WORLD FREE ZONES ORGANIZATION

World Free Zones Organization
Safe Zone Certification Program

SAFE ZONE

White paper

Abstract

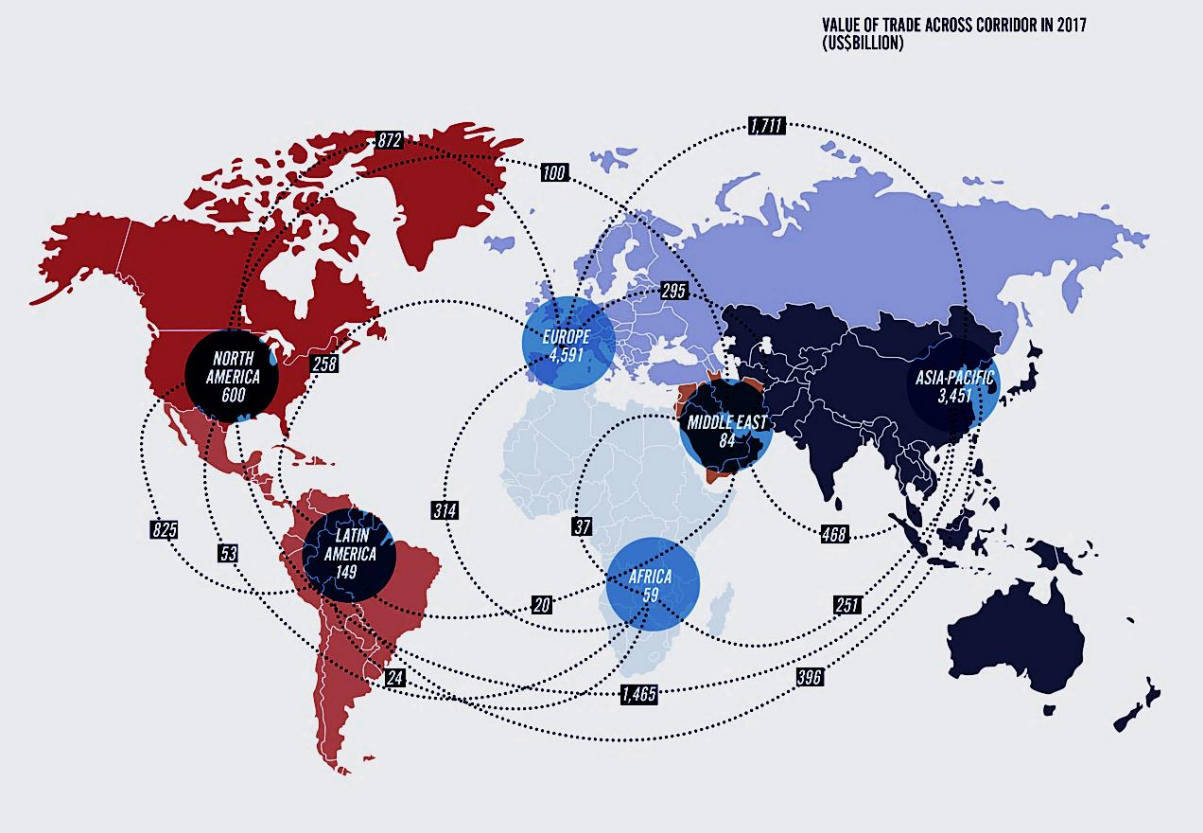
- Illicit trade is an unfortunate byproduct of global trade flows, accounting for 3.3% of global trade[1]. Counterfeit and pirated goods are shipped via complex routes that involve many stops in places where relabeling, repackaging, or even falsifying paperwork can take place.
- Governments use free zones as special economic enclaves to offer businesses a combination of modern and agile regulation, generous fiscal incentives and simplified customs formalities to attract investors. There are over 5,000 free zones in the world today, employing over 70 million people and supporting 23% of global trade[2]. Though successful in many ways, they can also attract criminally-minded players like any business enterprise.
- The World Customs Organization (WCO) introduced the SAFE Framework for Standards in 2005 to fight illicit trade. In 2019, the Organization for Economic Cooperation and Development (OECD) rolled out a Code of Conduct for Clean Free Trade Zones[3]. Based on this, a global standard certification would enable the right free zones to claim their clean trade credentials.

