

Freeports: innovative trading hubs or centres for money laundering and tax evasion?

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Abstract

Purpose – This article provides a critical overview of freeports’ trading operations and considers to what extent they may present a money-laundering and tax-evasion risk.

Design/methodology/approach – This study reviews the literature surrounding freeports and offers an up-to-date narrative of their potential money-laundering and tax-evasion activities. The paper relies on secondary data from published sources referencing peer-reviewed articles and ‘grey-literature’ material relating to freeports, offshore finance, and anti-money laundering control.

Findings – This study demonstrates the attractive trading advantages offered by freeports to enable enterprise and innovation. However, the article reveals that the secretive offshore space in which freeports operate also helps to obscure beneficial ownership and illicit trade-based practices that frustrate authorities’ efforts to trace laundered monies and recover government taxes. Despite freeports’ trade offerings, stronger regulation is needed to prevent them being abused for money-laundering and tax-evasion purposes.

Originality/Value – This study provides an important insight into the money-laundering and tax-evasion risks presented by freeports and, in doing so, advances the contemporary debate on illicit activities occurring through offshore jurisdictions.

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3 **Keywords:** freeport; free-trade zone; offshore; money laundering; tax haven; trade.
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7 **Paper type:** Research paper
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10 **1. Introduction**

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13 For many years, there has been an increasing trend for nations to introduce
14 specialised trade zones within its territory free from economic and commercial
15 restraint to invigorate the local economy and maintain fiscal dominance (Hakimian,
16 2011). This strategy has included establishing onshore zones, known as ‘freeports’.
17 Freeports are warehouses located within free-trade zones that lie within a country’s
18 geographical border but are designated by that country’s government to be outside
19 its normal customs regime (Webb, 2020). Freeports are typically located at nationally
20 strategic hubs, such as air, rail, and seaports, to facilitate trade through the country.
21 Freeports and the companies based within these zones enjoy several concessions,
22 like cheaper import duties, suspended custom obligations, and reduced bureaucratic
23 checks intended to streamline cross-border trade (Moiseienko *et al.*, 2020; Webb,
24 2020). Therefore, freeports seem to provide innovative trading advantages over
25 other jurisdictions bound by stricter customs obligations and, thus, offer a more
26 attractive environment through which to conduct business.
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47 However, there is concern that economic concessions and reduced regulatory
48 oversight enjoyed by freeports allows criminals to misuse them for illicit purposes.
49 According to Korver (2018), the art market, which relies on freeports for warehousing
50 its goods, can be obscured through nondisclosure of beneficial ownership of assets
51 transiting through international borders. Such secrecy can hinder authorities’
52 attempts to trace and recover illicit proceeds (Gilmour, 2020). Similarly, self-
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3 declaration practices occurring within freeports lend themselves to fraudulent over-
4 or under-invoicing of goods; thus, enabling trade-based money laundering (Korver,
5 2018). Therefore, the risks associated with freeports must be understood to
6 strengthen anti-money laundering (AML) efforts. Yet, despite freeports' possible
7 benefits for global trade, little research has addressed how freeports might enable
8 money laundering and tax evasion (Lavissière and Rodrigue, 2017).
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10 This article considers freeports' potential to enable money laundering and tax
11 evasion. It highlights several overriding criminal methods that are enabled within
12 freeports' offshore space of regulatory concessions and, therefore, advances the
13 scope in which offshore dealings are judged. This article argues that though
14 freeports present an innovative platform through which successful trade can be
15 enabled and maintained, their misuse for money-laundering and tax-evasion
16 purposes raises justifiable concerns. This article concludes that further government
17 oversight is needed to curb illegal activity through freeport zones.
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19 **2. What are freeports?**

