

International Trade Committee

Oral evidence: UK Freeports, HC 258

Wednesday 15 July 2020

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Members present: Angus Brendan MacNeil (Chair); Robert Courts; Mark Garnier; Paul Girvan; Sir Mark Hendrick; Mark Menzies; Taiwo Owatemi; Martin Vickers; Matt Western; Mick Whitley; Craig Williams.

Questions 1 – 45

Witnesses

I: Professor Catherine Barnard, Professor of European Union and Labour Law, University of Cambridge; Alex Stojanovic, Researcher, Institute for Government; and Chris Walker, Director and Co-founder, ChamberlainWalker Economics.

II: Simon Bird, Regional Director (Humber), Associated British Ports; Karen Dee, Chief Executive, Airport Operators Association; and Charles Hammond, Chief Executive Officer, Forth Ports.



Examination of witnesses

Witnesses: Professor Catherine Barnard, Alex Stojanovic and Chris Walker.

Q1 **Chair:** Welcome to today's International Trade Committee hearing on freeports. We have two panels today, the first more of an academic panel and the second a panel of those who might be more interested in running freeports. Given the balance of the second panel especially, I will gently say: do not be surprised if you get devil's advocate questions. It will be nothing personal, but it will be probing perhaps a little more into that.

Can I ask the first panel to introduce themselves? We have Catherine, Chris and Alex. I would like you to introduce yourselves on your own terms, starting with Professor Catherine Barnard, please.

Professor Barnard: Thank you very much for the invitation. My name is Catherine Barnard. I am Professor of EU Law at the University of Cambridge, and I am also Senior Fellow in The UK in a Changing Europe think tank, which is a non-partisan organisation.

Chair: Thank you very much. It is good to see you again, Professor Barnard. Chris Walker?

Chris Walker: I am Chris Walker. I am an economist and I am the co-founder of ChamberlainWalker Economics. Prior to that, I was a civil servant in the Government Economic Service.

Chair: Thank you. Alex Stojanovic, which I have probably said wrongly.

Alex Stojanovic: Alex Stojanovic. No worries. I am a researcher at the Institute for Government. My work is mainly focused for the duration of Brexit on trade and customs issues.

Q2 **Chair:** Excellent, thank you. To kick off, I have a general scene-setting question to Professor Barnard. Can you briefly summarise the purpose of freeports and how they differ from enterprise zones, just so that we remind ourselves what this is all about? There is much talk about it in the media, but quite often the basics are forgotten, so a scene-setter, please.

Professor Barnard: There is no rigid definition of the two concepts but, broadly speaking, a freeport or free zone is where goods come into a port, usually just inside a sea border but it can be inland, and those goods are usually entered with zero tariff. They are usually worked upon in some way to have value added, and then they leave the freeport. They either leave as exports from the country or they come into the domestic market, and it is at that moment that any duty that is due has to be paid. Essentially, freeports are about manufacture. Enterprise zones are more often about non-manufacturing, although it can be both. Enterprise zones are also about job creation schemes and other innovation.

Q3 **Chair:** Thank you very much. The UK had a number of freeports, which we discovered a while ago when this started. They ended comparatively recently, eight years ago in 2012. Why did the Government do that? Why



did the freeports come to an end?

Professor Barnard: It is interesting, isn't it, because there is no very clear statement that said, "They have come to an end for this reason"? If you dig into the weeds a bit, you discover that there was a sense that they had rather run out of steam, that we had become more modern in our delivery of customs so we could do the work without the freeports. It may also be something along the lines that the regulation that was required of freeports was becoming somewhat suffocating and, in fact, what was really needed was not so much freeports—because tariffs were generally quite low—but enterprise zones. That is where the Government focused their energy from 2011, 2012.

Chair: I will leave it at that and I might probe that point later. I will go to Robert Courts.

Q4 **Robert Courts:** I have a couple of questions I would like to ask building on that. I will start with Chris Walker. You have written about supercharged freeports, which if I understand correctly are freeports and enterprise zones put together, as we have just heard about. Could you expand on that a bit more, please, and let us know how a supercharged freeport differs from the traditional one that we have already heard about?

Chris Walker: You basically have it in one. In the supercharged freeports report, we took the very basic model, which is where you have a freeport that reduces your tariff barriers and gives you reduced tariffs and duties, and then you layer on top of that the enterprise zone, which can either give you enhanced capital investment allowances or reductions or discounts on your business rates. It was just a variation on a theme, in essence. I think in what the Government are consulting on, they are potentially going much further, and perhaps much closer towards China's special economic zones, which gives you a whole host of things.

Q5 **Robert Courts:** More of a super, supercharged freeport?

Chris Walker: Supercharged plus-plus. There you can layer on your tax advantages, your lack of tariff barriers or reduction in tariffs, but also potential deregulations. One of the deregulatory things in which the Government are interested in their consultation is planning so that ports can be much freer from planning restrictions and can expand within the freeport area.

Q6 **Robert Courts:** Can I ask our other two witnesses how they feel about this? Catherine, I will come to you first, please. I think you have written about the possibility of freeports, particularly in the north, giving us the opportunity for rebalancing economic growth—of course, what we now call levelling up, which is very much the buzzword of the moment. Would you agree that freeports now should be about more than customs, more about that traditional model that you have outlined to us?

Professor Barnard: I think that is right. If you look at the UK global tariffs that have been published, in fact the tariff rates are going down



somewhat, and particularly on key components they are zero or very low indeed. If you are looking at freeports purely on the old-fashioned model, as a location where you have zero tariffs on goods that have added value through manufacture, you think it is going to be a huge investment for not a huge amount of return. I think that is one of the reasons why freeports ran out of road the last time they were tried. If you are going to go for something like this, it clearly needs to be more than just a tariff issue.

Q7 Robert Courts: Thank you. Alex, could I ask you for your thoughts, please?

Alex Stojanovic: I agree with what Catherine has just said. Essentially, the tariff benefits are quite minimal, and that is particularly because tariffs on the intermediate goods or components are very small according to the EU tariff, and the UK tariff will be the same but less. The US example, where it has derived quite significant benefits, has quite high tariffs on some intermediate goods, particularly in car manufacturing, so they can get a significant benefit there.