[1] *Mapping the impact of illicit trade on SGs*, TRACIT, July 2019
[2] OECD statistics 2018
[3] https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0454

- The World Free Zones Organization (World FZO) was launched in 2014 to become the voice of free zones worldwide. It has designed the Safe Zone Certification program, in line with the WCO's SAFE Framework and strictly adhering to the OECD's Code of Conduct, to enable such serious free zones to demonstrate their compliant business practices with a new global compliance standard.
- The program has two main stages – first, an application and independent online assessment, then a site inspection of Safe Zone qualifying elements by internationally recognized third-party validators. The result of this process leads to either **Prospect** status, where free zones fall short of the certification criteria but are given a roadmap to correct any deficiencies over a 12 month period before re-inspection; or **Platinum** status, where free zones are confirmed as Safe Zone compliant.
- The World FZO has successfully implemented a pilot program to certify 5 free zones on 3 continents, with the full program rollout due to launch in July 2020.
- Using their Safe Zone compliance record, Platinum certified free zones can apply to their national Customs administration (through the World Customs Organization) for Authorized Economic Operator status to achieve even more recognition and credibility in the international commerce landscape.

Illicit Trade, Global Trade Flows, and Free Zones

Illicit trade is an unfortunate byproduct of global trade flows. By some accounts, it can represent as much as 15% of global GDP and 3.3% of global trade, or over U$509billion[4]. Though narcotics, weapons and contraband are criminal undertakings commonly associated to such illicit activity, intellectual property rights holders are also detrimentally affected in economies where counterfeit and pirated goods are distributed. While government resources are already heavily focused on the former, counterfeit and pirated goods often receive less attention despite their large impact on the territories where they are sold.

