United Kingdom*. July. OECD. ECO/WKP (2015) 62. The UK port sector was largely privatised in the 1980s. Fifteen of the largest ports, handling some two thirds of port traffic, are now private. This contrasts to the EU, where some 80% are state-owned.

<sup>5</sup> Pisu, M., Pels. B. and Bottini. N. 2015. *Op. cit.*

<sup>6</sup> The north of England is home to just under a quarter of the population, about a fifth of gross value added, but more than a third of total port throughput. Sunak. R. 2016. *The Free Ports opportunity*. Centre for policy studies. November.

<sup>7</sup> Jones. R. and Llewellyn. J. 2019. *Reducing inequalities*. Beyond Brexit: A Programme for UK Reform. NIESR Review no. 250.

<sup>8</sup> Sunak. R. 2016. *Ibid.* Also, Holmes. P. 2019. *Free ports – preparing to trade post-Brexit*. September. <https://blogs.sussex.ac.uk/uktpo/2019/09/26/freeports-preparing-to-trade-post-brexit/>

<sup>9</sup> Barnard. C. and Leinarte. E. 2018. Free zones. 7 October. The UK in a Changing Europe. <https://ukandeu.ac.uk/explainers/free-zones/>

<sup>10</sup> Sunak. R. 2016. *Op.cit.*

<sup>11</sup> Barnard. C. and Leinarte. E. 2018. *Op.cit.*

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<sup>13</sup> Rankin. J. 2019. Free ports favoured by Boris Johnson are money-

laundering threat – EU. 24 July. The Guardian.

<sup>14</sup> OECD (2017). Tracking special economic zones in the western Balkans: objectives, features, and key challenges. OECD. Paris.

<sup>15</sup> Hall. P. 1998. Cities in civilisation: culture, technology, and urban order. Wiedenfeld and Nicholson. London.

<sup>16</sup> PA Cambridge Economic Consultants. 1995. *Final evaluation of enterprise zones*. Department of the Environment. London.

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<sup>18</sup> Larkin. K. and Wilcox. Z. 2011. *Op. cit.*

<sup>19</sup> Gunther. W. and Leathers. C. 1987.

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<sup>20</sup> Centre for Cities. 2019. *In the zone? Have enterprise zones delivered the jobs they promised?* July.

<sup>21</sup> Centre for Cities. 2019. *Ibid.*

<sup>22</sup> Centre for Cities. 2019. *Ibid.*

<sup>23</sup> Centre for Cities. 2019. *Ibid.*

<sup>24</sup> Centre for Cities. 2019. *Ibid.*

<sup>25</sup> See: Serwicka. I. and Holmes., op. cit. p. 2019. See also US General Accounting Office. 1984. *Foreign trade zone growth primarily benefits users who import for domestic commerce*. Report to the Chairman, Committee on Ways and Means. House of Representatives. Washington DC; US General Accounting Office. 1989; and *Foreign trade zones program needs clarified criteria*. Report to the Chairman, Committee on Ways and Means. House of Representatives. Washington DC; US Government Accountability Office. 2017. *CBP should strengthen its ability to assess and respond to compliance risks across the programme*. Report to the Ranking Member, Committee on Finance. US Senate. Washington DC.

The analysis also added that there were inadequate data accurately to evaluate the number of net new jobs created by

Foreign Trade Zones.

<sup>26</sup> The UK's new Most-Favoured-Nation (MFN) tariff regime, the UK Global Tariff (UKGT), replaced the EU's Common External Tariff (CET) at the end of 2020, and applies to all trading partners with which the UK has no alternative agreements.

It aims to balance the interests of consumers and producers and "... scrap red tape and other unnecessary barriers to trade, reduce cost pressures and increase choice for consumers and back UK industries to compete on the global stage." [https://www.gov.uk/government/news/government-announces-uk-global-tariff]

The UK government also states that, when compared with the EU's CET, the UKGT almost doubles the number of tariff lines that have zero import tariffs, with just under half of all UK MFN tariff lines now set at 0%, and that, when combined with all other trade measures (including free trade agreements), approximately £445 billion worth of imported goods will be able to enter the UK tariff free per annum. This amounts to approximately 91% of the value of all goods imported into the UK, compared with 86% under CET tariff levels.

Relative to continuing to apply tariffs at the level of the EU's CET, the impacts of the UKGT on the UK economy are expected to be positive overall and for most sectors of the economy. Risks are acknowledged however, including to some businesses, particularly in manufacturing, that will face adjustment costs as a result of greater competition from the rest of the world.

