

# Panamanian Free Trade Zones: analysis and proposal of improvements to control illicit trade

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## ABSTRACT

The international community in customs and commercial matters unanimously agrees that the current Free Trade Zone systems show weaknesses that facilitate illicit commercial transactions, promote money laundering and allow the financing of organized crime. The abuse of Free Trade Zones that is evidenced worldwide is not foreign to the Panamanian reality and the current situation of our country, recently stigmatized by evident cases of lack of transparency, jeopardizes economic growth due to the lack of a sustainable vision and competitive for our Free Trade Zones. The lack of transparency of the activities, the intermittent controls, the lack of resources and deficiency in the training of human resources, in addition to the environment and the economic groups, facilitate the abuse of the Free Trade Zones by the criminal organizations. As a consequence, the rule of law weakens, fostering insecurity, attacking formal employment, citizens' health and undermining tax revenues. The international regulatory framework on controls within the Free Trade Zones for combating illicit trade is extensive but ambiguous. There is no unified criterion throughout the treaties and conventions that address the issue, which results in contradictions that hinder the adoption of measures tending to increase the transparency of operations within Free Trade Zones. The relevance of Free Trade Zones continues to grow as globalization defines economic progress. However, the evidence presented also shows that the rules, supervision and regulations that govern them have not kept pace with these advances, transforming the Free Trade Zones into areas highly vulnerable to encourage illegal trade, money laundering, organized crime and the financing of terrorism.

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## About the Author

Rodolfo Samuda Leiva graduated from the University of Panama with a degree in Law and Political Science, specialises in Commercial Law with major in International Business and obtained a Postgraduate Degree in Higher Education, both from the Interamerican University of Panama, the latter with the degree of *Summa Cum Laude*. He is currently a professor at the Interamerican University of Panama teaching International Commercial Transactions and New Commercial Contracts for the Master's degree, and Customs Tax Law, Commercial Law and Administrative Law for the Bachelor's degree.

He held various positions with command and jurisdiction in the General Customs Office of Panama, of which we can mention Head of the Department of Intellectual Property, Regional Administrator of the Eastern Zone, Customs Supervision Director and Deputy General Manager in charge.

In his experience in the customs service, he represented the Panamanian government in a number of activities, among which the following stand out: Negotiator of the Central American Customs Code IV and its Regulations

(CAUCA IV and RECAUCA); in the tables of legislation and procedures within the SIECA (Secretary of Economic Integration Central America); he participated as a negotiator for the drafting of the Protocol on Illicit Trade in Tobacco Products sponsored by the World Health Organization and has been a speaker in different countries on issues of border measures in defense of intellectual property rights.

He actively participated as liaison for the realization of the first diagnosis of the World Customs Organization to the Republic of Panama for the implementation of the normative framework SAFE<sup>1</sup> to ensure and facilitate global trade and the Law that Transforms the General Directorate of Customs into what it is today, the National Customs Authority.

He was the customs' representative at the intelligence table of the National Security and Defense Council from 2006 to 2008 and was the first customs intelligence liaison within the RILO program for the Panamanian Customs before the World Customs Organization.

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<sup>1</sup> Framework of Standards to Secure and Facilitate Trade

## II. Introduction

At present, the various global activities move at an accelerated pace and we are more connected than at any other time.

International trade holds a preponderant place in these activities, since its promotion is fundamental for the economic development and prosperity of our peoples, therefore governments and the private sector must ensure that this international trade is as transparent and fair as possible.

Free Trade Zones - in their broadest sense - have become, in the last decades, a fundamental tool to facilitate the exchange of goods and services in an agile way and with less bureaucracy, framed in the premise of peoples' development by means of the creation of jobs and the increase of direct foreign investment.

However, at present, these facilities aimed at promoting licit trade are also being exploited by organized crime. These organizations that operate outside the law, abuse the existing weaknesses in the current Free Trade Zone systems with the desire to increase their profits without scruples, weakening the rule of law, promoting insecurity, attacking formal employment, citizens' health and undermining tax revenues.

The concept of Free Trade Zone has acquired different nomenclatures over the years, however all the concepts coincide when considering the Free Trade Zones as a modality of customs regime, in which one of its main characteristics is the tax exemption and/or of the payment of other tariffs on the goods that are introduced, exported and re-exported in these segregated areas, but each one of these has its particularities. To extend the comparative analysis of this research study we will use the definition of Free Trade Zones provided by the Revised Kyoto Convention of the World Customs Organization, which defines them as *a part of the national territory in which the goods introduced are generally considered, in with respect to import duties and taxes, as if they were outside the customs territory.*<sup>2</sup>

In the last four decades, these types of initiatives have been growing, driven by the need to attract more foreign investment, generate employment and promote economic development.

The international community in customs and commercial matters unanimously agrees that the current Free Trade Zone systems show weaknesses that facilitate illicit commercial transactions.

The Panamanian economy is based on the development of the tertiary sector (services), with an approximate 70%<sup>3</sup>

weight in the GDP, primarily sustained through the creation of different Free Trade Zones.

The abuse of Free Trade Zones that is evidenced worldwide is not foreign to the Panamanian reality. The current situation of our country, recently stigmatized by evident cases of lack of transparency exposed by the international community, combined with the significant contribution to the growth of our country provided by the service sector in Free Trade Zones, makes this study a fundamental element for raising awareness among the public sector and the private sector about a potential slowdown in economic growth due to the lack of a sustainable and competitive vision for our Free Trade Zones.

Based on this reality, we develop this research work that we believe will serve as a guide to highlight the reality of Free Trade Zones at a global and regional level and at the same time identify the current weaknesses of our regime with the objective of identifying solutions that help to implement better controls and procedures and thus minimize the abuse by criminal organizations for illicit activities.

These recommendations are based on the analysis of different studies carried out at a global level, combined with empirical experience in the public customs system, through clear, pragmatic and real application guidelines in line with the different currents that worldwide seek to combat the scourge of illicit trade.

## III. Current situation of free trade zones worldwide and in Latin America

The first Free Trade Zone in the world was established at Shannon Airport, Ireland in 1959. At that time, Shannon Airport depended almost entirely on passengers in transit and refueling for transatlantic flights. The lack of government support and the clear signs that commercial airplanes would soon have more scope to elude the airport, mobilized the director Brendan O'Regan, who presented a proposal for a special manufacturing zone with tax incentives. According to his proposal, this would create much needed jobs and specific air traffic at the Shannon airport. The site adjacent to the airport was established in 1959 and the second area, Smithstown, several years later.

By 1975, 29 countries had approved the creation of 665 Free Trade Zones, according to the World Bank. This figure has multiplied more than five times and, over the years, the model has evolved organically in different ways in different countries.<sup>4</sup>

Free Trade Zone regimes spread across the five continents as one of the main employment and investment promotion tools for those countries that decide to adopt

<sup>2</sup> "Revised Kyoto Convention", World Customs Organization, 1999

<sup>3</sup> "Conjuncture Indicators", National Institute of Statistics and Census, 2017

<sup>4</sup> "Manifesto", World Free Trade Zones Organization, 2014.

them. According to information from the World Free Trade Zones Organization, there are more than 3,500 free trade zones in more than 130 countries worldwide, which generate around 70 million direct jobs, a figure equivalent to 1% of the world's population.<sup>5</sup> While it is very difficult to estimate the profits generated by the Free Trade Zones worldwide, the Financial Action Task Force (FATF) of the Organization for Economic Co-operation and Development (OECD) estimates that global free trade zones more than USD 400 billion through its exports<sup>6</sup>.