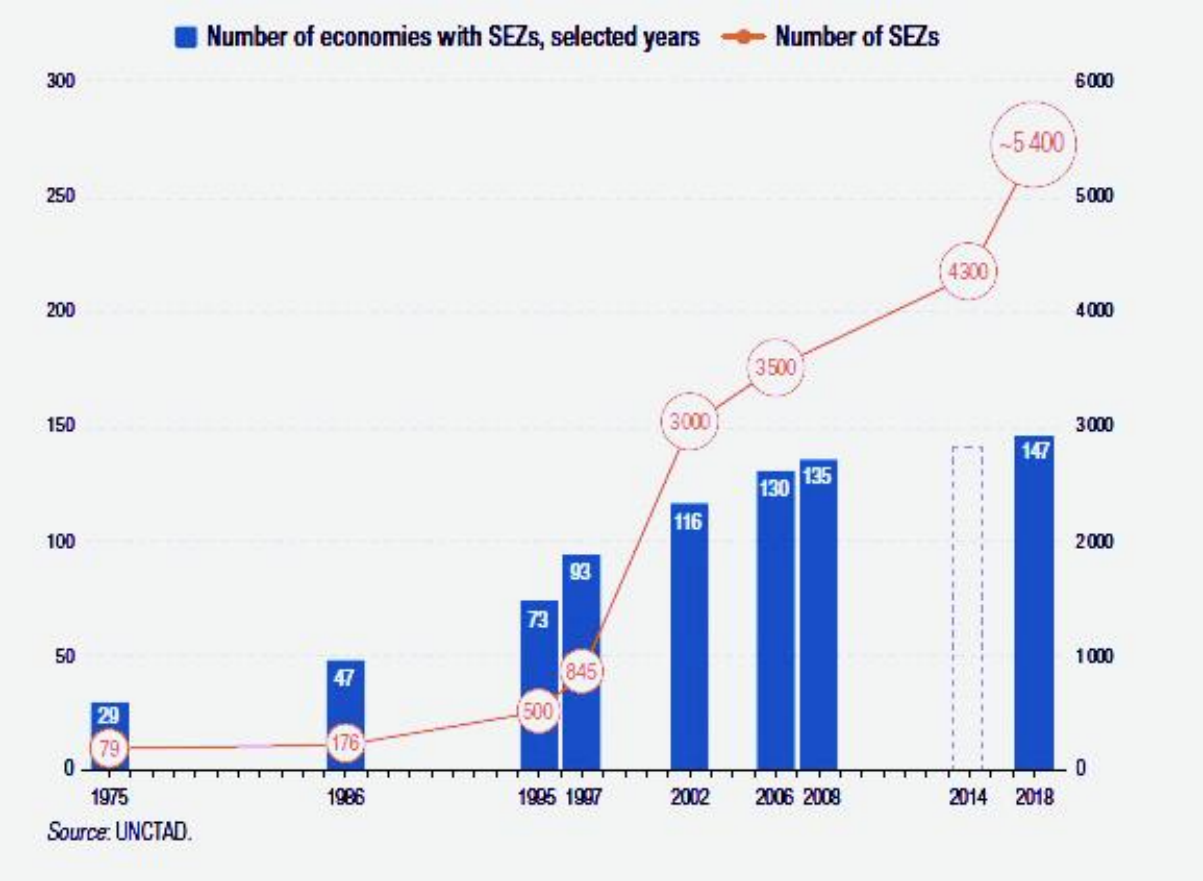


Counterfeit and pirated goods are shipped via complex routes that involve many stops in places where relabeling, repackaging, or even falsifying paperwork associated with such shipments can take place without attracting unwanted attention. Many factors can create circumstances for such illicit activity. Loose regulation, corruption, poor compliance tools, and

[4] *Mapping the impact of illicit trade on SGs*, TRACIT, July 2019

lack of border controls all contribute to spreading illicit trade. However, many other factors can create circumstances attractive to criminal minded individuals.

For several decades now, governments have used free zones to attract foreign direct investment, boost their exports, drive employment and enhance knowledge transfer. Free zones, sometimes called free trade zones, export processing zones or special economic zones, offer businesses a combination of lighter simplified regulation, Single Window (SW) procedures, generous fiscal incentives and simplified customs formalities supported by dedicated infrastructure to attract investors. The aim of free zones is to facilitate trade and economic growth by eliminating tariffs, quotas and other taxes and minimising bureaucratic requirements, including certain customs procedures and disclosure requirements. While free zones can provide a range of advantages to countries that host them and to companies that operate within them, they have also attracted the wrong kind of parties eager to engage in illegal activities.



By some counts, there are over 5,400 zones of different types around the world[5], spread across 147 countries. More than 500 new zones are currently in construction. Almost 70 million people work in free zones around the world, with a large majority of them based in Asia, many more in Africa and the Middle East, followed by Latin and Central America. Europe and North America have used the model more sparingly and with different combinations of incentives compared to emerging economies offering more aggressive packages. 23% of global trade flows through free zones, representing a value of over U$3.5trillion[6]. Free Zones form an integral part of the Global Value Chain that links exporting economies together from production to distribution and to final consumption. Unfortunately, some are also hosts to a large volume of illicit trade.

A recent study showed that an additional free zone opening in an economy is correlated with an average 5.9% increase in the value of counterfeit and pirated exports from that economy[7]. China, Turkey, Singapore and India make up over two-thirds of exported fake goods traded worldwide[4], and also host some of the largest free zones in the world. In fact, the share of fake goods from economies hosting the 20 biggest free zones is twice as big as from economies that do not host any free zones. Free zones have therefore become a target for illicit trade, despite a genuine desire from their hosting governments to fuel the growth of legitimate trade instead.

To protect clean free zones from such criminal activities, a new compliance model is required, designed specifically for these zones.