If you look at some of the examples of the really successful special economic zones around the world—not just China but those in Singapore, such as Jurong, and at Jebel Ali as well—they are much broader in ambition in what they do. The governance arrangements with them are quite complicated. If the Government are going to derive benefits from this, they definitely need to have a broader ambition. That comes with risks as well.

Robert Courts: Thank you very much, everybody.

Chair: Can I call Martin Vickers, who is a great advocate on the Committee for freeports? I have a sneaking suspicion that you might have a thing or two to say about freeports.

Q8 Martin Vickers: You are quite right, Angus, that I am a big advocate for them. My question is a fairly broad one to ask the panellists. What economic benefits do you think freeports could bring to the UK?

Alex Stojanovic: There has been mixed evidence of the economic benefits of freeports. There are some examples of benefits in employment. I think you have to be careful when assessing the economic evidence, though, because a lot of the beneficial ones are for closed economies, countries like Vietnam and Thailand, and I do not know how applicable or translatable the benefits that they have derived will be to the UK.

That said, there are developed economies that have derived significant benefit. It is hard to put numbers on the actual benefits because so much will depend on how these freeports are designed. A lot of them are dependent on things that are outside the scope of a normal freeport, such as access to infrastructure and skilled labour. Those things are important anyway for any kind of economic growth or investment you are making.



It is hard to put numbers on what the actual economic benefit will be because a lot of it depends on the design. I think there is enough evidence to show that there can be benefits if the schemes are well designed and they take account of the risk of displacing economic activity from one part of the UK to another part simply because there are tax advantages, for example.

Q9 **Martin Vickers:** Isn't one of the aims of Government to, in effect, displace the overheated south-east economy once moving to the north?

Alex Stojanovic: I think they should be careful of that. They should be careful of measures that only displace. I think maybe there will be some displacement, but you want there to be a net benefit. If you look at some of the proposals—for example, the Teesside Valley proposal—I am not advocating that the Government should accept this specific proposal but it does try to show that there will be a net benefit to the public finances. We need to be very careful when we are designing particularly the tax incentives. The successful examples provide incentives and conditions for those tax benefits. There are examples where it has gone very wrong, for example in Madeira where the aid they received amounted to €1 billion per year via tax exemptions but they employ only 1,000 people. There are big risks and certainly the UK wants to try to design its freeports to avoid that particular example.

Professor Barnard: The obvious answer to your question is job creation. As Alex said, the figures are suggested but some of the suggestions are in the region of about 85,000, 86,000, up to 150,000 if you are looking at some of the work that Christopher has done about the supercharged freeports. Clearly, job creation is the strongest argument. It must be said that in the past some of those job creation schemes ended up costing the taxpayer significant sums of money, but then you have to ask yourself: even if it has cost the taxpayer money, isn't that what Government policy is about, to try to encourage development in those regions that have suffered in the past?

Some of the other benefits you might talk about depend on your point of view. You could say the advantage of a freeport is lower taxes and/or less planning and/or less environmental regulation. Depending on your point of view, that would either be a benefit if you are in favour of deregulation or a disadvantage if you think that those rules should be applied.

As to the other benefits we would talk about, the literature says there are benefits of agglomeration. This is one of the big issues in the United States, that you end up bringing different resources together in one single location. I think that is a bigger issue for the United States just given the sheer geographic area of the US. If you look at the Government's consultation paper on freeports, it is pretty clear that the ambition goes beyond just manufacturing, also bringing together science and technology expertise. Wearing my university hat, one of the great attractive features of the Government's consultation paper is that it is



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trying to harness some of the expertise in colleges and universities with the freeport initiative.

Chris Walker: To echo Alex and Catherine, there is a lot of uncertainty around the benefits and it will depend on the specific policy and the model that we adopt. In my supercharged freeports paper the guys cited some of the figures: 150,000 jobs from seven freeports in the north and a £9 billion boost to Northern Powerhouse GDP, which would make a significant contribution to the levelling-up ambitions.

What we have to remember is that ultimately economic interventions like these have two high-level rationales, according to the HM Treasury Green Book. The first is an economic efficiency argument, which is about economic growth and expanding the size of the economy. The second is an economic fairness argument, which is ultimately about levelling up. Done in the right way, the UK freeports policy could tick both boxes. On economic efficiency, in essence you are enabling firms to participate more seamlessly in global supply chains. That gives you more trade and more trade throughput, and increased trade, as most of us know, is associated with economic growth. As Catherine alluded to, you also get potential agglomeration benefits where you have economic activity coming together. You would have an exchange of knowledge, what we economists call positive knowledge spillovers.

On the levelling up, in the supercharged freeports publication we talked about locating freeports in places like Middlesbrough, Hull and Liverpool, where deprivation measured by the Government's deprivation index is very high. If you get it right, you can tick both boxes.

Just a very quick word about displacement. I think it is really important in the displacement debate that we are very careful to talk about what is good displacement and what is bad displacement. There is such a thing as good displacement. If you are, for example, displacing lots of disparate economic activity from several different locations and you are bringing them all together into one single freeport location, you are potentially getting clustering and agglomeration benefits and that is an economic efficiency benefit. It is what the "Green Book" would call net additional supply side economic benefit. If you think back to the economic reforms of the 1980s and the Thatcher era, it was all about supply side benefits.

Then, of course, in levelling up, if you are displacing economic activity from rich areas to poor areas—and again the other guys alluded to this—that is another example of good displacement from the national perspective. There is also bad displacement, don't get me wrong. I am not trying to gloss over that, but I think it is really important that we nuance that.

Martin Vickers: Very good, thank you.

Q10 **Sir Mark Hendrick:** In a previous life I was a Salford city councillor and very involved in the 1980s with the work to develop the enterprise zone



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on the old disused docklands in Salford. At the time, there was this argument about displacement and that all we were doing was moving companies that were doing perfectly well anyway to a new site to give those firms tax advantages. However, since then we have seen big instances like the BBC, and many other media companies, move to Salford and we have created what is called Media City. That is a clustering of businesses in Salford in what was a very deprived and poor area, which I used to represent about 25 years ago. Thanks.

Chair: Is there a question being directed there?

Sir Mark Hendrick: How much work has been done on this good and bad displacement? I would like to know if there was a percentage, for example, that given a port you can calculate or say that 30% of that is good displacement and 70% is bad displacement.