The current reality of Free Trade Zones in Latin America is no stranger to what is evidenced worldwide. Over the last 90 years, these regimes have been used continuously by Latin American countries as instruments for attracting foreign direct investment, creating new jobs and contributing to national economic growth, particularly in the area of tariffs and taxes to companies that operate under the regime.<sup>7</sup> Currently, 12.7% of the Free Trade Zones of the world are located in the Latin American region, bringing together about 8,000 companies from various productive sectors and services. In addition, the Free Trade Zone regime in the Americas generates 925,000 direct jobs and about 1,180,000 indirect jobs<sup>8</sup>.

### Types of Free Trade Zones in Latin America:

According to an analysis prepared by the Association of Free Trade Zones (AZFA) of the Americas, there are three types of Free Trade Zones in the region:

1. *Export Free Trade Zones: with three identified models.* On the one hand, there are the Free Trade Zones of (i) industrial diversification that are used primarily to increase the added value of products and services marketed in those areas. Among the examples cited by AZFA are Costa Rica and the Dominican Republic, which in less than 10 years went from having a textile industry, to having today high value-added industries such as technology products, medical instruments and drugs.

(ii) On the other hand we find Free Trade Zones that are *dependent on the machines*, which have been established in El Salvador, Honduras, Guatemala and Nicaragua, with the objective of maximizing the benefits of the free trade agreement of Central America and the Dominican Republic (CAFTA – DR).

(iii) Finally, within this group we find Free Trade Zones of logistics services which have been implemented exclusively for the distribution of goods and services obtaining logistical advantages in countries such as Argentina, Chile and Uruguay.

### 2. Free Trade Zones of import substitution

These zones are located in Brazil and were implemented with a view to obtaining a greater supply of foreign goods and services in the domestic market.

### 3. Mixed Free Trade Zones

Finally, the analysis of AZFA considers the model of mixed zones that consists of the use of three different types of Free Trade Zones that operate primarily in Colombia and Uruguay. Within this group there are permanent mixed models where we find Free Trade Zones referring to delimited geographical areas that have been specially designated by the government so that the companies that operate there are entitled to various incentives in terms of taxes and tariffs. In another group we find the *Special Free Trade Zones* or "*uni-business*" zones that are the areas in which the benefits of the free trade regime are granted, in tax and tariff issues, to a specific company as long as it meets investment and employment requirements. Finally, we have the model of *Transitory Free Trade Zones* that refer to an area where the government grants a special authorization for international fairs, exhibitions, congresses or seminars, which are important for the national economy and international trade to take place.

### Statistics of Free Trade Zones in Latin America

The first country that established the Free Trade Zone regime was Uruguay, followed by Panama and Colombia. The latter stands out as the Latin American country with the largest number of Free Trade Zones in the region, with a total of 102; followed by the Central American region where countries such as the Dominican Republic have 55 Free Trade Zones, Nicaragua has 49 and Honduras has 43. The number of Free Trade Zones follows, Guatemala with 24, Costa Rica with 23, and El Salvador and Panama with 17 respectively. Other countries in the region such as Uruguay, Chile, Paraguay and Ecuador have only one or two Free Trade Zones. Brazil, one of the main markets in Latin America, only has the "Free Economic Zone of Manaus."<sup>9</sup>

We find that jobs generated by Free Trade Zones in Latin America play a very important role in the region. The Dominican Republic has the largest number of jobs generated, with 153,000, followed by Honduras with 146,000. Brazil, although it only has one Free Trade Zone in the country, generates around 126,000 direct jobs. El Salvador, Colombia, Costa Rica, Guatemala and Panama generate between 80,000 and 50,000 jobs in their Free Trade Zones, respectively. Chile, Uruguay and Puerto Rico generate an average of 16,000 jobs. Smaller countries such as Haiti and Paraguay generate 7,000 and 2,500 jobs respectively. It is evident that the number of Free Trade Zones in each country is not related to the number of jobs generated. The largest number of companies operating in a Free Trade Zone is in Chile,

<sup>5</sup> *Ibid.*

<sup>6</sup> "Money Laundering vulnerabilities of Free Trade Zones", Financial Action Task Force, 2010.

<sup>7</sup> "Panorama of Free Trade Zones in Latin America", Association of Free Trade Zones of the Americas, 2015

<sup>8</sup> *Ibid.*

<sup>9</sup> *Ibid.*

where about 2,850 companies operate in the two Free Trade Zones of the country. Chile is followed by Uruguay and Colombia, with 1,560 and 772 companies operating in the Free Trade Zone, respectively. Puerto Rico and the Dominican Republic have 731 and 602 companies in their Free Trade Zones. Finally, the countries with the least number of companies in the Free Trade Zone are El Salvador, Nicaragua and Paraguay.<sup>10</sup>

With respect to industrial diversification in the Latin American Free Trade Zones, we find that in countries such as Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, the Dominican Republic and Colombia, user companies carry out activities in more than 4 different sectors. In countries such as Chile, Argentina, Brazil and Paraguay, diversification in different sectors is lower.<sup>11</sup>

In summary, the 400 Free Trade Zones in Latin America generate approximately 900,000 direct jobs with more than 8,000 established companies.

#### **IV. Current Situation of the Free Trade Zones in Panama**

The Free Trade Zones in Panama are part of a special, comprehensive and simplified regime oriented to the establishment and operation of companies that aim at the development of the country, the generation of jobs and currencies which are incorporated into the global economy of goods and services by means of the promotion of investment and the economic, scientific, technological, cultural, educational and social development of the country.

Panama has created a set of laws and regulations that allow local and foreign investors to establish businesses in special segregated areas that possess a variety of fiscal, migratory and labor incentives with the main objective of developing different types of activities and promoting international trade, manufacturing production and complementary services.

Law 32 of 5 April 2011 establishes the legal framework for the special and simplified regime of establishment and operation of Free Trade Zones and is regulated by Executive Decree 26 of 9 February 2012.

According to said regulatory framework, the Free Trade Zones are delimited for the development of infrastructures and operative organization that need to be established within the same national and foreign companies, promoting the scientific, technological, economic, cultural, educational and social development in the country.

The types of free trade zones regulated by the aforementioned Law are:

1. *Private Free Trade Zones:* Those whose investors are natural or legal persons, national or foreign; their establishment, operation and administration is under the power and responsibility of their owners.

2. *State Free Trade Zones:* Those whose only investor is the State. Their establishment, development, operation and administration will be the responsibility of a State entity or a private operating company, to which the administration contract is conferred in accordance with established legal procedures.
3. *Mixed Free Trade Zones:* Those whose property is shared between the State and national or foreign investors. Their development, operation and administration will be the responsibility of a State entity or a private company.