Global efforts implemented so far

In 2005, the World Customs Organization (WCO) rolled out its SAFE Framework of Standards[8] (SAFE Framework) to bring a connected, system-based set of controls to the entire supply chain. The key angles of the SAFE Framework are the voluntary partnership between Customs and the private sector, and a tight relationship with other border agencies. The SAFE

[5] *World Investment Report 2019*, UNCTAD
[6] OECD statistics 2018
[7] *Trade in Counterfeit Goods and Free Trade Zones*, OECD – EUIPO, 2018b
[8] http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/frameworks-of-standards/safe_package.aspx

Framework has been adopted by 169 countries to date, shaping the foundation for modern Customs practices.

The unique feature of this program is the Authorized Economic Operator (AEO) concept. An AEO defines a party involved in the international movement of goods that has been approved by, or on behalf of, a national Customs administration as complying with WCO or equivalent supply chain security standards. The AEO label can apply to any kind of private operator that meets this definition. More than 70 countries have operational AEO programs in place while another 30 countries are in the process of implementing the instrument. The transparency and reliability of such programs is a key element of clean trade. Its implementaion should be supported and encouraged to spread farther across more countries.

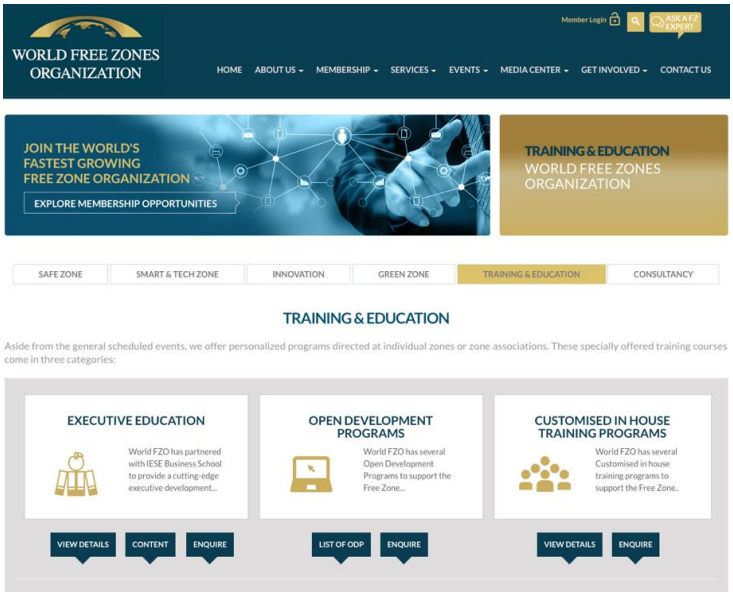
The SAFE Framework has proven to be highly effective at deterring criminal activities across territories. The World Trade Organization (WTO) Trade Facilitation Agreement (TFA), which came into force on February 22nd, 2017, is also built upon compliance management and the use of the AEO model from the SAFE Framework. 141 WTO Members have so far ratified the TFA.

In parallel, the OECD Task Force on Countering Illicit Trade was established in 2015 to address the governance gaps that criminal entrepreneurs successfully navigate to operate across borders. The Task Force meets regularly to focus on different facets of illicit trade, including work on the Recommendation on Enhancing Transparency in Free Trade Zones, that includes a Code of Conduct for Clean Free Trade Zones. This Code was designed in consultation with over 200 stakeholders as the basis for a risk management toolkit to help spread better practices in free zones against illicit trade. It was adopted in 2019 by the OECD Council.

Compiling these pioneering efforts into a specific compliance certification instrument designed for free zones will integrate this framework into the free zone operational model.

The role of the World FZO

In 2014, the World Free Zones Organization[9] (World FZO) was created as a not-for-profit multi-lateral organization to serve as a uniting voice for free zones around the globe. Registered in Switzerland and headquartered in Dubai, the World FZO provides its members with knowledge, networking and support through regular publications, an annual conference and exhibition, and multiple programs to enhance free zone operations worldwide. Its mission in bringing together free zones from all over the world is to promote their positive impacts by providing guidance, intelligence and solutions to its members, and to enhance the contribution of all free zones to the economic prosperity and social development of the host country.