Chris Walker: I think that that will ultimately depend on the location involved and the model of the freeport that you adopt. What you absolutely want to avoid is just simply, other things being equal, moving economic activity from one location to another if they are equally deprived. That could be a bad thing to do because it could be economically inefficient, reduce your economic growth if you do that. It is a real risk, but those percentages that you described will vary from one location to the next and on the freeport model adopted. But I totally agree, much more work needs to be done on displacement effects.

Alex Stojanovic: I agree with Chris's point. There is good displacement and then there is bad displacement, and the Government can define that according to their objectives. The important part to remember about some of the bad displacement is that if you replace economic activity and have lower taxes there, you have just caused a dead weight loss and that is part of the issue. There is also a potential issue that if you are moving a business from one place that is quite rich to another place, if it does not have good access to infrastructure and skills and you are not investing in those things, you have moved it from a high-productivity place to a lower-productivity place. That just lowers productivity.

That being said, if the Government pay attention to and focus on the wider issues—the access to resource, skills and infrastructure—it can be part of a regeneration and redevelopment project. There was a study on the experience of the 1980s by the Centre for Cities, which surveyed a lot of the enterprise zones that were done then. It mentioned that at least some of the errors came in by focusing too much on some of the incentives to improve capital—investing in businesses, investing in machinery—but that did not translate to employment and in many cases a lot of the gains were captured by local landowners. I think we need to pay attention to the specific incentives and where the gains are going to be captured and how they will translate into more employment, more benefits for the area.

Sir Mark Hendrick: One of the things I noticed was there was a lot of



public money involved, particularly derelict land grants from central government and European structural funds coming into the city, which was a draw for a lot of private investment, but land values increased considerably. The company called Peel Holdings that used to be the ship canal company became very, very rich, where it used to have lots of derelict land and now is doing very well.

Q11 **Chair:** There is a private gain there from public good. To Alex and Professor Barnard: how will the UK's global tariff affect the competitiveness of UK freeports?

Professor Barnard: If we decide to go for a freeport model that has zero tariffs on goods coming in—the average tariff under the UK global tariff is about 6%. That average is in one sense very misleading because it is distorted by still very high tariffs on agricultural products, for example, where the tariffs can be up to 40% or 50%. There is also a significant amount of much lower tariffs of 3%. Given that our tariffs will be lower than the EU average—the EU average is about 7%—clearly there is some competitive advantage there. The point is that generally, away from agriculture, tariffs are really rather low. That is one of the reasons why the old-fashioned model of freeports is no longer really sustainable if the freeport is just that, a freeport without the relevant infrastructure being built around it.

Q12 **Chair:** Is that why the 6% or 7% withered on the vine in 2012, together with being in the single market?

Professor Barnard: Exactly. Going back to Sir Mark's point about Salford, which I have had the great pleasure of going to a number of times, what is really striking is that it is not just an enterprise zone in and of itself but the infrastructure has been built around it in order to enable people to live there and also to get there.

It is more complicated than just tariffs. It is a bigger picture, and that is why the freeport idea that the Government are now advocating is clearly much more imaginative than the earlier model that withered in 2012. When it withered in 2012, do any of us really remember people being sad that it had disappeared? I tried to find out whether there was a clear Government statement about why it had declined, and in the end all I could find was something in *Hansard*, from Mr Gauke who was then the Exchequer Secretary to the Treasury. In answer to the question about freeports he says, "A free zone brought together a number of custom reliefs and procedures in a geographic location. The lapsing of the statutory instruments in 2012 that set up free zones has not removed the customs reliefs, which local operators continue to use within the port area." He seems to be saying in not very clear language that it did not make a great deal of difference.

Q13 **Chair:** I can remember it. I was in Parliament at the time and I think a number of others on the Committee were, but I do not remember any fuss at the time. Alex, do you want to come in?



Alex Stojanovic: Just to add that the lower our global tariff in the event of no deal, the less benefit we will derive. The tariff specifically on the intermediate goods, the components, is what really matters here because that is what you are bringing in to assemble and reexport. They are already very low, so the benefits are already small and they are potentially smaller under the Government's no-deal tariff plan, which liberalises further.

One other thing to add on the customs procedure stuff is that there are existing customs procedures that allow you to do what a freeport allows you to do, so bringing in goods and deferring the duty. It is called inward processing relief, and there are other things such as bonded warehouses and so on. Some people argue that they could be simplified further, that these are still quite burdensome, and that maybe as part of a freeport you could simplify those procedures even more.

Q14 **Chair:** A general question to the three of you. My favourite question whenever somebody talks about a free trade agreement in this post-Brexit world is: what is the GDP gain? Does anybody have any idea what the potential GDP gain might be from freeports? The damage of Brexit is about 4.9%, according to HM Treasury and current trajectory. What might freeports bring back to restore that damage?

Chris Walker: The US evidence that I looked at in my report suggested that the foreign trade zones, which is like the US equivalent of freeports, could boost international trade volumes by two to three percentage points a year. That is from a baseline of about five percentage points in nominal terms, so basically from 5% to 7% or 8% a year. That is just a trade boost. Using the same sort of modelling that that HM Treasury modelling used suggests that a one percentage increase in international trade translates to something between a half and three-quarters percentage increase in GDP growth.

Q15 **Chair:** The maximum you could look for would be what, about three-quarters of a percent of GDP growth from freeports?

Chris Walker: Per annum, yes. I think some of the figures that you were citing were over a period of time, so it is important to distinguish that.

Q16 **Chair:** Are freeports the panacea? Are they better than free trade agreements in GDP terms?

Chris Walker: If you are talking purely about a freeport that just offers you zero-tariff arrangements, I would concur with the others that the benefits of that are probably going to be quite limited. Certainly, compared to a free trade arrangement where there are no tariffs at all, of course they are not going to be beneficial. I guess the issue is that there is a lot of uncertainty, particularly at the moment, about what the global trading regime and environment is going to be. Are we going to get an agreement with the EU? Are we going to lapse back into WTO terms? Even within the WTO, there has been a rise of protectionism in recent years. The trade war between the US and China is one classic example of



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that. I do not think we can automatically assume that in 20 years from now the global tariffs will be lower than they are today. It could ping anywhere.