Law 32 provides for two types of licenses:

1. *License as promoter or Free Trade Zone operator:* It is obtained by submitting an application to the National Commission of Free Trade Zones.
  - (i) *As Operator:* natural or legal persons, private or public, national or foreign, will be those who assume the responsibility of the management, administration, operation and supervision of the integral operation of the Free Trade Zone. They will be responsible for ensuring maximum efficiency in their operation, so that users have the optimal conditions to achieve high levels of competitiveness.
  - (ii) *As Promoter:* Natural or legal person, private or public, national or foreign, who conceives or acquires the idea and transforms it into a feasible project, invests and contacts investors to contribute capital, buy or lease the land, negotiate with credit institutions to obtain financing, organizes, directs or hires specialized services for the international market. The same person can act as promoter and operator.

2. *License as a company established in the Free Trade Zone:*

This type of license is created for companies interested in settling within free trade zones. This type of companies must present a study that contains: the activity of goods and services to be developed; the origin and details of the raw material, materials, equipment, supplies, machinery, accessories; the number of jobs that are projected to be generated; the initial investment and the future investment project; the execution schedule.

Among the main incentives offered by Law 32 we find the exemption of taxes and import duties, and for the promoters of Free Trade Zones the exemption of income tax in the lease and sublease. Additionally, important migratory and labor benefits are offered.

Regarding the control and monitoring measures, the Law establishes that all the areas destined to the development of Free Trade Zones will be delimited so that the entrance

<sup>10</sup> *Ibid.*

<sup>11</sup> *Ibid.*

and exit of people, vehicles and merchandise must be done through the signaled spaces.

Finally, the Law grants oversight and control of the fiscal regime of the Free Trade Zones to the National Customs Authority in all the limited space that includes the Free Trade Zone. Supervision is carried out through the Special Customs Control and Surveillance Service. Customs officials must exercise systematic control of non-nationalized merchandise, raw materials and inputs that enter, move or leave the Free Trade Zone for physical and documentary capacity and other customs controls. However, as we will see later, the practice differs significantly from the spirit provided by the law.

### The Colon Free Trade Zone

The Colon Free Trade Zone (CFTZ) serves as a platform for the redistribution of wholesale and tax-free goods from Asia, Europe and North America to Latin America and the Caribbean. Located in the extreme Atlantic of the country, this area is supported by a wide variety of logistic and financial services that take advantage of its connectivity to expand the flow of merchandise to regional markets. Created in June of 1948, CFTZ has served for 69 years as the main commercial center for Latin America and the Caribbean. Its operations began in a segregated area of 35 hectares in the City of Colón and with 10 companies. Now, this Free Trade Zone is divided into nine different sectors that total about 1,065 hectares with more than 3,000 companies.

The companies established in CFTZ are primarily engaged in the purchase and sale of merchandise at the international level, mainly of food, beverages, cigarettes and agricultural materials; textiles, clothing and shoes, household products; construction materials, heavy equipment and plumbing; machinery and other related equipment; motor vehicles and motorcycles, their spare parts and accessories.

CFTZ offers great fiscal, migratory, labor and corporate advantages to companies that are established in this commercial area. Among these benefits we find the exemption of taxes on imports, re-exports and manufacturing of goods; the exemption from taxes on re-export income; the exemption from taxes on billing; the use of the US dollar as legal tender; low costs in the rental of land, buildings or other spaces; migratory facilities to foreign executives and a financial network of a large number of national and international banks.

CFTZ has reported a decrease since 2012. For the year 2016, the commercial movement of this Free Trade Zone reached USD 19,655 million, i.e. a deceleration of 10.6% with respect to 2015. Of this total, imports totaled USD 9,238 million while re-exports amounted to USD 10,417

million. The main products imported from the Colon Free Trade Zone in 2016 were pharmaceutical and chemical products, machinery and electrical appliances, textiles, footwear and other textiles. These products come mainly from China, Singapore and the United States. Meanwhile, these same products are re-exported to Latin American markets, mainly to Puerto Rico, Colombia and Costa Rica.

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### V. Free trade zones as facilitators of illicit trade and money laundering

As highlighted in the preceding pages, Free Trade Zones play a central role in the globalization of the world economy. The development of Free Trade Zones has progressed and is reflected in the range of types of regimes specially designed to reduce barriers and facilitate global free trade while providing an important financial stimulus to national economies.

Although all these Free Trade Zones are a source of investment, employment and development, the other side of the coin evidenced through statistics and case studies shows that criminal organizations abuse lax controls, administrative inefficiency and lack of transparency, thus promoting illicit trade.

According to the Financial Action Task Force (FATF), *"free trade zones are used improperly for money laundering and terrorist financing (...) Proliferators of weapons of mass destruction (WMD) abuse Free Trade Zones to transfer dual-use goods and disguise the final destination of sensitive products (...) Cigarettes, alcohol, and other high duty items are more vulnerable to smuggling and contraband due to the increased revenue that can be generated by not paying tax"*.<sup>13</sup>

#### Illicit trade

Illegal trade is a complex global phenomenon. Globalization has provided new opportunities for criminal organizations to expand the scale of operations with devastating consequences for the economy, the environment and the well-being of society in general. According to statistics from the United Nations Office on Drugs and Crime (UNODC) it is estimated that the profits of criminal organizations amount to USD 870 billion, which represents 1.5% of global GDP<sup>14</sup>.

Illicit trade has a terrible negative impact on economic stability, social welfare, health, public safety, and our environment. Its diverse and complex causes lie in legislation and inadequate sanctions; protectionist policy measures; lack of human and financial resources; weak customs controls; public ignorance; disparities in prices

<sup>12</sup> "Commercial Exchange", GeorgiaTech Panama Logistics Innovation and Research Center, 2016.

<sup>13</sup> "Money Laundering vulnerabilities of Free Trade Zones", Financial Action Task Force, 2010.

<sup>14</sup> "Estimation of Illicit Financial Flows from Drug Trafficking and Other Transnational Organized Crime: Research Report", United Nations Office on Drugs and Crime, 2011

controlled by tax differences between different jurisdictions and corruption.

The vulnerabilities of Free Trade Zones as facilitators of illicit trade have been highlighted innumerable times by the international academic community in matters of customs and control. The Financial Action Task Force (FATF) summarizes these vulnerabilities in a study conducted in 2010, which identifies three major areas of weakness:

In the first place, **the light supervision and the lack of transparency** that exist in the Free Trade Zones, as a consequence of the intermittent controls that the customs are authorized to carry out, stand out. Many of the products that enter and exit the Free Trade Zones usually go through various economic operations, including assembly, manufacturing, processing, storage, repackaging, depositing, transshipment, export and re-export. The lack of controls over some or all of these activities makes it even more difficult to carry out the necessary control to prevent and combat abuse by criminal organizations. Additionally, there is a lack of clarity regarding the customs responsibilities within the Free Trade Zones; consequence of the absence in the definition of customs jurisdiction over potentially illegal activities within the zones. There is also a great facility in most Free Trade Zones to establish legal companies demanding little information about the company's property and due diligence standards that facilitate the establishment of ghost companies.

Secondly, the **lack of interoperability in the national systems** used to report activities to the customs authorities and to the authorities in the Free Trade Zones. Although in theory transactions should be reported to both authorities, in many jurisdictions the systems are not integrated and sometimes transactions are recorded in physical and electronic form. The lack of integration in these systems generates great difficulty in analyzing trends related to ports, zones, regions and specific businesses at the local level but also at the regional level given the lack of coordination between different jurisdictions.

