

Centre for the Study of Corruption



Freeports Consultation
*Submission by the
Centre for the Study of Corruption
at the University of Sussex*

Contact: Robert Barrington
*Professor of Anti-Corruption Practice
r.barrington@sussex.ac.uk*

May 2020



The **Centre for the Study of Corruption (CSC)**, founded in 2011, is the UK's foremost academic centre for studying corruption. Located within one of the world's leading universities, CSC is regarded as a highly credible source of independent and objective research and ideas. It is widely recognised for combining world-class academic approaches and research with the practical experience of how corruption can be addressed in the real world. We operate in three broad areas:

- **Research:** undertaking rigorous academic research to address the world's major corruption issues
- **Courses & Teaching:** training the next generation of anti-corruption professionals around the world from undergraduates to PhDs, with three Masters courses
- **Policy:** ensuring that our research informs evidence-based policy and helps change the world.

CSC's research activities are based around four themes:

- Corruption in politics
- Corruption in international business
- Corruption in sport
- Corruption in geographical context – with particular strengths in the UK, Germany & Eastern Europe, China and Africa.

Full details of the published and current research undertaken by our core faculty can be found in the detailed biographies of each faculty member at www.sussex.ac.uk/scsc

Important Note

Consultation submissions made by academic staff at the University of Sussex do not represent official university views or policy unless explicitly stated. This submission should therefore be taken to represent the view(s) of the author(s).

May 2020

Centre for the Study of Corruption University of Sussex, Falmer, Brighton BN1 9QE

<http://www.sussex.ac.uk/scsc>

Contact: Professor Robert Barrington
r.barrington@sussex.ac.uk

Freeports Consultation

*submission by the
Centre for the Study of Corruption
at the University of Sussex*

Summary

1. Freeports and corruption risk

The DTI consultation document does not contain any mention of corruption, indicating that corruption is not currently recognised as a risk in the creation or operation of freeports. The appropriate approach would be for a comprehensive corruption risk assessment to be undertaken so that the risks are identified.

2. The UK's experience of freeports

Overall, by accident rather than design, the UK created in the Overseas Territories the ideal conditions for corruption to thrive. The example of the Overseas Territories should act as a warning light that, by accident rather than design, in creating freeports the UK may also create ideal conditions for corruption to thrive.

3. Does it matter?

The UK government needs to ensure that its existing anti-corruption strategy is properly applied to freeports and that they are not granted a carve-out from this strategy. This will act as a safeguard against organised crime and security threats, protect the UK's reputation and demonstrate that post-Brexit Britain is willing to maintain a set of values that reinforce free trade and prosperity.

4. Recommendations

Recommendations are made in six areas:

- i. Risk assessment
- ii. Design in anti-corruption mechanisms
- iii. Transparency by default
- iv. Anti-corruption provisions for operators and other actors
- v. High standards of integrity for professional and financial firms
- vi. Focus on integrity amongst public sector officials

1. Freeports and corruption risk

The risks of freeports being used for money laundering are well-documented, not least by the Financial Action Taskforce¹ and, for the UK, by RUSI's Centre for the Study of Financial Crime. This remains to area of greatest concern for anti-corruption experts.

However, it also needs to be recognised that other corruption risks will exist, depending on how the UK's freeports are set up and operated. Freeports, by their nature, contain a number of ingredients that make them high risk for corruption.

They are areas that have been set up to facilitate trade and investment, and as a result are usually promising lower bureaucracy and/or favourable taxation environments. This can mean lower scrutiny both over the entities that operate there and over their activities, in particular from tax and audit or regulatory authorities.

The actors are often companies that are domiciled elsewhere, and therefore less familiar to the relevant authorities, if their beneficial owners are known or declared at all.

Freeports may sit outside a society's unofficial accountability and scrutiny mechanisms, such as the press or civil society, and there can be reduced levels of transparency about their operations.

There is nothing intrinsically corrupt about freeports. As with corruption risk in other spheres, the risk does not automatically translate into corrupt activity. The corruption risk can be mitigated: but although the risk of corruption can be mitigated, this is only likely to happen if the risk is recognised.