Q17 Chair: Can I check something that you said there? Where there are no tariffs there is not much of a benefit from freeports and in the idea of the European single market, where there was an open, free market with no tariffs and no checks, the need for freeports is almost redundant or it is lessened. Would that be fair?

Chris Walker: Within the EU, of course; you have only the zero tariffs within the EU. You do not have that for goods coming from outside the EU. I think there is a tariff of about 10% on car imports and for some components, which you would use in global supply chains to manufacture stuff, the tariffs can be higher still. If you are talking purely within the EU, you are absolutely right.

Chair: Okay, thank you. I will move on to Mark Garnier who is waiting patiently by.

Q18 Mark Garnier: Alex, can I come to you first? Given what we have just been discussing, that it is very difficult to find any significant advantage given the fact that our global tariff is going to be that low and, of course, stripping out agricultural products, which are irrelevant with respect to free trade ports, you end up with very little advantage. You referenced a bit earlier the Jebel Ali free trade zone, which I think also has 0% corporation tax, no VAT, no income taxes, basically no taxation at all. Alex, given where we are getting to in this conversation, do you think the answer is that we have to find some particular niche and something like the Jebel Ali free trade zone is a model that maybe we want to go down, or is that going too far?

Alex Stojanovic: I think that you definitely need to look beyond the traditional freeport if you are going to find benefits. The UK needs to pay a lot of attention to the particular incentives it is going to design. As you say, the Jebel Ali example is something that we should be looking at and the same with the Jurong town one in Singapore.

There are a couple of things to bear in mind. You have to be very careful with some of the tax measures particularly. If you just lower corporate income tax, that tends to benefit businesses once they are profitable, but a lot of investments when they start are not profitable so it is not going to have very much effect on that. When a business becomes profitable, it potentially benefits, but then what you risk is the fact that if a business is already profitable, that investment might have happened anyway and now it is just going to happen under lower tax. I think the answer there is to find tax incentives that are more likely to lead to the kind of outcomes you want: allowances on research and development, tax allowances on certain kinds of training of skills, those kinds of things. They are things that the successful freeports look at in a much broader way.



You need to look at the governance arrangements of the successful examples. In Jebel Ali and in Singapore they set up a specific regulatory authority that helps to improve the success of those areas by interfacing between the operators and the many different departments in central government that still have an ongoing role to play. That is another important factor. It is not the case that you just lower taxes or provide some incentives and that is it. It requires sustained, ongoing investment probably from departments on an ongoing basis. That will be really important.

Q19 Mark Garnier: That is very helpful, Alex. Chris, you obviously want to come in on this but I have another question as well. We have just talked about that one of the niches that you could have with a free trade port or a free trade zone is taxation, a fiscal one. You talked a little bit earlier about the hubbing effect of bringing together disparate businesses that when they come together in a hub could be quite good. Is there an argument, therefore, for having some type of business-orientated hub with both the fiscal benefits but also something else that could be a type of benefit that is drawn together because of that collective activity? What I am really looking for is whether there is a niche that we can deliver that is something more than just tax breaks.

Chris Walker: I think we certainly need to go beyond the traditional freeport model, and I am encouraged by the discussion around Jebel Ali and Singapore. We need something that is much broader and much more holistic, and there are a whole host of tax breaks that you can explore. We need to look more fundamentally at how we can continue to modernise the UK economy and strengthen the manufacturing base, particularly advanced manufacturing, and make it more export oriented. I think that if there was a particular sector that we should focus on it should be advanced manufacturing and engineering. These are certainly areas of strength, particularly in the Northern Powerhouse, which as you know have been spoken about.

Going beyond tax, I know one of the guys alluded to it earlier but I will make the point now because it is really important, we think more holistically about transport and the transport infrastructure and connectivity. The freeports model that I described in my paper would not work very well in the Northern Powerhouse unless you fundamentally strengthen the infrastructure there, particularly that east-west connectivity that is such an issue at the moment, and regional air connectivity as well. The connectivity is going to be really important for some of the places at which we are potentially aiming these freeports.

Q20 Mark Garnier: Alex, you wanted to come back and, Catherine, I am quite keen to hear your point of view as well.

Alex Stojanovic: I wanted to add that one of the major successful examples where this has been done in the UK is the Isle of Dogs. What happened there was sustained investment in infrastructure, so the DLR, sustained investment in skills, looking at housing and commercial



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property. It was over a decade of sustained investment in a lot of things around the port, not just tax breaks, that allowed that area to be successful and allowed it to regenerate. It is important to recognise that this is not like a free lunch where you just lower some taxes and then the business floods in. It requires sustained effort and investment, which will be expensive not just from the taxes lost but active investment also. I think a lot of local authorities see the port and the customs side, even some of the trade aspects, as quite incidental to those other benefits, but as long as it comes together in a comprehensive package it has a greater chance of success, which the Isle of Dogs demonstrates.

Q21 Mark Garnier: I think that is fair. The old argument goes that if you build a road you will get economic activity at the end of it, and infrastructure is crucial to all of this.

Following on from that question, I completely get the argument that if you are going to have a free trade port or a free trade zone you have to have motorways going there. You have to get your staff in and out and all the rest of it. Why do you need the free trade port in the first place, because if you build that infrastructure, to a certain extent you will get the jobs anyway? It is really a question of the extra niche that you need.

Chris Walker: Ultimately you are talking about two levels of connectivity: connectivity within the domestic economy, the roads and the motorway, and international connectivity. One of the reasons that freeports generate economic growth is that they enhance international connectivity by making trade a lot more seamless. You need to do both things together, if that makes sense. You cannot really do one without the other.

Q22 Mark Garnier: We can go round in circles a bit on this. I am wondering whether turning Harwich and Felixstowe into a free trade port would make it more worthwhile tripling the A14 or less worthwhile. Do you see what I mean?

Chris Walker: Yes. I get that there is a chicken and egg situation here, but if you have more trade coming into a port and that trade needs to go on for inward distribution, you need to have the infrastructure to accommodate that.

Q23 Mark Garnier: Catherine, do you want to pull all that together?