As of June 2020, the World FZO counted over 600 members from more than 130 countries representing tens of thousands of companies. Its annual conference and exhibition regularly hosts over 1,000 free zone stakeholders from around the world who congregate to share best practices and discuss partnership strategies in panel discussions, workshops and networking events. The World FZO has gained observer status with UNCTAD, consultative status with UNIDO, and actively cooperates with ITC and WCO. It has been involved in several OECD meetings that addressed trade issues in free zones. The World FZO also works in

[9] www.worldfzo.org

partnership with the World Trade Organization, the UN Conference on Trade and Development, and several other major multi-lateral organizations to develop tools and solutions for free zones around the world.

The World FZO recently launched its Free Zone of the Future program, anchored by its flagship Izdihar Index – a global initiative for local prosperity. The Program provides tracked indicators, systematic cyclical evaluations and official progress certifications based on best practices, innovation and sustainability within a framework of business excellence and economic contribution to their host country. Its flagship index offers free zones a roadmap and a dashboard of key metrics to optimize their operational performance in key areas including governance, compliance, transparency, sustainability, technology and logistics with a view to becoming a Free Zone of the Future.

The World FZO has built a unique set of data and perspectives on global trade through free zones. This makes it one of the most relevant bodies to solve the problem of integrating free zones into the compliance management system of the global trade community.

In March 2019, the World FZO headed a delegation of 20 free zones to meet with the OECD secretariat. This was followed by another meeting in June 2019 with OECD secretariat. The OECD's Code of Conduct was adopted by the World FZO as an integral part of the compliance instrument required for its free zone members.

All these research projects, in-depth discussions, data gathering exercises, analysis and adoption of important legal international frameworks led to the World FZO's innovative certification program: Safe Zone.

World FZO Safe Zone Certification Program

There are two kinds of models that can mitigate illicit activity. **Compliance models** are voluntary, designed to identify low risk entities and to highlight their integrity and transparency through incentives for compliant behaviour. **Risk management models**, on the other hand, are usually compulsory and designed to target high risk players to bring them back in line. While a combination of both has been found to be most effective, compliance models usually demonstrate a higher endorsement rate and foster better conduct due to their voluntary enrolment.

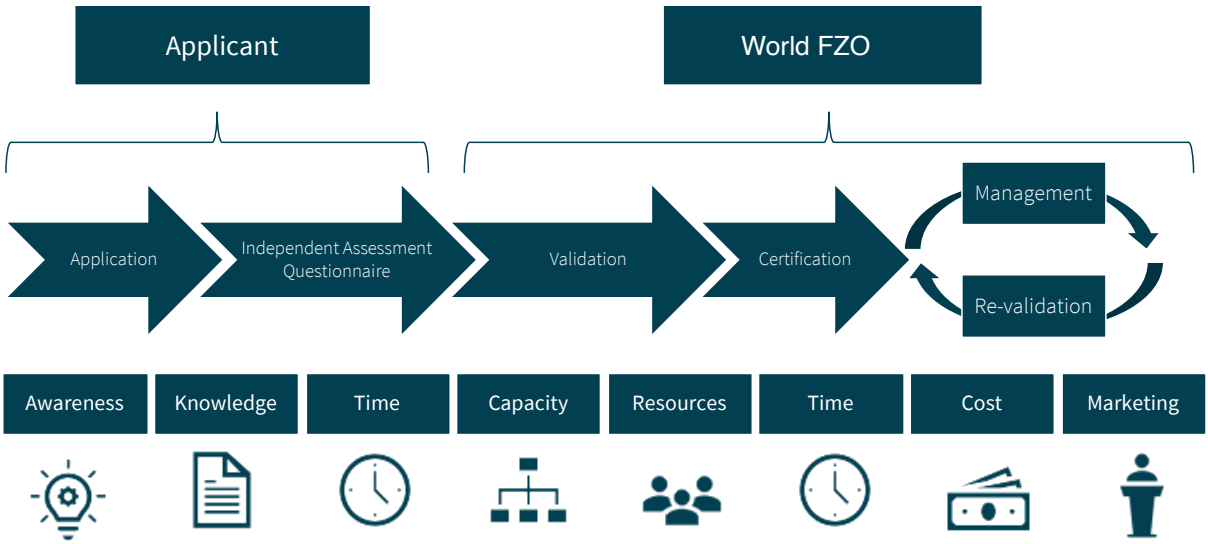


The World FZO has built the Safe Zone Certification Program as a voluntary compliance model to protect clean free zones from illicit activities taking place within their borders and to help them promote their integrity, transparency and clean governance to clients, partners and stakeholders.