By contrast, freeports can operate as haven within a wider environment of corruption. For example, some of the Special Economic Zones in China were regarded by foreign companies as relatively free of corruption compared to the rest of mainland China, while others were held back due to corruption scandals.

Two examples of corruption risks associated with freeports are:

Bribery

- Although it is widely believed that bribery is uncommon in the UK, this does not mean that bribery does not occur. Indeed, the first prosecutions under the Bribery Act 2010, which had originally been designed to counter corporate bribe-paying overseas, all related to bribers paid

¹ <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf>

or offered within the UK. The conditions of freeports might well encourage bribe-paying: for example, if there is a secure area within which certain economic conditions prevail and a controlled 'border', there could be an incentive to pay bribes to those who control the border, in order to move goods or people in or out of the freeport. Any difference of regime between one area immediately adjacent to another carries the risk of such exploitation: an example within the UK is the exploitation of farm subsidies cross-border between Northern Ireland and Ireland.

Cronyism and nepotism

- When the freeport is in operation, officials at all levels are likely to have a degree of discretionary power. A classic corruption analysis indicates that discretionary power in tandem with lowered levels of scrutiny or accountability increases corruption risk. Even when bribe-paying is not taking place the exchange of favours to gain an advantage, often brought about through a prior personal connection or family connection, is a plausible scenario. This is a characteristic mechanism used by organised crime.

These are illustrative examples and clearly not a comprehensive list. But precisely because the UK authorities have little experience of bribe-paying and other forms of corruption, the need to design anti-corruption mechanisms, and the best way to do so, may be overlooked.

In particular, the UK authorities and law enforcement agencies have very little experience of prevention of bribery or corruption of public officials in the face of determined attempts to corrupt them. There is therefore an additional risk that even if the corruption risk is adequately identified, the UK's standard mitigation measures will be insufficient. For example, these are often based on an assumption of the personal integrity of public officials, and that they will aim to operate in the public interest. A freeport with the wrong culture amongst officials might severely question these assumptions.

The DTI consultation document does not contain any mention of corruption, indicating that corruption is not currently recognised as a risk in the creation or operation of freeports. The appropriate approach would be for a comprehensive corruption risk assessment to be undertaken so that the risks are identified.

2. The UK's experience of freeports

One analogy for the creation of freeports in the UK may be the UK's Overseas Territories. Although these are offshore and at some distance from the UK, UK government policy specifically sought to create a low-bureaucracy jurisdiction for financial services.

Over time, this has been increasingly exploited by criminals, organised crime and criminal entities. The lack of accountability and scrutiny enabled this to be under the radar until the situation was firmly embedded.

At the same time, neither the UK government nor the Overseas Territories themselves have been able to develop an exit strategy from the criminality, while the increased financial clout of the Overseas Territories governments has enabled them to mount a lobbying campaign to retain the lax regime that has been financially advantageous to a small number of those in power.

Overall, by accident rather than design, the UK created in the Overseas Territories the ideal conditions for corruption to thrive. The example of the Overseas Territories should act as a warning light that, by accident rather than design, in creating freeports the UK may also create ideal conditions for corruption to thrive.

3. Does it matter?

The UK's own *Anti-Corruption Strategy 2017-22*² outlines why corruption and money laundering matter to the UK, as does the *OECD Recommendation of the Council on Countering Illicit Trade: Enhancing Transparency in Free Trade Zones*.³ The *Anti-Corruption Strategy* is quoted below, as this clearly explains the threats to the UK's prosperity, security and international reputation from corruption. Moreover, the Strategy also notes the opportunities for the UK post-Brexit in clearly being an international beacon for the rule of law and creating a level playing field for business.

'It is clear that corruption threatens our national security and prosperity, at home and overseas. It can also erode public confidence in our domestic and international institutions, if left unchecked. The threat is compounded by the fact that its full impact is often not well understood....

'The UK's role as a global financial centre is important to the country's prosperity but can also be exploited by criminals. The 2016 National Strategic Assessment of Serious and Organised Crime notes that the UK is one of the most attractive destinations for laundering the proceeds of grand corruption² and that professional enablers and intermediaries play a role in this...