Professor Barnard: You mentioned Felixstowe and the A14. I probably ought to declare some interest here because I am at Trinity College and Trinity is a major landowner around Felixstowe. I am well aware of both Felixstowe and the A14.

What I was going to add is that the benefits you might be able to join up would be, for example, some of the innovation that you see in the Cambridge area of science parks and the developments there. Cambridge has led the way in science parks. It may be that you could get some of that R&D investment, some of that incentive structure that you were



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talking about before, through the use of the science park and join it up with some of the neighbouring ports.

Q24 **Mark Garnier:** To finish on this, the key point is not to be entirely hung up on a free trade port having to be by the sea. You could have a free trade zone in a science park or in Swindon for a car manufacturing area, that type of thing?

Professor Barnard: Absolutely. A port would include airport, not just seaport. Then you can be much more creative about how that freeport might work.

Chair: Thank you. Matt Western has his finger hovering and is about to come in.

Q25 **Matt Western:** On that final point, do you imagine, in talking about niches for the UK, that there could be a variety of niches by different ports and that in reality every town or city of this country could apply to become a freeport because they have a manufacturing facility or they want to develop enterprise in that area, irrespective of whether they have a seaport or an airport? Is that not the case?

Professor Barnard: That is exactly right. At the moment, the Government are talking about 11, I think, but you could imagine a more ambitious programme. Then the problem is how you define the geographic limitation of that port. The standard definition of a freeport is that there is some sort of perimeter fence and then the question is what happens on the outside of the perimeter fence. This is where you go back to the question about job creation versus job displacement. There are clearly bigger issues that need to be addressed in that respect.

Q26 **Matt Western:** Thank you for that because that is the area that I wanted to come into. I cannot remember which one of you was talking about Madeira, but I want to examine the sorts of risks. All three of you have alluded to risks with this approach, and perhaps you could expand on that. Whoever was referring to Madeira I think said that 1,000 jobs were created. I am interested to know what they created, what sectors they created there, and whether they recognised the risks when they established themselves.

Alex Stojanovic: I think it was me who brought up Madeira. It was created in the 1980s and its existence is a sort of holdover from when Portugal joined the EU. One thing to mention that we have not mentioned yet, which could act as a barrier to these projects, is state aid. Whether the UK sets up its own system, whether the obligations we have under the Northern Ireland Protocol end up catching some of these things, whether we have an agreement with the EU that has some provisions on state aid, in all of those scenarios there could be potential issues, although I also think we should not overstate that because the rules can be quite flexible.



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On the actual specific economic activity, there was a report by the European Green Party published in 2017 that went through this in some detail. It found basically that it is very opaque. It is hard to tell what a lot of the companies do. A lot of them are companies attached to quite famous people, but the actual ownership is very hard to determine. A lot of people had multiple jobs, apparently; it was not clear what they did. This is another crucial element, which is that transparency is quite important to the success of the project. If you create quite an opaque zone where the Government do not know what business activity is occurring, you potentially engender not only impacts for exports, where presumably we are still going to be exporting to the EU, but you may face stronger controls because of the risk. There are also risks of corruption, which are not theoretical. There was a recent case two years ago of a border force officer being jailed. It only takes one to cause some quite serious damage. I think that there need to be measures put in place.

I will mention very quickly the freeports like Geneva, which have been accused of harbouring high-value goods that are basically stand-ins for smuggling and illicit money. While the Government's consultation alludes to the fact that they do not want to encourage high-value storage—which is basically artwork and things like that—I think it should just ban it outright because I do not see what benefit that is going to provide for employment or anything else. If you get illicit activity in these areas, it will disincentivise other legitimate business from going there. I think we really need to be careful of that.

Q27 Matt Western: I would like to come back to that, but Professor Barnard?

Professor Barnard: I was going to build on that very point. Geneva has admitted that there is a serious issue about what is happening to artwork holdings. Apparently, they have over a million artwork holdings there, including 1,000 Picassos, and the ownership structure of any of those is extremely unclear. In Luxembourg there was a high-value warehouse, essentially. Now Luxembourg has decided to clean up its act and has imposed more stringent requirements than EU law requires. Obviously, there is the issue about state aid, but the recent money laundering directive also now applies to freeports. Luxembourg has gone beyond that in requiring greater transparency and, as a result, lost 20 or 30 of its high net worth clients because of the demands of transparency.

For me, what is encouraging about the Government's consultation paper is that it expressly refers to the money laundering directive and the UK's implementation, and there was no hint that the Government were going to withdraw from those obligations. It also refers to OECD guidelines, so it is clear that the UK is not trying to outcompete Geneva or Luxembourg in essentially becoming a very large warehouse. There is a lot of concern and, of course, there is a reputational risk around freeports.

Q28 Matt Western: A cynic might suggest that this has an air of emperor's new clothes about it, and I am sure that is probably not the case—that there are advantages with this sort of approach. There is a real risk, isn't



there, about certain projects that are going to be attracted under any sort of regional policy? You would be wanting to attract inward investment anyway, but these projects could simply be diverting it—and you have talked about displacement—from one region to another. How do you stop that?

Chris Walker: One of the things that you can do, and it came up earlier when we were talking about niches, is potentially tailor freeports to areas that already have particular specialisms. Places like Middlesbrough, Redcar and Teesport have the petrochemicals cluster; Hull and Humber have the Energy Estuary. You could basically allocate your freeport status but keep it confined to the goods that help support the particular areas and existing clusters. That will also help to draw in the extra FDI.

The other real emphasis that the Government are making is how we can drive innovation through freeports. One of the things that you could do there in a decarbonisation agenda, for example, is that if you were to give freeport status to one of the airports, you could turn that airport and the runway into a living lab, where you do test flights for low carbon technologies. There are some niches that will not only help support that innovation and general clustering but also avoid some of the risks that you are describing.

Q29 **Mark Menzies:** This is a question to all three of the witnesses. What is your view on the Government's specific proposals for freeports as outlined in the consultation, specifically relating to customs, tax and planning? Alex, do you want to kick that one off?