Finally, certain products are particularly **vulnerable to their illicit commercialization** due to their value, size, high tariff rate, trade volume and/or their potential to be counterfeit. Some of the examples mentioned by FATF are cigarettes, alcohol, luxury items, electronic items and other high duty products. The Free Trade Zones tend to facilitate the transfer of these products as criminal organizations take advantage of a system where there are few inspections of large shipments entering and leaving and the few supervisions that are carried out are not exhaustive regarding importation, re-labeling, export and repackaging. This last activity is a method commonly used

by criminals in the Free Trade Zones to cut ties between the country of origin or real destination. In turn, the facility offered in the re-edition of commercial documentation also shows vulnerabilities for those products that are imported into the Free Trade Zones, which are then re-exported with a different product description under the names of different owners.

#### Case Study 1: Contraband and Tax Evasion<sup>15</sup>

A US company received shipments of alcohol and tobacco from national and international suppliers in customs warehouses and Free Trade Zones. The company re-packaged the goods and sent them under the name of another company to another customs warehouse and in other Free Trade Zones, ultimately smuggling them into the markets for sale. The profits were mainly bleached through the purchase of real estate in several jurisdictions. The investigators were able to determine that the company behind the criminal activity used double billing, false customs forms, a counterfeit customs seal and counterfeit customs signatures to facilitate smuggling, transshipment and the sale of duty-free cigarettes. One of the elements of the scheme was to sell to foreign diplomats.

During the execution of a search warrant at the business location of the US company, police authorities seized alcoholic beverages and duty-free cigarettes worth USD 947,195 that had been prepared to be smuggled out of the United States. The investigation resulted in arrests and convictions of 12 people who were also involved in an illegal arms and drug distribution organization associated with the Abu Sayyaf Group, a terrorist organization based in the Philippines.

This case has exposed two main vulnerabilities in the Free Trade Zones and customs warehouses. First, the lack of associated processing and due diligence standards. Ports work differently and apply different rules. Some ports require that ship managers receive prior approval in person with all relevant documentation before making deliveries. Other ports require delivery to take place first and only then some relevant forms are provided. The lack of a single standard exposes a vulnerability in the system.

Second, all transactions are initially made through paper documents and the entry into an automated system is not standard in all ports. This makes the diversion of products easier. Some ports register the movement of free merchandise, but other ports do not, exposing the vulnerability of some ports.

## VI. Free Trade Zones in Latin America as facilitators of illegal trade

### Free Trade Zone of Corozal in Belize

The Free Trade Zone of Corozal (FTZC) was established in 1994 and has more than 314 registered companies. It offers facilities for the manufacture, processing, storage, packaging and distribution of goods and services. The companies established there operate without restriction to

<sup>15</sup> "Money Laundering vulnerabilities of Free Trade Zones", Financial Action Task Force, 2010.

international exchange; receiving several benefits that include the exemption of taxes of import and export, fiscal stamps, taxes to installments and replacement of rents. The income tax established in the Area ranges between 2 and 8%<sup>16</sup>. However, this amount can be reduced through tax cuts for employing Belizean workers.

Additionally, during the first five years of its existence, a company in the FTZC is exempt from income tax, capital gains taxes or any new corporate tax levied by the Government of Belize. Any dividend paid by this company will be exempt from taxes for the first 20 years of its operation. This lightening is reflected in the number of duty-free stores located in the area. In 2011, 17 new discount retail stores that sold FTZC-free products were enabled. These advantages and its geostrategic position mean that Belize functions as a point of reception and redistribution of high duty products.

FTZC has been identified in recent years as one of the most important platforms to smuggle contraband products, due to the laxity of controls in internal movements and expenditures from the area, the ease in the exchange of currency and the transfer of funds within the Free Trade Zone. The prominent role of Belize in contraband is likely to be reinforced by its porous borders, the lack of security measures and the rugged geography; all factors that have contributed to an increase in the activity of organized crime in recent years in the country.

According to several journalistic reports<sup>17</sup> the Free Trade Zone of Corozal has been identified as a drug trafficking paradise, with an enormous influence of criminal organizations such as the Salvadorean Maras or the Mexican drug cartels. The Department of State of the United States of America<sup>18</sup> highlighted the importance of Belize as a point of smuggling illicit products and drugs to the United States and urged the country to fight against the criminal organizations that plague that nation.

According to estimates of the Chamber of Guatemalan Industry (CIG), the government of this country fails to receive USD 2 billion<sup>19</sup> in taxes as a result of smuggling from the Free Trade Zone in the neighboring country. Mexico, El Salvador and Honduras are also affected by the large-scale transfer of cigarettes, liquor, clothing, sports shoes, electronics and perfumes.

### **Free Trade Zone of Aruba**

The Aruba Free Trade Zone (AFTZ) has two designated areas in Bushiri and Barcadera. The Bushiri Free Trade Zone has been operational since 1999 and covers an approximate area of 9 hectares, while the new Barcadera Free Trade Zone covers 40 hectares.

The AFTZ offers operators the possibility of developing a wide range of commercial activities such as import and

export operations, direct dispatch (between manufacturer and retailer), retail sales to tourists; industrial activities, among which processing and packaging, repair and maintenance, exhibition and service activities of all kinds.

In the AFTZ the income tax is 2%, while the established companies also enjoy an exemption from the payment of import duties and consumption taxes on products and equipment, from the payment of taxes on the sales volume generated by activities of export, and finally, from the payment of tax on dividends. Also, it should be noted that the industrial companies operating in the AFTZ do not pay any kind of import duties on packaging materials and raw materials, semi-finished products and components used in the production process.<sup>20</sup>

AFTZ is another collection center in our region that facilitates illicit trade mainly to Colombia and Venezuela. According to the Federation of National Governors of Colombia tons of whiskey, cigarettes and cooking oil among other products are collected in the Free Trade Zone of Aruba and then by sea, pass to Venezuela and La Guajira in Colombia<sup>21</sup>.

Estimates from this institution confirm that oil smuggling generates USD 100 million in profits annually.<sup>22</sup> According to this same institution, smuggling from the AFTZ is increasingly linked to money laundering.

In the 1990s, Aruba was included on FATF's blacklist (Financial Action Group) as a result of the accusations that linked that country and its Free Trade Zone with the presence of gangs, money laundering and smuggling. As a result of international pressure, several businessmen operating within the AFTZ were extradited to the United States to face charges for money laundering. However, the evidence provided by the Federation of Governors of Colombia would seem to demonstrate that the AFTZ has been reactivated as a logistic hub for criminal organizations.

### **Model Cities in Honduras**

The Zones for Employment and Economic Development (ZEDEs) in Honduras,<sup>23</sup> or Model Cities, show a new challenge in the quest to promote economic development without increasing illicit trade.

This alternative to the Free Zones, in the process of being implemented in Honduras, will seek to carry out and achieve a governmental administrative model that aims to establish several "model cities", a term whose colloquial use describes an administrative system where designated areas within a given country have a high level of autonomy in terms of their own political system, both legal and economic. The model cities project in Honduras is the first pilot on a global scale to transfer an abstract economic

<sup>16</sup> "Commercial Free Trade Zones Act", Government of Belize, 2000.

<sup>17</sup> "Belize, narco's paradise", Excelsior, 2014.

<sup>18</sup> "International Narcotics Control Strategy Report", U.S. Department of State, 2015.

<sup>19</sup> "The millions that circulate in the country for contraband", Prensa Libre, 2016.