20 The idea of freeports being hubs relatively free of trading regulation has been long
21 established: the first modern economic freeports were established at strategic South-
22 East Asian sea- and airports throughout the late 1960s (Sellick, 2020). Many
23 freeports operate around the world, though, some of the most prominent now
24 specialise in the storage of fine art, such as those in Beijing, Switzerland, and
25 Monaco (Steiner, 2017, p. 356). As Steiner (2017, p. 354) has noted, Switzerland's
26 freeports, home to renowned auction houses, are instrumental to the success of the
27 art market that is now worth \$75 billion globally. However, according to Letzing and
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3 Colchester (2015), freeports were originally conceived as temporary storage spaces
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5 free of taxes while goods were in transit to their onshore destination.
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9 Korver (2018) recognised freeports as tactical depots intended as spaces to
10 temporarily house valuable assets, like artwork, precious metals and gems, wine
11 collections and antiques. However, Weeks (2020, p. 4) has stated that many art
12 dealers now commonly exploit freeports' beneficial goods-in-transit position to house
13 their assets on a more permanent basis. This means, as long as the dealers' goods
14 remain within the freeports' storage facility, those dealers are unaccountable for any
15 duties (such as value-added taxes [VAT] or capital gains taxes) which would
16 normally be applied upon export (Weeks, 2020; see also Schwarzkopf and Backsell,
17 2020, p. 7). It also means those same goods would not be subject to the cross-
18 border scrutiny of authorities as other exported goods would be. For Weeks (2020),
19 the exploitation of freeports in this way enables illicit activity, such as money
20 laundering and tax evasion.
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38 **3. Freeports: indicators of developing global offshore capitalism?**

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41 Recent scholarship has conceptualised freeports as manifestations of offshore
42 capitalism that has evolved throughout an increasingly globalised society (Lavissière
43 and Rodrigue, 2017; Post and Calvão, 2020; Schwarzkopf and Backsell, 2020).
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45 Leyshon and Thrift (1997) argued that an increased mobility of capital across
46 permeable state borders is key to progressive forms of capitalism. They also
47 highlighted two causes of the global proliferation of privately held finance: (1)
48 implementation of flawed fiscal regimes of Western governments that have tried to
49 regulate and control capital; and (2), and the globalisation of monetary supplies and
50 services (Leyshon and Thrift, 1997, p. 74). Post and Calvão (2020, p. 4) argued that
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3 freeports have arisen from the advent of offshore jurisdictions made necessary to
4 spread and accumulate global wealth “no longer tied to colonial or national spaces”.
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8 Ogle (2017, p. 1446) similarly viewed the liberation and deregulation of financial
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10 markets being pivotal to the development of offshore capitalism. It is within such
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12 context that freeports have flourished.
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16 The offshore nature of freeports means that wealthy business clients of luxury art
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18 and other assets held in freeport zones can avoid the restrictive regimes of their
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20 home countries (Weeks, 2020). For example, Weeks (2020, p. 5) explained how
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22 investors managed to avoid restrictions brought in by Germany’s 2016 Act on the
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24 Protection of Cultural Property that limited trade in antique art valued over €300,000.
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27 Consequently, owners of valuable art chose to shift their assets to freeports in
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29 neighbouring Switzerland and Luxembourg before the law was enacted. The
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31 dynamic shifts of global capital strengthened by the flexibility offered by freeports
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33 suggests freeports help to drive a global offshore-capitalist agenda.
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38 However, literature on freeports has also conceptualised the regulatory space
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40 occupied by freeports as being contrary to free-market capitalism. Schwarzkopf and
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42 Backsell (2020) have argued that the offshore regulatory model in which freeports
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44 operate discourages capital mobility. They explain that the growth in freeports is
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46 indicative of a retrograde trend in global capitalism akin to medieval times
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48 (Schwarzkopf and Backsell, 2020). This concept seems plausible considering that
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50 freeports’ beneficial goods-in-transit position provides for assets to remain stored ‘in
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52 transit’ indefinitely – yet goods can be sold and purchased without ever leaving the
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54 storage facility and without tax being imposed (Helgadóttir, 2020; Post and Calvão,
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56 2020; Weeks, 2020). Therefore, freeports’ legal-spatial paradigm acts to restrict
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3 capital flow. Such state of perpetuity opposes the liberalised economic policies of
4 many Western governments that advocate freeports.
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9 The following section considers to what extent freeports promote free trade and
10 encourage commercial innovation.
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14 15 **4. Freeports' benefits for trade and innovation.** 16