Alex Stojanovic: The consultation does a good job of spelling out all the different areas that they are considering, and it asks good questions. I think the proof will be in how those questions exactly are answered. In the tax areas, it asks about the potential benefits of the specific measures, and I think there we need some quite concrete, specific answers. One of the big lessons that we can learn is that, particularly when it comes to tax benefits, they need to be attached with some conditionality. They have to be quite closely matched with what you are trying to drive. Simple cuts in corporate income tax are probably less likely to deliver the benefits that you want. Maybe it can be part of a whole range of efforts, but if you just focus on those aspects and do not do much of the other stuff, I think you risk becoming more of a tax haven, like Madeira is accused of being.

The consultation is a good start and addresses a lot of the issues. Catherine mentioned particularly the transparency stuff and the risk of smuggling and so on. It mentions some of this stuff but it does not make any firm commitments. It mentions that it does not want to encourage high-value storage, but if it does not end up making a commitment on that, it potentially will still encourage it. But I think it is a good document for a consultation.

Q30 **Mark Menzies:** That is great, thank you. Professor Barnard?



Professor Barnard: I probably agree with that. Quite a lot of thought had gone into the document, and clearly the main issues have been assessed. It was obviously asking for feedback. There was not very much empirical analysis about the cost-benefits of this. In one sense, the elephant in the room when it came to the consultation paper is the very elephant that you have alluded to collectively this afternoon, which is whether it will make a significant difference, and what particular model the UK should be going for.

What struck me as not being there, unless I missed it, was employment regulation. One of the issues is that in some of the most successful freeports across the globe, employment standards are very low indeed. It is low cost as well, and that is, of course, an added advantage for those freeports. The Government do not mention employment regulation at all. Does that mean that they are not intending to tackle that as an issue, or is it one way of gaining a competitive advantage over our neighbouring countries, particularly in the EU, which, of course, then feeds into the issues about level playing field conditions in the free trade agreement?

Q31 **Mark Menzies:** It is interesting that you mention the employment issues. One of those is skills, training, people development and so on. Have you given any thought to what kind of incentives, for example, could be offered for the training and employment and so on that sits over and above things that are currently available in order to particularly attract high-end, high-value-added employers? Have you given any thought to those things?

Professor Barnard: The consultation paper expressly talks about apprenticeships, FE colleges, working with those, all of which are good, but if you are talking about really high end, things like nanotechnology, you are talking about people with PhDs and beyond, so it is serious investment at university level. Of course, I could be accused of special pleading, but remember I am not a scientist, I am a lawyer. You clearly need to work very closely with the universities to deliver that really high end and not just middle to high end.

Q32 **Mark Menzies:** What about around planning? Are there any changes to planning law or that type of thing that you think need to be looked at?

Professor Barnard: Alex, do you want to say something about planning, because you were talking about it before?

Alex Stojanovic: I am not an expert on the planning system and I think you definitely need to get someone who knows more about that to give evidence on this. It is a crucial part of so many of the freeport proposals that you speed up some of the planning procedures.

I think the focus needs to be not on the consultation but on the bids. Teesside has produced a document and Ports UK has produced a document where they try to go into more detail about what they want. That is how it should be because you want this to be more bottom-up



driven. The local authorities and the ports will be better placed to identify the sectoral benefits and what they really want. Some of those documents are quite well developed. The Ports UK one mentions planning and also mentions environmental regulation. It talks about the habitats directive and how long it takes for the environmental impact assessment. They are not saying let's have massive deregulation. They are saying we could improve the speed of these things for these designated areas.

I also think, which is something that the document acknowledges, that there is a way of addressing that without necessarily getting rid of or watering down some of the regulations. That is looking at the statutory authorities that have to approve this stuff. With Natural England, for example, if you give it specific time limits to approve some of these things but you also, crucially, give it more resource to be able to do it, you may be able to speed up the process. What you should not do is impose time limits but not give it the resource to be able to approve those things faster. I think that is a way—and the Ports UK document mentions this—of helping to speed up some of these processes without necessarily compromising on some of the regulation stuff.

Chris Walker: I felt the consultation document was quite strong on planning. It talks about permitted development rights, for example, which is basically the national granting of planning permission for something and, in particular, the alignment of permitted development rights between ports and airports. At the moment, they are different. It is talking about deregulating to the same sort of level that airports have, which gives them more freedoms. It also talks a lot about zonal planning and local development orders. Local development orders grant permission to build a particular type of thing in a particular area or zone. It is obviously trying to float some ideas, as any Green Paper or consultation document should, about relaxing planning and giving more planning freedoms for freeport areas.

Q33 **Mark Menzies:** Chris, what improvements, if any, would you like to see following the consultation?

Chris Walker: You could go even further with planning. You could almost allow the port authorities to have carte blanche over planning for their freeport area. That would be the extreme position, but if there are no adverse implications, no residential homes nearby, for example, what would be the real risk of doing that? I am not sure there would be, personally.

Q34 **Mark Menzies:** You touched on airports in the previous answer. In my constituency, I have an enterprise zone that has two parts to it, both of which have separate runways, one of them a very long runway, another one shorter but it can still operate jet aircraft. Thinking of the airport example, what more do you think Government could do or what would you like to see in Government proposals to bring to life the airport options as well?



Chris Walker: I think the issue at the moment, to take the permitted development rights, is that only really covers operational buildings pertinent to the airport operations. That is a much broader category for airports than it is for seaports, without going into too much detail. If you are talking about an ambitious freeport policy, you could potentially extend that beyond just the airport operations to some of the buildings used for the industries that you want to locate there.

Q35 **Taiwo Owatemi:** Following up on the consultation paper, the Government set out three main objectives of innovation, regeneration and investment. How achievable are those objectives? Are there any other objectives that you think are missing from that consultation?

Professor Barnard: I saw them as positive, in the sense that it clearly set the agenda for a much more ambitious use of freeports than the traditional importation of goods to add value through working on those goods and exporting them. I was broadly encouraged by what the consultation objectives were. I would also like a statement that all of these should be done while maintaining good standards of environmental protection, worker protection and so forth. That, of course, already limits what you can do elsewhere. Going back to the questions about planning, what might be advantageous for the operators of the freeports may be to the huge disadvantage of the local community, which may like the jobs, but not like the added traffic and noise. It would be good to see in there a role for some sort of consultation, not just of the interested parties, but also an involvement of local civil society.

Q36 **Taiwo Owatemi:** Thank you. Alex, do you have anything to add to that?