<sup>27</sup> A study by the UKTO and the Financial Times suggested that under the UKGT the only industry likely to be able to gain from tariff inversion in a Freeport was dog and cat food. FT August 2 2020 Peter Foster: *Freeport advantages for business are 'almost non-existent'* <https://www.ft.com/content/7ee9e853-bea6-4797-9119-f7e20cdae3c0>

<sup>28</sup> Such figures simply take the total number of jobs within existing US FTZs (420,000), assume that they are all 'additional jobs', and then adjusting the *pro rata* for the relative size of the UK labour force (33 million) relative to that in the US (161 million).

<sup>29</sup> Mace, 2018. Mace insights. *Supercharged freeports. The ultimate boost for Britain's economy.*

<sup>30</sup> For more on this, see Smith. K. 2018. *Supercharged freeports: putting Mace's big idea for the North in the dock*. Construction Research and Innovation. 9 (3): 68-72.

<sup>31</sup> Siroën, J-M. and Yücer. A. 2017. *Trade performance of export processing zones*. The World Economy. 40 (5): 1012-1038.

<sup>32</sup> Serwicka. I. and Holmes. P., 2019. *Op. cit.*

<sup>33</sup> That inequalities can take many forms – of access to income, food, education, health care, infrastructure, and more – has been emphasised by many eminent economists, including not least Professor Amartya Sen and Professor Sir Angus Deaton. For more on this, see for example Jones. R., and Llewellyn, J., 2019. *Reducing Inequalities*. Policy Reform Group, NIESR Review No. 250. Available at: <https://www.policyreformgroup.org/our-work> and <https://journals.sagepub.com>

<sup>34</sup> See ISO website and the material therein on Authorised Economic Operators. Available at ISO - What we do [Accessed 26 January 2021]

<sup>35</sup> Besley. T. and Davies. R. 2019. *Formulating industrial policy*. Beyond Brexit: A Programme for UK Reform. Policy Reform Group, NIESR Review No. 250. Available at <https://www.policyreformgroup.org/our-work>

<sup>36</sup> There are other important policy areas too, including ensuring that there is sufficient reasonably priced commercial and residential property supply in these areas. For more, see Martin. J. 2019. *Supporting dynamic economic adjustment*. Beyond Brexit: A Programme for UK Reform. NIESR Review No. 250. Available at: <https://www.policyreformgroup.org/our-work> and <https://journals.sagepub.com>

<sup>37</sup> For more, see Besley and Davies, 2019. *Ibid.*

<sup>38</sup> For example, Scotland is to develop its own network of freeports: see Macnab, S., 2021. *Scotland to press ahead with post-Brexit freeports network*. The Scotsman, 21 January. Available at [Scotland to press ahead with post-Brexit freeports network | The Scotsman](https://www.policyreformgroup.org/our-work) [Accessed 26 January 2021]

For an interesting proposal regarding 'semi- autonomous cities', put together

*inter alia* by EY, see Dettoni, J., 2020. *Honduras's economic experiment: the ZEDE legislation is one of the most advanced of its kind in the whole world*. fDi Intelligence, 1 September. Available at [fDi August, September 2020 :: 46 \(yudu.com\)](https://www.fdiintelligence.com) and at [Honduras becomes testbed for autonomous cities | fDi Intelligence – Your source for foreign direct investment information – fDiIntelligence.com](https://www.fdiintelligence.com)

And a particularly broad, holistic, set of proposals is advanced by Shanker Singham: see for example his webcast hosted by the Centre for Policy Studies and Global Economics Neural networks, available at [Free ports, nodes, and networks: harnessing trade after the pandemic - YouTube](https://www.youtube.com/watch?v=...) [Accessed 26 January 2021]

<sup>39</sup> For more, see Vines. D., Gretton. P. and Williamson. A. *Developing Trade*. November. Beyond Brexit: A Programme for UK Reform. Policy Reform Group in NIESR Review no. 250. Available at: <https://www.policyreformgroup.org/our-work> and <https://journals.sagepub.com>

<sup>40</sup> A major paper on the potential appropriateness and usefulness of an Australian-style productivity Commission by Professor Vines is shortly to be published by the *Policy Reform Group*. Enquiries to [Policy Reform Group](https://www.policyreformgroup.org).

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