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18 Governments are constantly seeking new ways to boost foreign investment and
19 support their nation's economic prosperity and global trading repute. For instance, a
20 state can bolster its fiscal and technological capability through Foreign Direct
21 Investment [FDI], a process whereby an overseas investor establishes an influential
22 interest within that state's locality (Nketiah-Amponsah and Sarpong, 2020). State
23 governments can also implement legal and practical measures, like tax incentives,
24 and reduced trade barriers, towards attracting enterprise and overseas investment.
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26 Such incentives have propelled many areas, like Hong Kong, Singapore, and the
27 Seychelles, to specialise in financial services for non-residents and to become
28 globally dominate Offshore Financial Centres (OFCs; Chan and Lee, 2007). Around
29 11 per cent of the Seychelles' Gross Domestic Product, for example, derives from
30 overseas investment protected by its attractive financial services market (Mugarura,
31 2017).
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49 In early 2020, the UK government published a consultation into proposals to create
50 Freeports across the UK in an aim to stimulate the economy following Brexit.
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52 According to the publication, the main purpose of freeports is to facilitate trade and
53 promote innovation and employment (HM Government, 2020, p. 10). Such literature
54 has stated that freeports can promote imports through reduced tax and
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3 administrative costs and controls (HM Government, 2020). For example,
4 strengthened trade enables manufacturing companies to save on costs of
5 administration and raw ingredients compared to external companies (Stojanovic,
6 2020). Therefore, freeports act as zones that are advantageous for newly
7 established companies to base their operations as the usual state custom controls,
8 where the zone is geographically located, do not apply.
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18 Companies registered within a freeport benefit from tax relief which supports their
19 capital growth. Also, reduced supervision within freeports provides a more private
20 environment to conduct business and helps companies to better compete
21 internationally (HM Government, 2020). A clear example can be seen with the
22 Middle East, where the Jordanian port of Aqaba, designated a freeport in 1973,
23 became a successful transit hub for trading, further strengthened at the time, by
24 regional oil reserves. Today, the Jebel Ali freeport in the United Arabs Emirates
25 accounts for a fifth of the country's FDI and helps to support over 160,000 jobs ("The
26 role of freezones", 2013). Further, Steiner (2017, p. 355) noted that the area of
27 Geneva in Switzerland has since profited some CHF 10 million each year after a
28 freeport was established there. Such prosperity has helped the area resist the
29 damaging impact of 2008's global financial crisis (Steiner, 2017).
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48 Lavissière and Rodrigue (2017) highlighted freeports' arbitrage advantages.

49 Arbitrage is the procedure in which investors can profit from concurrently buying and
50 selling goods across different international markets. Such practices promote market
51 productivity and maintains freeports' competitive lead over other jurisdictions. It may
52 also mean that nations seeking to remodel their trading links with others (such as,
53 post-Brexit United Kingdom) can still prosper through the freeport model because
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3 any future trade barriers would potentially further freeports' arbitrage advantages
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5 (Lavissière and Rodrigue, 2017).
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9 Nonetheless, the UK Trade Policy Observatory (UKTPO) recently concluded that
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11 freeports offer little benefit when a country's trade tariffs are already low (Winters
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13 and Holmes, 2020). Holmes (2019) pointed out that freeports do not free goods
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15 completely from tariffs – rather, they merely delay duty being imposed until the
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17 goods arrive at their destination. The trading benefits of freeports also depend on
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19 factors, such as capable labour and access to passage within the freeports
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21 (Stojanovic, 2020). Such questions raise doubt over whether freeports really do
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23 innovate economic growth. For Stojanovic (2020), freeports simply reroute current
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25 initiatives into freeport zones through an allure of tax relief; thus, burdening the
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27 taxpayer due to lost government revenue.
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33 Holmes (2019) has argued that to realise any significant long-term benefits in
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35 freeports, governments must broaden the incentives that freeports offer (akin to
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37 'enterprise zones'), rather than simply providing short-term duty-free access. For
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39 instance, designating the Isle of Dogs in London as an enterprise zone following the
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41 demise of the surrounding docks in 1982 provided much needed economic
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43 prosperity to the area. The zone gained government support beyond tax breaks,
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45 through relaxed development planning rules and improved infrastructure, leading to
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47 new employment in the area and neighbouring Canary Wharf (Holmes, 2019).
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50 Therefore, expanding freeports' remit to better incentivise the surrounding local
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52 economy should be considered.
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3 The next section explores the primary money-laundering and tax-evasion risks
4 posed by freeports and considers the methods through which such illicit activities
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10 11 **5. Money-laundering and tax-evasion risks.**