The World FZO worked with international partner KGH Global Consulting, a border expert consultancy with over 800 professional specialists working with government and private sector companies around the world. KGH contributed its vast expertise in customs protocols to help design the Safe Zone Certification process for candidate free zones.

The Safe Zone Certification is designed to become a new global compliance standard for free zones. The program incorporates the WCO SAFE Framework AEO concept, the Authorized Operator model of the WTO Trade Facilitation Agreement, and strictly adheres to the OECD TF-CIT Code of Conduct for Clean Free Trade Zones. The certification will single out free zones with a solid commitment to clean trade, marking them out as compliant operators within the Global Value Chain.

Safe Zone certification process



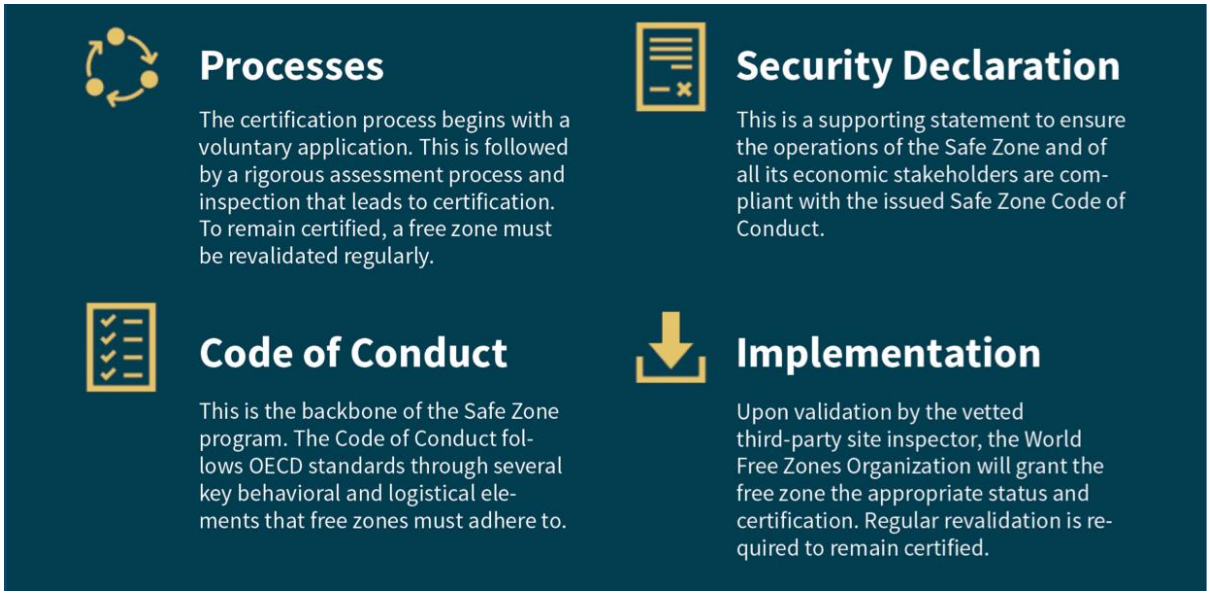
To properly assess whether a free zone has implemented best practices to promote clean trade within its borders, a number of key criteria must be thoroughly assessed.