Alex Stojanovic: Where I think there should be a bit of improvement is in the section on the governance. It asks questions, it knows that there is a range of different models, but it does not really specify or give many case studies of the other examples of how they are run. Catherine mentioned the different incentives, and you may have different incentives between the people who are operating versus local authorities and central government and what involvement they have.

I think it is quite important that we look at how the successful models have been run. They often set up a whole government authority that is given the task of monitoring the developments of the authority, but the private sector tends to run it. It seems a bit counterintuitive when you are talking about freeports, wanting to reduce burdens and so on, but looking practically at how the successful examples have developed and how they are practically run is important. There is evidence out there on more of the detail of how that can work.

I think because of state aid law they will be forced to try to design the policies in such a way that they meet the objectives that state aid law permits. Regional development and environmental goals are big exemptions and the existing freeports often try to frame their benefits and what they do in those terms. If the Government are still bound, if



they are setting up their own state aid regime and they want that to be effective, they probably will still need to try to couch the benefits of the freeports in those kind of exemptions, otherwise you are creating quite big distortions that state aid policy would try to catch. I think that will guide the policy towards those objectives.

Chris Walker: I have nothing to add really. I am broadly in agreement with the three high level objectives that the Government have set out. I think they are broadly the right ones and the reason that you would want to do freeports or a bigger version of them.

Q37 **Mick Whitley:** Good afternoon to all the witnesses. Should the freeport model be adapted for the different nations of the UK and, if so, how would you do that?

Chris Walker: This is a really interesting question, because you have areas of devolution in planning, for example. We have talked a bit about planning. You also have devolution in some taxes, yet in other areas you have very much national policy and that is certainly the case with tariffs and trade arrangements. It is going to be interesting to see how that works out. I think the document is talking about 10 or 11 freeports in all, so it will be interesting to see how many of those will be located in England and where, and how many in Scotland, Northern Ireland and Wales. From a national unity perspective, you would probably want at least one in each of the nations.

Chair: The national unity of England.

Chris Walker: I think in essence it comes back to my earlier point. Ultimately, if you want to make these things an economic success you need to play on the strengths of the areas. We all know that the different nations have their own strengths and any way we can facilitate that and design policy to do that has to be for the better.

Alex Stojanovic: I think there is a difficulty with incentives. Perhaps Angus may be able to describe that better than me. If the ambition for Scotland is to join the EU but what Westminster wants to do is to create freeports that in some ways depart quite significantly from the kind of freeports that are possible in the EU, it might be quite difficult for Scotland to get on board with that.

Q38 **Chair:** The next question, and you have a very good point there, is Northern Ireland's status vis-à-vis Brexit and how that might affect freeports. You might want to expand on that a little.

Alex Stojanovic: Yes, for sure. To finish the point, I was also going to say that if you set up a bunch of freeports in England and they take investment away from Scotland, for example, that could create an even bigger problem. That is another reason why you want this to try to be quite compliant with some of the state aid stuff, because state aid is designed to try to prevent this kind of subsidy war. It might be quite difficult for Scotland because it might be disadvantaged relative to



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England but in the ambition to join the EU it may be disincentivised to create some of these things that upon joining it would have to modify or change quite significantly.

In Northern Ireland definitely it would have to comply with the state aid regime there. That is not impossible. It does not mean that Northern Ireland cannot have a freeport. It just means that it will have to be carefully designed. There are 14 in Poland. They are quite well managed in the sense that there is a permit system, where any business that wants to operate has to apply for a permit and that gives the Polish Government some transparency so that they can say to the Commission what activity is happening there.

That is again why transparency is going to be important. To make it compliant with the state aid rules, you are going to need to be able to say with some confidence what business activities are going on there and then also it might have some difficulty with some of the tax stuff, that I think the Commission definitely has some bigger issues with. Madeira exists; it is being reviewed by the Commission but it had been approved. Poland has multiple freeports and they have been approved. Not many new freeports tend to be created. These tend to be legacies of countries that have joined, so there might be a problem for Northern Ireland to do freeports on the same scale as England but I do not think it would not necessarily be able to.

Professor Barnard: I would like to say a couple of things first. I sincerely hope that because of the devolved issues the consultation paper does acknowledge those areas where the powers are reserved and those where the powers lie with the devolved nations. It is, therefore, extremely important that the devolved nations have their say in what sort of freeport they want and that is where the argument that it should be bottom up, rather than top down, becomes relevant.

My third point relates to Northern Ireland and this question of state aid. As you know, under the Northern Ireland Protocol the EU state aid regime applies, certainly to Northern Ireland where there is an effect on trade between Northern Ireland and the rest of the EU. You should also bear in mind that the protocol is probably wide enough to catch any freeport legislation that applies throughout the United Kingdom. Any UK legislation that has an effect on Northern Ireland trading goods, and thus an effect on interstate trade, will have to be notified to the Commission under the state aid regime as laid down in the Northern Ireland Protocol. I realise that is quite a mouthful, but the bottom line is that as a result of the Northern Ireland Protocol the EU state aid regime will continue to be relevant to not just Northern Ireland but the rest of the United Kingdom.

That is not the end of the story, because the EU state aid regime does not say no, but you have to notify in advance where there is going to be state aid and then the Commission can approve it. The stereotype is that the Commission says no to all state aid requests. This is certainly not the



case at the moment. The furlough regime that has been notified—remember that at the moment we are still, to all intents and legal purposes, in the EU—has been approved. There are, of course, exceptions to the prohibition on state aid, but it does act as an obstacle to the Government doing what they want when they want.

Q39 Sir Mark Hendrick: My question relates to some of the discussion we have just had. What effect, if any, will the UK's future relationship with the EU have on UK policy around freeports? It has been fairly well answered on its impact on Northern Ireland but what will the impact be on the rest of the UK?

Professor Barnard: Alex, do you want to go first, because I have already talked a lot?

Alex Stojanovic: In addition to the Northern Ireland Protocol, which Catherine has outlined, that impacts on both the whole of the UK and Northern Ireland specifically, there could be a deal between the EU and the UK. If you had a situation where a UK freeport has basically attracted investment that would have gone to France but instead goes to a freeport in the UK, and the reason it has gone to a freeport in the UK is because some tax incentive has basically been the deciding factor, any kind of agreement is likely to catch that. Definitely from the EU's perspective, if there is going to be a deal it will want to have a way of addressing investment that has shifted due to distortions.