12 13 14 *5.1. Freeports help to conceal beneficial ownership.*

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16 Contemporary scholarship has argued that the secretive offshore space in which
17 freeports operate helps to conceal beneficial ownership and, thus, promote
18 money laundering and tax evasion (Financial Action Task Force [FATF], 2014;
19 Korver, 2018; Moiseienko *et al.*, 2020; Post and Calvão, 2020). The FATF (2014,
20 p. 8) defined a beneficial owner as,
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30 ... the natural person(s) who ultimately owns or controls a customer and/or
31 the natural person on whose behalf a transaction is being conducted. It also
32 includes those persons who exercise ultimate effective control over a legal
33 person or arrangement.
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36 In cases where the true beneficial owner cannot be identified, law-enforcement
37 and tax authorities can find it difficult, if not impossible, to trace illicit proceeds
38 and recover taxes connected to those entities or transactions (Transparency
39 International UK [TI UK], 2017). This issue is compounded by law-enforcement
40 authorities' lack of understanding on the methods criminals use to conceal
41 beneficial ownership using offshore jurisdictions (Gilmour, 2020; Yeoh, 2018; see
42 also FATF, 2018).
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53 Additionally, anonymous shell companies can be used as vehicles to launder
54 money (Le Nguyen, 2018). Shell companies typically have no actual presence
55 apart from a registered address and employ no real people. They create little or
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3 no independent financial worth and carry out no significant regular commercial
4 endeavours (Gilmour, 2020; Pacini *et al.*, 2019; Pacini and Stowell, 2020). Yet,
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6 they can be used to shift assets and substantial amounts of funds worldwide
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8 while offering the apparent legitimacy of a registered and fully functioning
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10 corporation (Pacini *et al.*, 2019). However, the true beneficial owners of assets
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12 tied to those shell companies can remain hidden from interested parties,
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14 including the authorities.
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21 The linking of anonymous shell companies to form complex ownership structures
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23 can further obscure beneficial ownership and the source of assets based within
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25 freeports (Post and Calvão, 2020, p. 9). Pacini and Stowell (2020, p. 374)
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27 clarified that shell companies can be linked to various territories reinforcing the
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29 corporate structure's anonymity and making it difficult for law-enforcement
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31 officials to decipher. This linking of shell companies also enables the corporates
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33 better access to global financial markets and to launder illicit money.
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38 Furthermore, freeports' offshore environment helps to distance the beneficial
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40 owner of assets from criminality and serves to further complicate illicit corporate
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42 structures (FATF, 2018). Steiner (2017, p. 363) explained that it is possible for
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44 illicit money to be laundered through the sale of goods stored in freeports, such
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46 as artwork. The customer who purchases the art using illicit cash could then store
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48 the goods within a freeport without having to disclose the real owner, by simply
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50 listing an agent responsible for their disposal on the inventory instead. Importers
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52 could also simply self-declare on inventories, providing ample opportunity to
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54 falsify invoices and other records to evade taxes and facilitate trade-based
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3 money laundering (Korver, 2018). Another concern of freeports is the potential
4 they pose in enabling trade-based money laundering.
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9 5.2. *Trade-based money laundering.*