<sup>20</sup> "General Information", Aruba Free Trade Zone, 2014

<sup>21</sup> "The routes through which contraband is 'bleeding' the industry", El Pais, 2014

<sup>22</sup> *Ibid.*

<sup>23</sup> "La Gaceta, Ley Orgánica de las Zonas de Empleo y Desarrollo Económico", 2013

concept, a practical initiative to attract foreign investment and promote the production of goods and expand the range of services in established areas of the country. Prepared by the economist Paul Romer, current Vice President of the World Bank, the theoretical concept was taken as the fundamental basis to be part of a long legal and legislative process in order to approve the organic law of the Zones for Employment and Economic Development (ZEDEs) in the year 2013.

After acquiring national and international traction, the ZEDEs model was finally approved in that year and it has the financing of private investors to establish, among other areas, special investment zones, areas linked to particular legal systems and a mixed model close to that of the free zones. In this context, it should be noted that the ZEDEs are not exactly synonymous with the free zones because, thanks to the administrative autonomy enjoyed by the ZEDEs, they have independent and own legal personality unlike the free zones. However, it can be seen that with this model, the idea behind the ZEDEs is to facilitate their integration into the corresponding city or municipal area that "sponsors" them. In this way, the various ZEDEs in Honduras have a support of USD 20 million from the Inter-American Development Bank in order to assign and delineate the respective zones within the country. In parallel, future ZEDEs may be created with the aim of developing international logistics centers, international commercial courts, and special investment districts that share similarities with the current model of the free zones in force.

In order to achieve and maximise this economic and political ambition, the organic law that describes the functions and conditions of the ZEDEs, assigns for its administration a Committee for the Adoption of Best Practices (CAMP) composed of 21 people, of which seven are foreigners. In its mandate, the functions assigned to the CAMP include the approval of the internal regulations for each ZEDE, the proposal of lists with candidates to occupy political positions as judges or magistrates and the appointment of the Technical Secretary for each ZEDE. According to Article 12 of the Law, the Technical Secretary is the highest level executive officer and at the same time the legal representative of their respective ZEDE.

Despite the dynamic and expeditious development of this project, several international media report that the model as a whole does not expressly come without problems and controversies<sup>24</sup>. During the judicial approval process, the law was rejected several times by the Supreme Court of Honduras, leading the four judges who rejected it to be replaced. In turn, the ambitious ZEDE system does not

seem to take into account the endemic problem of Central American gangs who could diversify their illegal activities within the ZEDEs and take advantage of their experimental judicial systems. According to a report conducted by *The Economist*<sup>25</sup> in 2017, with its arbitrary legal and police system, ZEDEs can foment corruption and money laundering. Likewise, a report carried out by the North American Think-Tank known as *The Carnegie Endowment*<sup>26</sup>, identifies a problem of great importance in the area, mentioning Honduras as "an emblematic country among those where corruption is an accepted and operative system formed by governmental networks."

## VII. Free Trade Zones in Panama under the microscope

The Free Trade Zones in Panama, during the last years, have been under the microscope of both national and international authorities. The weaknesses that appear in terms of their internal regulations and the lack of appropriate controls transform them into the ideal environment for the illicit trade of all kinds of products such as being; liquors, solar batteries, sportswear, perfumes, footwear, electronic items, cigarettes, etc. Money laundering is facilitated through the illicit trade in these products, which in some cases allows the financing of terrorism.

According to statistics from the National Customs Authority in 2016, more than 1 million counterfeit items were seized for an estimated value of 21 million dollars<sup>27</sup>.

PRODUCT CATEGORY	DECOMISSATED AMOUNT
Cell phone accessories	284,373
Personal care items	222,273
Footwear	211,470
Toys	118,409
Library items	83,168
Party items	57,072
Leather goods	5,050
Watches	4,902
Electronics articles	4,694
Jewelry	4,425
Household items	3,260
Textiles	849
Perfumery and Cosmetics	480
<b>TOTAL</b>	<b>1,000,425</b>

The statistical information confirms that China is the country of origin of all counterfeit goods that have been confiscated in 2016. 61% of the seizures were sent in transit, with final destination to other countries in Latin America. Additionally, it is confirmed that 28% of seizures were made in ports established in the city of Colón, evidencing that the confiscated products were mostly sent to companies in the Free Trade Zone.<sup>28</sup>

The empirical evidence from the National Customs Authority demonstrates on the one hand the new strategy of the Authority whose objective is to maintain a frontal

<sup>24</sup> "There are no peasants here", Foreign Policy, 2015  
<sup>25</sup> "Honduras, model cities rejected", New York Times, 2012  
<sup>26</sup> "Tropical mini-Utopias", The Economist, 2017

<sup>26</sup> *Ibid.*  
<sup>27</sup> "Seizures Statistics", National Customs Authority, 2016  
<sup>28</sup> *Ibid.*



fight against smuggling, tax evasion and trademark piracy in our country, which indiscriminately affects national economy and people health and, on the other hand, the confirmation that the largest illegal traffic passes the Colon Free Trade Zone and when it leaves the Panamanian territory it does so through the Pases Section and the CAB 2 (Abel Bravo), these being the departures with greater incidents, followed by the door of Corridor 1 and the Container Gate of France Field <sup>29</sup>.

It is sufficient to review weekly Panamanian and regional news websites to corroborate the permanent seizures that demonstrate a reality neglected by our governments.

### **Illicit trade as a barrier to trade**

Illicit trade from free trade zones in Panama is also configured as technical barriers to trade. In June 2013, Panama requested consultations with Colombia regarding the imposition by this country of the tariff on textile, clothing and footwear products from the Colon Free Trade Zone. In its response to the World Trade Organization, Colombia argued that illicit trade was not covered by the obligations of the General Agreement on Tariffs and Trade (GATT) and that imports at prices outside the market should be considered illegal trade. However, the ruling of the World Trade Organization determined that the tariff imposed by Colombia on textile and footwear imports from the Colon Free Trade Zone is not compatible with the GATT. After an unsuccessful appeal, the Colombian government was forced to suspend the mixed tariff in November 2016. However, it decided to approve two decrees that tighten customs controls and make it more difficult to import footwear and textiles from the Colon Free Trade Zone.

The case highlights the clear need for the intervention of the World Trade Organization not only for the resolution of disputes, which is evidenced in its actions, but also in its absent figure as an international body of protection against illicit trade. The case in turn shows the thin line between the facilitation of trade and illicit trade, in this case "technical" originating from a Free Trade Zone.

### **Vulnerabilities**

The weaknesses of the Colon Free Trade Zone, in terms of illegal trade and money laundering have been identified by international and national authorities so it receives periodic checks from the Intendancy of Supervision and Regulation of Non-Financial Subjects of the Ministry of Economy and Finance. The strategic geographic location of Panama; its dollarized economy; its status as a financial, trade and regional logistics center and inconsistencies in the regulatory system make it an attractive target for money laundering. After the scandals of Panama Papers and the Waked group, European countries and the United States have imposed greater

demands on nations such as Panama, in such a way that transparency and honesty in the handling of international business operations are fulfilled.

Between 2015 and 2017, the Board of Directors of the Intendancy of Supervision and Regulation of Non-Financial Subjects, issued a total of fourteen resolutions, addressed to the different Non-Financial Obligors, which are specified in Law no. 23 of 27 April 2015, in order to guide them in the proper interpretation and application of the aforementioned law and its regulations.