Q40 Sir Mark Hendrick: How would that be adjudicated upon?

Alex Stojanovic: It depends. There are different models. The EU's position is that you have the ECJ and the Commission. The ECJ has to approve, or a UK body with consultation with the Commission approves it but ultimately the ECJ is the decider and only the ECJ can determine whether something is state aid or not. There is not a mechanism that the EU will agree to where a separate body will be able to determine whether something counts as state aid under EU law. That does not mean that there are not compromises or ways round that, ways that you can bring dispute resolution in to adjudicate on these questions, but it will not be answering the question. It is quite complicated. It will not be answering the question whether something is state aid or not.

There have been suggestions of a compromise whereby either side can impose safeguards so they can impose interim tariffs if they feel like investment has unlawfully broken the rules. The next step down from what the EU wants is hard for the EU, it is difficult to design, but it is not impossible. There have been proposals from some state aid experts on possible landing zones, but they are tricky.

Q41 Sir Mark Hendrick: Is not the involvement of the ECJ at all, given the Government's position, a no-go area and looking at a no deal possibly because of it?



Alex Stojanovic: I do not want to overstate this, but there have been hints that perhaps on the EU side there is some recognition that having EU institutions adjudicate on public spending measures is very strong. It will go beyond, for example, what the Ukraine has agreed but at the same time what the UK is asking for—which goes beyond Canada or other free trade agreements but it is still a free trade agreement—is still accepting quite a lot of barriers to trade between the UK and the EU. I believe that the Government will not accept that and perhaps the EU might be open to try to devise other ways. Some of that involves the UK committing to setting up a UK authority that does a lot of this stuff. It ports over a lot of the EU system and it can make modifications.

This is going to be the subject of a paper that I am working on currently for the Institute for Government. I have gone into too much detail, but essentially you mirror what the EU system is and the UK can make modifications to that to better suit itself, but maybe the EU will be okay with that if it can say, “Okay, you have a system that will police yourselves, so we do not have to bring disputes about subsidies because you have a system that is effective and we have a system that is effective, therefore we can come to an agreement”. I think that is possible but it takes both sides, the UK and the EU, moving. The UK is going to have to commit to more than what it is offering, which is really just what exists in the World Trade Organisation on the subsidies.

Professor Barnard: I will pass on that. Alex has given a comprehensive answer. The only way that you have no role for the ECJ is if you have no role for EU law.

Q42 **Paul Girvan:** The last comment really says it all. On the Northern Ireland Protocol—and I just want to get clarification of the interpretation of it—if there were to be a freeport in Northern Ireland, it would be under EU state aid rules; is that correct?

Chair: Is that correct? Everybody is nodding. Am I right? Can I get a yes, yes, yes for the record?

Professor Barnard: Yes.

Alex Stojanovic: Yes.

Chris Walker: Yes.

Q43 **Chair:** That is affirmative from all three there. Are you happy that was the answer that was given, Paul Girvan? You might not be happy with the answer, but might be of course. I do not want to put any sort of words in your mouth.

We are coming to an end of panel 1 and I know panel 2 is waiting patiently, and I know we are over time. We have had some written evidence from the Royal United Services Institute for Defence and Security Studies Centre for Financial Crime and Security Studies that states their concerns about freeports and trade in counterfeit goods, drug



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trafficking, smuggling of untaxed goods such as cigarettes, trade-based money laundering, tax evasion. Do freeports have problems? I note the economist Richard Murphy—I am quickly looking at my phone—was raising concerns about this, that it distorts markets and if UK regulation is so bad why not just change it everywhere in the UK rather than in parts of the UK? Can I get maybe 40-second reflections, at the very most, on all of that from each one of you, before I move to panel 2?

Professor Barnard: Freeports do not have the best of reputations for that very reason and that is what perhaps they are best known for or most infamous for. One way round that is to say that freeports in the UK will not be used as a site for storage of alcohol, artworks over a certain value, the things that are most likely to be problematic. Also, you need to have very good systems of tracing and record-keeping about what is in those freeports, so it goes back to the point about transparency.

Chris Walker: I think you have freeports because ultimately you want to shape where economic activity happens. For me, one of the big rationales for freeports or freeports plus, however you want to describe them, is to drive the conglomeration effects. You need to do that in a tailored way and in quite a targeted way so that you develop the particular specialisms in different parts of the country. That is what I would like to see.

Q44 **Chair:** Over and above the points I have raised to you, does the UK have the border capability for this? There would be big border demands put on the UK Border Force and tariffs and customs and so on. Is this an extra pressure that could come their way?

Chris Walker: I think there will be some extra pressures, but some of what you would have to do under freeport arrangements you already have to do anyway. There will be some overlaps but some additional resource requirement for both the port operators and customs operators.

Q45 **Chair:** Alex, you might want to wrap up on the final response from panel 1 on the counterfeit goods, the smuggling and the border policing issues that would be required.

Alex Stojanovic: Prevention is better than cure. Particularly when it comes to who, the port operators are going to be doing some background checks. These processes already exist. Not removing those and doing them properly is a way to help prevent this kind of activity taking hold and I think there needs to be an ongoing monitoring role. There needs to be someone who is responsible for not only monitoring the success of the freeport according to its objectives but also monitoring the risks and whether it is being used as a tax haven or being used for smuggling and so on. I think there needs to be some investment in that and other freeports that exist that are successful have the authorities to do that.

On the point of why not just change regulations everywhere, I think the argument is that you can experiment in these designated zones and then sometimes, if they are successful, you can apply it everywhere. That works in freeports that exist currently, often sometimes even to raise



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standards, particularly for developing economies. Whether that applies to the UK I do not know, but the argument is it is supposed to be experimental. I think the Government are trying to take that attitude and that is probably a good thing.

Chair: Areas like Scandinavia where they can do something in one jurisdiction and then spread it through the other countries, which is something I am anxious to bring to the British Isles a bit more as well, but that is another issue entirely.

Thank you all, panel 1, for your time. I think we have run over time because of the interest and the vast areas we can go on in this. We will kick off and move over to panel 2.