A free zone seeking Safe Zone certification must first apply online and complete a detailed assessment questionnaire of fifty questions on its operations and business methods, namely:

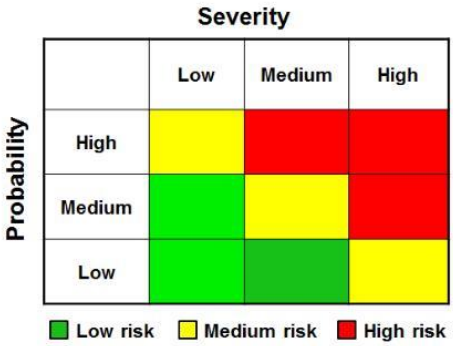
- General information - 11 questions.
- Due Diligence and Risk Hazards (risks and programs) - 3 questions
- Trade Compliance (compliance/ noncompliance) - 7 questions
- Transparency & Code of Conduct (emergency readiness & technology) - 8 questions
- Record keeping (meetings & auditing) - 7 questions.
- Supply chain & security requirements - 12 questions.
- Financial Viability - 2 questions.

The free zone must also provide at least 3 reference letters for professional entities such as a bank, a Tier1 customer, or a national regulatory authority.

Based on successful validation of this questionnaire, the Code of Conduct and Security Declaration are introduced and signed by the applicant. The Code of Conduct outlines the rules and regulations for Safe Zone status. The Security Declaration outlines the relationship between the free zone and its members as well as the relationship between the free zone and the World FZO.



Thereafter, an independent internationally recognized third-party validator (vetted by the World FZO or one of its key partners) will perform a site inspection and risk mapping evaluation to audit the free zone's operations in line with key criteria of the Safe Zone label. Such inspections may, on a case-by-case basis, be performed by an appropriately trained local Customs administration operating in a country with an established AEO program and taking into account any and all AEO Mutual Recognition Agreements (MRA) signed by the country.



The initial goal is to identify risks associated with the applicant's supply chain activities and its safety and security protocols. When the validator has an understanding of a particular free zone's operations, he or she can determine which, and to what degree, identified risks are relevant. Additionally, the validator will be able to develop an opinion on the measures required to cover these risks and make an assessment as to the significance of these risks.

An assessment of the business's risk can be made by using the risk mapping method which prioritizes risks by evaluating the likelihood and their potential impact on the Safe Zone

objectives. Responses to risk utilize one or several of the following strategies, based on the 4Ts:

- *Take* = it is acceptable;
- *Treat* = set up plan to mitigate/decrease risk;
- *Transfer* = set up a mechanism whereby an identified risk can be mitigated; or
- *Terminate* = reject the risk as unacceptable

If any identified risk falls into the latter category, a free zone's application will be rejected, and certification will not be granted. If all identified risks fall into any of the other three categories, two outcomes are possible:

1. <u>The free zone is eligible but does not yet fulfil all Safe Zone criteria</u>

   The free zone is then granted Safe Zone Prospect status and given an activity plan to fill any gaps remaining in its business practices to reach full Safe Zone status. The free zone has a 12month deadline to fulfil all missing criteria
2. <u>The free zone fulfils all Safe Zone criteria</u>

   The free zone is then granted the Safe Zone Platinum Certificate, valid for up to 2 years. Upon expiration of that time, re-validation will be required in order to remain Safe Zone certified.

Beyond Safe Zone Platinum certification, when a compliance record has been established and identified risks are being monitored, free zones can apply for AEO status. This status is for free zones that can comply with the WCO's SAFE Framework AEO standard. Through the Safe Zone program, free zones can build the necessary compliance record and demonstrate the relevant transparency to be candidates to apply for AEO status with the relevant national Customs administration.

As with any compliance management program it is important to have a number of instruments and tools to be able to enforce the mechanisms in the program. The Safe Zone model offers a free zone operator several instruments and tools to monitor and manage their own compliance. As part of this process, control, validation and site inspection are undertaken by Customs, by a Customs authorized body taking into account any and all AEO Mutual Recognition Agreements (MRAs) signed by the country, or by a vetted third party validator.

A personalized digital dashboard, featuring all these instruments and metrics, is accessible by the free zone across multiple platforms and devices via a dedicated Safe Zone app and a dedicated microsite linked to the World FZO website. A unique Safe Zone whistle blower function is installed for all Safe Zones and their tenants to monitor and support continually enhanced integrity, transparency, and safety for all stakeholders.