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11 The main purpose of money laundering is to legitimise and conceal criminal profit
12 (Naheem, 2015a; Zali and Maulidi, 2018, p. 44). Money-laundering methods are
13 numerous. Illicit trade-based practices, for example, tend to operate within
14 sophisticated global networks of transactions, which typically challenges domestic
15 AML authorities to a greater degree, compared to other types of money laundering
16 (Stack, 2015, p. 81). Trade-based money laundering (TBML) remains a significant
17 threat to the stability and integrity of the global financial system. FATF (2020, p. 7)
18 reported that the volume of global trade increased by 3% in 2018, while the value of
19 global trade reached nearly USD 20 trillion.
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33 The definition of TBML is widely disputed (see Naheem, 2015b; Soudijn, 2014;
34 Sullivan and Smith, 2012). FATF (2006, p. 3) defined it as “the process of disguising
35 the proceeds of crime and moving value through the use of trade transactions in an
36 attempt to legitimise their illegal origin or finance their activities”. Naheem (2015b, p.
37 514) argued that TBML centres on the dishonest manipulation of trade invoices and
38 freight information to ship goods. However, FATF’s (2020, p. 11) recent report
39 clarified that the aim of TBML is to transfer the money enabled by trading, rather
40 than to move goods. Still, such schemes typically involve the misrepresentation of
41 the quality, price, or quantity of imported or exported goods. TBML schemes also
42 involve bogus shipments; multiple invoicing of the same shipment; and other
43 methods to fabricate invoices, transfer funds, or to ship illicit goods, such as drugs
44 and contraband (FATF, 2010; Neale, 2019). Freeports pose particular risk from
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3 TBML because of the high volume of transactions occurring through freeports,
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5 combined with freeports' reduced regulatory supervision (Moiseienko *et al.*, 2020).
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9 Additionally, Neale (2019, para. 18) and Simser (2013, p. 49) agreed that most
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11 international trade settlements occur through open merchant accounts. Here, the
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13 seller ships the goods and all related business documents to the trusted buyer, who
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15 then agrees to pay the seller's invoice later. However, the banks completing the
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17 transactions on behalf of the merchants would typically have no awareness of the
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19 reasons behind the trade and would not have reviewed the underlying business
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21 documentation before processing the transaction (Neale, 2019; Simser, 2013).
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25 Arguably, banks are responsible for carrying out customer due diligence, including
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27 detecting and reporting suspicious transactions (as obliged by AML laws). Therefore,
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29 banks should also know the underlying detail of all global trade transactions that they
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31 transact (Neale, 2019).
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36 The European Union's Fifth Anti-Money Laundering Directive (AMLD5), introduced in
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38 2018, amends earlier directives to widen the scope of institutions obliged to follow its
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40 rules and now includes freeports. Freeports are required to conduct customer due
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42 diligence, report suspicious transactions, and record beneficial ownership
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44 information (Helgadóttir, 2020; Korver, 2018; Sellick, 2020). All EU Member States
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46 were required to transpose the AMLD's requirements into national law by 10 January
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48 2020 (Council Directive 2018/843/EU, 2018; Sellick, 2020). Freeports are also
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50 covered to some extent under the US Foreign Account Tax Compliance Act (FATCA)
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52 and the Organisation for Economic Co-operation and Development's (OECD)
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54 Common Reporting Standards (Korver, 2018).
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3 However, freeports are not classified as ‘financial institutions’ under such regimes
4 and are only regarded as obliged ‘non-financial institutions’ (Helgadóttir, 2020, pp.
5 13-14; Korver, 2018, p. 6). This means freeports have no obligation to automatically
6 share information with authorities. Freeports are also not required to inform
7 authorities about the details of private commercial information that they do share
8 (Helgadóttir, 2020). This represents a clear failing of AML rule. Freeports are
9 inherently secret spaces where client confidentiality and discretion provided to
10 businesses operating within freeports is of the utmost importance. Therefore, better
11 transparency of freeports and strengthened laws are needed to combat TBML
12 activities that occur through freeports.
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28 **6. Conclusion.**

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30 This article provides a critical insight into freeports’ offshore illicit trading operations.
31 Freeports are innovative trading hubs that provide platforms for invigorating
32 enterprise and economic growth, where businesses can enjoy several economic
33 concessions (Moiseienko et al., 2020; Webb, 2020). Although the growth in freeports
34 may have originally evolved from a desire to stimulate global investment by
35 deregulating financial markets, some argue that freeports’ permanent storage
36 spaces only act to stifle capital mobility (Lavissière and Rodrigue, 2017; Ogle, 2017;
37 Post and Calvão, 2020; Schwarzkopf and Backsell, 2020). Nonetheless, freeports do
38 seem to provide innovative trading advantages to enable businesses to thrive in
39 today’s competitive global market (Winters and Holmes, 2020; Holmes, 2019;
40 Stojanovic, 2020).
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57 However, freeports can be abused for money-laundering and tax-evasion purposes.
58 Freeports help to obscure the true beneficial owners of assets through secretive
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3 corporate practices that thwart authorities' efforts to trace illicit profits and recoup
4 government taxes (FATF, 2014, 2018; Korver, 2018; Le Nguyen, 2018; Moiseienko
5 *et al.*, 2020; Post and Calvão, 2020). Freeports also enable trade-based money
6 laundering by the falsifying of trade invoices to deceive authorities (FATF, 2020).
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11 The many international transactions occurring through freeports coupled with
12 freeports' lack of regulatory supervision poses notable challenges for government
13 officials (Moiseienko *et al.*, 2020).
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21 Therefore, further government oversight is needed to curb illegal activity through
22 freeport zones. Banks that facilitate the numerous international trade transactions
23 need to be more alert to illicit trading and responsible for carrying out proper due
24 diligence around freeport transactions (Neale, 2019; Simser, 2013). Although, recent
25 legal regimes recognise the threat that freeports present by incorporating freeports
26 within AML rules, there is still scope for freeports to operate without transparency.
27 This article concludes that despite freeports' trade offerings, stronger regulation is
28 needed to prevent them being abused for money laundering and tax evasion
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