'Corruption impedes economic growth and investment, not just in the UK but with our trading partners and allies across the globe. Bribery committed internationally by UK entities has reputational, financial, political and social consequences. Corruption can increase the cost of doing business for individual companies by as much as 10%, distorting markets and deterring trade and investment...

² <https://www.gov.uk/government/publications/uk-anti-corruption-strategy-2017-to-2022>

³ <https://legalinstruments.oecd.org/en/instruments/OECD-LEGAL-0454>

'Tackling corruption is at the heart of the UK government's efforts to keep Britain safe, and to preserve the prosperity we enjoy. It also underpins the rules based international system and global prosperity. Open, fair and rules-based commerce fosters trust, certainty and investment and helps build an economy that works for everybody. A reputation for high standards and integrity attracts high-quality investment. It provides the certainty that allows investors to innovate and take risks, confident that their property rights will be respected and their ideas will not be stolen...'

'As the UK leaves the European Union, it is crucial to capitalise on the opportunities this will create. We need to work with partners to level up the playing field in new and fast-growing markets. We can also leverage the UK's reputation for integrity – and our strong reputation for enforcing robust anti-bribery legislation – to help UK business and industry to increase their global competitiveness.'

In other words, the UK government needs to ensure that its existing anti-corruption strategy is properly applied to freeports and that they are not granted a carve-out from this strategy. This will act as a safeguard against organised crime and security threats, protect the UK's reputation and demonstrate that post-Brexit Britain is willing to maintain a set of values that reinforce free trade and prosperity.

4. Recommendations

i. Risk assessment

A comprehensive corruption risk assessment should be undertaken.

ii. Design in anti-corruption mechanisms

It is much harder to retro-fit anti-corruption mechanisms into an organisation or system once a problem has been discovered. When corruption takes root it can be hard to eradicate, and it is sometimes describe as flowing like water wherever there is a crack. Once the corruption risks have been thoroughly identified, an anti-corruption approach should be hard-wired into the design of freeports.

iii. Transparency by default

The principle of 'transparency by default' should apply to the maximum possible extent for the UK's freeports. This will enable scrutiny and accountability. Freeports in the UK should be able to thrive because they provide favourable regimes for doing business – but not because they are shrouded in impenetrable secrecy. This is an important lesson to learn from the Overseas Territories. For example, it should be an absolute condition that any company that has any trading relationship with or within or related to a freeport should publicly declare and register its beneficial owners. This already applies to UK companies, but should equally apply to non-UK companies.

iv. Anti-corruption provisions for operators and other actors

It seems likely that the private sector will play a considerable role in creating and operating the freeports. There is a global norm of anti-corruption good practice procedures for companies, building on the Bribery Act,⁴ US Foreign Corrupt Practices Act⁵ and more recent *Agence Francaise Anticorruption*⁶ guidance. All companies with significant operations or trading relationships in, or related to, the freeports should be required to have in place a high standard of anti-corruption procedures. Freeports can give economic advantages to companies without operating as a Wild West, and a simple requirement to operate to the global best practice norm would help alleviate the risk.

v. High standards of integrity for professional and financial firms

The related professional services infrastructure that a freeport will require can function as an important check on corrupt behaviour – or, if poorly regulated, operate as facilitators of corrupt behaviour. For example, in the Overseas Territories and Crown Dependencies, a number of professional services companies (financial services firms, law and accounting firms, trust & company services providers, etc) have played an important role in facilitating the corruption. However, good oversight and regulation of these professional actors means that they can act as a deterrent to, and brake on, corrupt behaviour. It is possible that a special licensing regime should be established for professional services companies wishing to operate in the UK's freeports that gives primacy to operating with integrity.

vi. Focus on integrity amongst public sector officials

There should be a specific focus on building and maintaining integrity among public sector officials, learning from the UK's wide experiences ranging from the Committee on Standards in Public Life for more senior officials to the police anti-corruption units' experiences with more junior officers.

-Ends-

⁴ <https://www.gov.uk/government/publications/bribery-act-2010-guidance>

⁵ <https://www.justice.gov/sites/default/files/criminal-fraud/legacy/2015/01/16/guide.pdf>

⁶ https://www.agence-francaise-anticorruption.gouv.fr/files/2018-10/French_Anticorruption_Agency_Guidelines.pdf