A key aspect of this program is the internationally recognized third-party vetting that the independent site inspection provides. As a free zone voluntarily submits to inspection, it enhances its transparency and commitment to clean trade, promoting itself as a compliance champion on the global trade landscape.

Pilot program

In June 2019, the World FZO launched the pilot phase of its Safe Zone Certification program. In order to properly assess the impact of the program, pilot candidates were selected to achieve broad geographical coverage and to assemble different operational profiles. The first five free zones involved in this pilot phase are:

- *Le Freeport Luxembourg (Luxembourg)*
- *Bogota Free Zone (Colombia)*
- *Dubai Airport Free Zone DAFZA (United Arab Emirates)*
- *JSC Klaipeda Free Economic Zone Management Company (Lithuania)*
- *El Consorci Zona Franca Barcelona (Catalonia, Spain)*

The pilot phase concluded in February 2020 and was a resounding success. All the free zones involved gave overwhelming positive feedback on the benefits of the certification, both to enhance their internal processes and to attract better prospects from partners and clients.

This pilot phase will now lead to a full rollout of the program after the World FZO's AICE in April 2020.

Benefits of the Safe Zone program

First and foremost, the Safe Zone Certification program will increase the security and safety of all free zones involved. The program provides compliant companies with an effective transparency and integrity solution that adds value to the entire supply chain and international value chains. As a new global compliance procedure for free zones, Safe Zone will raise the bar for best practices and will enable free zones to become better integrated into global supply chains.

An immediate benefit for Platinum certified free zones will be the clean trade label that the certificate confers. This will attract better terms from partners and service providers, better collaboration with local and international customs services, and better attractiveness for companies looking for a free zone to settle in. Specifically, the certification will create rich relationships with local authorities like Customs, police and anti-fraud teams. This will prove useful to help tenants develop similar relationships for their respective businesses.

A connected benefit will be the reduced risk profile of Platinum certified free zones. This will prove very attractive to insurance companies providing protection against fraud and related activities, as their exposure will be reduced. This will benefit both the free zone itself and all its tenants as well. Similarly, investors and bankers will view Platinum certified free zones as more attractive clients due to their reduced risk profile. This will attract liquidity and capital to such free zones in the form of lower bond and insurance premiums and lower interest rates on financing.

The compatibility of the program with established international standards from global entities like the WCO, the WTO and the OECD will enhance business practices for all parties involved. This will further cement the program as a global standard to be adopted and adhered to across the international commerce landscape.

Another key feature of the program is a whistle-blower system that will be accessible via the Safe Zone microsite. This anonymous system will allow anyone to report violations of the OECD Code of Conduct integral to the Safe Zone program in any certified free zone. Such reports will prompt an investigation to verify any departure from agreed terms, ensuring that Safe Zone certification standards are not breached. Any free zone found to be in such breach will be stripped of its certification immediately.

Regular reviews and inspections will further ensure that the Safe Zone certification remains a trusted label of clean trade across the world, helping to protect serious free zones from the detrimental effects of illicit activities and promoting a new global clean trade path for every free zone to embark on.

Conclusion

It has been proven over the last two decades that voluntary compliance management models that use transparent system-based controls are the most efficient solution for all stakeholders involved.

Looking at global value chains in international trade, it has become clear that the best way to promote a clean trade approach amongst and within free zones is to use a unified framework with the rest of the industry.

This is why the World FZO has developed its Safe Zone Certification program based on international standards and best practices defined by leading multi-lateral organizations like the WCO, the WTO and the OECD. Increasing the integrity, transparency and compliance of free zones is an organic responsibility that falls most of all on the free zone community itself. Safe Zone offers compliant free zones a transparent, secure, and credible solution to display clean trade credentials.

With support from international institutions, national agencies, and the international private sector trading community, the Safe Zone Certification program will be a global reference and an important win-win instrument for all stakeholders.