Among these subjects are the companies established in the Colon Free Zone, Panama Pacifico, Zona Franca de Barú and Free Zones among others.

Resolution No. JD-002-015 of 14 August 2015, issued by the Board of Directors of the Intendancy of Non-Financial Obligors, is an advance to attack the vulnerabilities of the Colon Free Zone in the area of illegal trade and the consequent laundering of assets that this entails, by imposing guidelines regarding standards of due diligence, know your client, sanctions, etc.

However, this administrative decision gives the companies established in the Colon Free Zone and Free Trade Zones, the power to issue reports of suspicious transactions, which means that such commercial transactions used for illicit trade activities simply elude that report and with this, the due supervision of the body.

That is why it is imperative that a third and impartial entity complements the activity carried out by the Intendancy, being able to act *ex officio*, that is, perform discretionary inspections, grant licenses to companies that trade with certain goods identified by FATF as those with a greater inherent risk for money laundering operations, financing of terrorism and financing of the proliferation of weapons of mass destruction, act at its discretion on said obligations, and if applicable, apply the appropriate sanctions. This should be an autonomous body within the orbit of the Ministry of Finance, Customs or the Free Zone Administration.

Consequently, the progress in the regulation of Free Trade Zones in Panama must continue to achieve a true scope to combat illicit trade and money laundering and the financing of terrorism, because otherwise there would be a false assurance that regulation is already in place, that it is finalised, and this poses an even greater risk than the lack of any type of regulatory norm in this respect.

## **Case Study 2: Free Trade Zone in Albrook**

<sup>29</sup> "In a single day, Customs makes 38 operations in the Colon Free Trade Zone", National Customs Authority, 2015

In January 2012, a company of Asian investors began producing cigarettes in the Albrook Free Trade Zone in Panama. The Ministry of Commerce and Industry granted it a commercial license, which authorized the production of cigarettes exclusively for export.

The company produced cigarettes for different business partners located in other Free Trade Zones of the region, such as Maicao in Colombia, Corozal in Belize, Houston in the USA and Nicaragua. From there, the cigarettes entered illegally in Mexico, Colombia, Costa Rica, Guatemala, El Salvador, Honduras and Nicaragua. The company's products were also confiscated innumerable times in the Panamanian market, violating their obligations according to the license granted. The estimated production of this company amounted to almost 3 billion cigarettes per year representing a tax evasion in Costa Rica, Guatemala and El Salvador of approximately 40 million dollars.

Several journalistic articles have been published in Central American countries, identifying the company as the center of production of contraband cigarettes for the entire region, relating it to organized crime and drug trafficking<sup>30</sup>.

Since the beginning of 2015, the governments of Guatemala, Costa Rica and El Salvador filed formal complaints with the National Customs Authority and the Ministry of Health, relying on the growing smuggling of cigarettes from the brands of this company.<sup>31</sup>

In August 2015, the National Customs Authority and the Ministry of Health raided the company temporarily closing it based on the investigation and audit generated by Guatemala's formal complaint.

Then, and as a result of the violation of different provisions, on 4 April 2016, through Resolution No. 120, the National Customs Authority ordered the cancellation of access to the Official Customs Computer System, and all the keys that have been granted to persons related to that company, as an external user of the Integrated Customs Management System (SIGA)<sup>32</sup>. At present, the company is currently unable to perform import and export operations of raw materials.

The factory is temporarily closed and the cancellation of its license is expected by the National Commission of Free Trade Zones of the Ministry of Commerce and Industries.

## VIII. Weaknesses of the Panamanian Free Trade Zones

<sup>30</sup> Narcos allied with cigar smuggling mafias, Diario Extra Costa Rica, 2015

<sup>31</sup> "Illegal cigarettes, favorites in Panama", La Estrella de Panamá, 2015

Unfortunately, the Panamanian Free Trade Zones have similar weaknesses to those that have been identified in other Free Trade Zones around the world.

**Lack of transparency of the activities:** consequence of the absence of an pioneering and proactive regulatory framework against the dynamic advance of illicit trade that benefits from insufficient due diligence, poor control of supply chains, facilities for the establishment of companies ghosts, vulnerability to money laundering, etc.

**Intermittent controls:** because of the eternal dispute between control and trade facilitation, which hamper the daily verification of the National Customs Authority on the activities that take place inside the Free Trade Zones, often translating into obstacles to the entry of the authority in the zones.

**Lack of resources and deficiency in the training of human resources:** Given the significant commercial activity that is generated within the Free Trade Zones, the current human resources allocation is insufficient, even to perform the brief controls that the National Customs Authority is allowed. Additionally, the training of existing human resources is deficient in view of the dynamism in the modalities of illicit trade in different products.

**The environment and the economic groups:** The resounding fall of the commercial activity of the Free Trade Zones in Panama<sup>33</sup> combined with the economic interests of the business groups generated by them, sometimes make it impossible to advance regulatory frameworks, such as resolution JD-002 015, to establish standards that allow to increase the controls and the transparency of the activities within the zones.

## IX. Current International Regulatory Framework on Free Trade Zones and Illicit Trade

The international regulatory framework on controls within the Free Trade Zones for combating illicit trade is extensive but ambiguous. There is no unified criterion throughout the treaties and conventions that address the issue, which results in contradictions that hinder the adoption of measures tending to increase the transparency of operations within Free Trade Zones. The following analysis identifies some of the international instruments that could serve as a basis for introducing recommendations at the national level to counteract the abuse of Free Trade Zones by criminal organizations.

### a) Revised Kyoto Convention of the World Customs Organization

The Revised Kyoto Convention is the main agreement for the facilitation of the customs trade. It was developed by the World Customs Organization and came into force on 3 February 2006. It is a revision and update of the

<sup>32</sup> Resolution 120, National Customs Authority, 2016

<sup>33</sup> "Activity of the Colon Free Trade Zone fell by 24%", La Prensa, 2016

International Convention on the Simplification and Harmonization of Customs Procedures (Kyoto Convention) that was adopted in 1973-1974. The main objective of this multilateral agreement is to help Contracting Parties achieve a modern customs administration, improve facilitation and control, as well as provide a simpler, more harmonized and flexible approach to achieve a balance between trade facilitation, controls Customs and tax collection. There are currently 110 countries that have ratified the agreement.

#### **Specific Annex D: Customs Warehouses and Free Trade Zones**

Chapter 2 of Specific Annex D refers to the role of Customs in Free Trade Zones and describes the guidelines in relation to the establishment, management and control of Free Trade Zones, the admission of goods, authorized operations, the duration of the stay, the assignments and the withdrawal and evaluation of the goods. Within this chapter, there are two relevant points that are worth highlighting in view of the objective of this study:

First, Standard 4, which states that customs must have an unlimited right to enter and observe operations in Free Trade Zones.<sup>34</sup>

*Second*, recommended practice 6<sup>35</sup> on the admission of goods reinforces the importance of the protection of intellectual property rights, denying access to Free Trade Zones of counterfeit goods.

While the Revised Kyoto Convention contains excellent models for Free Trade Zones, its impact is limited by the few signatories that have adhered to Specific Annex D without reservations. And even in those cases, the effectiveness of the provisions will depend fundamentally on their adoption in stricter laws in each country due to the fact that CKR does not include any dispute or punitive actions for non-compliance.

Unfortunately, Panama is one of the many countries that has not yet agreed to this agreement and although there is a certain regulatory framework at the national level that sponsors these standards, it is worrisome that our country does not adhere to an international treaty that contains excellent models to propitiate transparency and the necessary balance between trade facilitation and customs controls.

#### **b) Protocol for the Elimination of Illicit Trade in Tobacco Products of the World Health Organization**

The Protocol for the Elimination of Illicit Trade in Tobacco Products of the World Health Organization is based on Article 15 of the Framework Convention on Tobacco Control and was developed in response to the growing illegal trade in products of tobacco, which poses a

serious threat to public health, generates large losses to the income of governments and, at the same time, contributes to the financing of international criminal activities. The Protocol was negotiated for several years and was adopted in November 2012. Any Party to the WHO FCTC may be a Party to the Protocol. Although the Protocol is an instrument exclusively oriented to combat illicit trade in tobacco products, its analysis is of special interest given the implications it will have on the control of Free Trade Zones.

#### **Article 12 of the Protocol: Free Trade Zones and International Transit**

The negotiators of the parties to the WHO FCTC decided to include in the Protocol an exclusive article to attack the problem, based on the broad consensus that exists on the role of Free Trade Zones as facilitators of illicit trade in tobacco products. In compliance with this article, the Parties shall implement controls on the manufacture and transactions of tobacco and tobacco products that develop within the Free Trade Zones. Article 12 includes, in turn, a prohibition to mix tobacco products with other types of products in the same container. The Parties should also take measures to ensure that international transit and transshipment comply with the provisions of the Protocol.

#### **The implementation**

Article 12 establishes the principles that the parties must follow for the implementation of controls in Free Trade Zones, however and unlike the Revised Kyoto Convention, the Protocol does not offer practices or standards that suggest to the parties how to carry out said implementation. It is estimated that these recommendations will be the result of the first Meeting of the Parties to be held in October 2018.

At this meeting, the parties will have the opportunity to combine existing multilateral treaties to preserve the health of citizens, promote transparency in the transactions of operators of Free Trade Zones with tobacco products, facilitate trade, protect tax revenues and promote the coordination between customs and Free Trade Zone administrations to avoid abuse by criminal organizations.

To preserve these objectives, the parties should recommend principles already incorporated in the Protocol, such as:

1. **Customs control and supervision:** allowing national customs to freely access Free Trade Zones to control and supervise the daily activities that take place there.
2. **Licensing system:** In line with Article 6 of the Protocol, establish a licensing system for the manufacture, import, export, shipment of tobacco products, raw materials for the production of tobacco products and any other key input necessary for the production of products tobacco.

<sup>34</sup> "International Convention on the Simplification and Harmonization of Customs Procedures - Specific Annex D: Customs Warehouses and Free Trade Zones" World Customs Organization, 1999

<sup>35</sup> Ibid.

3. **Due Diligence:** In line with Article 7 of the Protocol, conduct due diligence before the beginning and during the course of a commercial relationship with Free Trade Zone operators and their supply chain of tobacco, tobacco products and any other key input necessary for production of tobacco products, including: manufacturers, brokers, importers, exporters, freight forwarders, suppliers and customers.
4. **Compliance with labeling requirements:** in line with Article 11 of the WHO FCTC, Requiring that all manufactured tobacco products, repackaged or transshipped in Free Trade Zones, comply with the labeling requirements demanded by the health authorities of the countries of final destination.
5. **Track and Trace Systems (T&T):** In line with Article 8 of the Protocol, establish a T&T system for tobacco products, within the free trade zones, based on open standards that allow technological compatibility across the different jurisdictions that are impacted by the flow of tobacco products. tobacco from these areas.
6. **Sanctions:** in line with Article 16 of the Protocol, Clearly define illegal conducts for non-compliance to impose appropriate sanctions according to national legislation.

In a study published by the CID Gallup consultancy in 2016<sup>36</sup>, cigarette smuggling levels in Panama amount to 67%. This means that 7 out of 10 cigarettes sold in Panama are illegal and as a consequence, the State loses more than USD 57 million in taxes annually. This figure put into perspective represents the total annual budget of the National Customs Authority plus an additional USD 8 million<sup>37</sup>. Given this situation, its global position at a logistic level and as the owner of one of the most important Free Trade Zones in the world, Panama is expected to take a leading role in these negotiations.

The Protocol is still a young international treaty but it has the potential to become an exemplary model for combating illicit trade for other products. The success of this treaty is now in the hands of its parties, who must guarantee an implementation that ensures strong control measures to reduce the high levels of illegality without transferring the problem to jurisdictions not adhering to the Protocol and aspiring to a global scope that encompasses the largest number of countries in the world.

### c) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)

The TRIPS Agreement does not provide for special provisions for Free Trade Zones, and as a consequence of the differentiated treatment that Free Trade Zones have at the level of customs control, some countries have erroneously interpreted the Free Trade Zones regime as if

they were outside the customs jurisdiction for non-tariff cases. As a consequence, the Free Trade Zones of these countries do not fully comply with the TRIPS requirements and therefore do not exercise the necessary control, leaving in many cases the homeowners of brands at the mercy of counterfeiters.

With a better interpretation that includes the Free Trade Zones, the members of the World Trade Organization could apply the TRIPS requirements within the zones. This interpretation is consistent with the treatment of Free Trade Zones in other WTO agreements that refer to Free Trade Zones, such as the Agreement on Subsidies and Countervailing Measures of the WTO.

The TRIPS Agreement contains a series of provisions that, if applied within Free Trade Zones, would allow WTO members to take action against infringing goods by imposing criminal sanctions against deliberate counterfeiting and piracy on a commercial scale. In addition, since counterfeit goods are exported, a government could seize the assets immediately after they move from the Free Trade Zone.

### d) SAFE Framework of Standards

First adopted in 2005, the WCO Framework of Standards to Secure and Facilitate Global Trade (SAFE) was updated in June 2012. The purpose of SAFE is to promote the movement of recognized secure trade, prevent terrorist attacks on trade, and prevent abuse of trade to promote terrorism.

Although SAFE does not specifically mention free trade zones, there are two important concepts that could be extrapolated and implemented in Free Trade Zone operators. On the one hand, the concept of Customs-Enterprise cooperation is defined, in which companies self-regulate to comply with the rules and obtain recognition by national customs as Authorized Economic Operators (AEO), a state that has significant implications for exporters and, on the other hand, the Customs-Customs cooperation in which customs administrations cooperate, for example, extending mutual recognition to each other's AEOs.

The WCO SAFE may be the most effective international instrument for honest businesses and Customs administrations to correct the misapplication of Free Trade Zones. For example, Customs administrations would not recognize as an AEO a company in a Free Trade Zone where Customs is not permitted to enter the zone to validate AEO requirements. In addition, national Customs should consider the risks of mutual recognition for a potential partner country, where FTZs and the free-zone regime are not properly controlled by Customs.

### e) Anti-Counterfeiting Commercial Agreement (ACTA)

ACTA makes several important contributions to address trade in counterfeit goods in FTZs. Unlike TRIPS, ACTA specifically includes Free Trade Zones within its scope defining "territory" as "the customs territory and all Free

<sup>36</sup> "From ant contraband to an elephant in the market", CID GALLUP, 2016

<sup>37</sup> "Law 358 of 2016 - General Budget of the State for the Fiscal Effect of 2017". National Assembly, 2016

Trade Zones of a party" in its Agreement. In addition, ACTA explicitly addresses border measures applicable to transit and transshipment. It retains the TRIPS approach of allowing Customs officials to undertake procedures with respect to suspect goods. The agreement permits parties to adopt such measures voluntarily. Several ACTA provisions could serve as models for countries that wish to move beyond the TRIPS baseline and prevent the proliferation of counterfeit goods.

#### f) United Nations Convention Against Corruption

Although the agreement is a specialized instrument, we can indicate that the main objectives are:

- a) Adopt measures to more effectively and efficiently prevent and combat corruption, as well as strengthen existing standards.
- b) Encourage international cooperation and technical assistance in the prevention and fight against corruption.

### X. Recommendations for Improvements

International agreements, comparative legislation, the experience of holders of intellectual property rights and international best practices provide a wide range of alternatives to combat the abuse of Free Trade Zones as facilitators for illegal trade.

**Self-regulation** in favor of transparency is today a differentiating value for investors in Free Trade Zones. In line with these requirements that the business sector begins to demand, the Zonal administrations themselves should promote internal guidelines to prevent piracy, counterfeiting and smuggling through licensing regimes associated with due diligence procedures and in combination with a system of penalties for non-compliance. Additionally, Free Trade Zone administrations should encourage the entry of Customs to control operations and compliance with tariff and non-tariff requirements. In turn, it would be advisable to promote the exchange of data with automated systems of the national customs to facilitate the validation of the state of goods.

Second, national governments should grant **ex officio powers to Customs** to control and seize merchandise within Free Trade Zones that may be suspected of piracy, forgery or contraband. It is essential that national governments validate the jurisdiction that Customs have to enter and observe the daily operations of Free Trade Zones allowing them to audit the books and records of companies in the area, validate the status of goods and compliance with the measures tariff and non-tariff under the national mandate. In addition, national governments should promote cooperation between Customs and the Free Trade Zone Administration authorities in order to ensure the effective application of criminal and civil laws against counterfeiting, piracy and contraband while regulating the crimes mentioned above with more dissuasive sanctions. In addition, national governments should promote training programs for customs officials

- c) Promote integrity, the obligation to render accounts and the proper management of public affairs and goods.

In the same order of ideas we are of the opinion that there is legislation included in the agreement that could also, together with other measures, contribute to the fight against illicit trade. Some of the modalities by which illicit trade violates the controls in the Free Trade Zones, is through the bribery of authorities and the unjustified enrichment, illegal acts that are described among the types of crime that the States must include in its internal regulations. In this regard, the Convention recognizes that an efficient and transparent public function is the basis of good governance. Likewise, it indicates that in order to avoid the harmful effects of corruption, it is essential that its rules are also applicable to the private sector and that society be involved in the design and implementation of strategies in this area.

to specialize in Free Trade Zone regimes, equipping them with the necessary tools to combat the scourges linked to the abuse of Free Trade Zones.

Third, **international organizations must play a more prominent role** in order to establish clear and unambiguous criteria and standards that allow their parties to adapt at the national level. The revision of the international regulatory framework, described in the previous section of this paper, shows clear flaws in this regard.

In the case of the *World Trade Organization*, it is alarming that who should be one of the leading agencies in the fight against illicit trade and the main preacher of transparency in the Free Trade Zones, does not include these issues as part of its work agendas. At the disposal of this body is the immediate possibility to clarify the jurisdiction of the Agreements on the Aspects of Intellectual Property Rights related to Trade (TRIPS) and its application on Free Trade Zones, forcing its parties to comply with its provisions within and out of them. As an additional measure, it is very important to reestablish the working group on compliance with this agreement in order to study the rapid expansion of Free Trade Zones, and their abuses, which have allowed criminal organizations to exploit the gaps of jurisdictional authority and evade the routine application.

On the other hand, the *World Customs Organization* should promote with greater emphasis the importance of the obligations established by the Revised Kyoto Convention, especially its Annex D, with the objective of achieving at least the adoption and implementation by those countries that have Free Trade Zones with a high degree of vulnerability to illicit trade. The extension of the status of Authorized Economic Operator (AEO) under the framework of SAFE to operators in Free Trade Zones, could be a viable alternative for Customs

to have a mandate to recognize companies that use best practices and prevent different modalities of illicit trade that take place in the Free Trade Zones. Additionally, the World Customs Organization should promote standards for routine observations by Customs officials that tend to be less intrusive than raids and would facilitate the work without sudden interruptions of legitimate businesses. Cooperation and exchange of information and best practices among all the actors involved is of vital importance, however there is no platform as such in the case of Free Trade Zones, a task that would be advisable for the World Customs Organization to lead and implement.

Another international body that comes into play on discussions to increase transparency in Free Trade Zones is the *World Health Organization*, with the potential entry into force of the Protocol for the Elimination of Illicit Trade in Tobacco Products. In the hands of the parties to this young treaty, the challenge lies in promoting guidelines to control the illicit trade in tobacco products. The exercise could be an excellent pilot test to replicate in other industries.

Condition sine-qua-non will of course be the **mutual cooperation** between these international organizations, national governments and Free Trade Zone administrations, to achieve positions aligned to the global and particular objectives that each of these organizations seeks to protect.

### Conclusions

The empirical data presented in this study show that Free Trade Zones are fundamental for an integrated global economy. They stimulate economic growth and play a central role in business for many leading countries and manufacturers.

The relevance of Free Trade Zones continues to grow as globalization defines economic progress. However, the evidence presented also shows that the rules, supervision and regulations that govern them have not kept pace with these advances, transforming the Free Trade Zones into areas highly vulnerable to encourage illegal trade, money laundering, organized crime and the financing of terrorism.

*At the international level*, the unification of criteria is essential given the large number of agreements, conventions and treaties that address the issue of Free Trade Zones in a different way. For this to be possible, the World Trade Organization and the World Customs Organization must work hand in hand to facilitate an international regulatory framework that allows for the necessary control without threatening trade facilitation within Free Trade Zones.

*At the local level*, governments should concentrate their efforts on establishing guidelines that allow for the redefinition of internal regulations within the Free Trade Zones to facilitate effective controls and increase transparency in Free Trade Zone operations through licensing and due diligence regimes.

*The education and awareness* of the authorities responsible for oversight and control, through training programs on the abuse of Free Trade Zones is an enriching element that should be a foundational pillar in the vision of local governments at the time of cleaning up the Free Trade Zones.

Finally and as a central axis, *cooperation* between the competent authorities at national and international level with the private sector must be taken into consideration in order to comprehensively tackle this issue. The exchange of information is a key element to better identify illicit activities that are perpetuated in the Free Trade Zones and in turn the identification of best practices that can be replicated in other jurisdictions.

Many Free Trade Zones in the world are beginning to move towards a business model based on sustainability and ethics as differentiating principles. While it is true that this reality is not yet tangible, the competitiveness of Free Zones in the future will be framed under these principles as an engine to attract more investment. Free Trade Zones in Panama have the potential to adapt to a sustainable transparency model and thus achieve greater competitiveness. Transforming the potential into reality is in the hands of the authorities.

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