



WCO Secretariat Note

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Expanding the Concept of Authorized Economic Operator (AEO) to Free Zone Stakeholders

I. Introduction

Free Zones (FZs) have become a global phenomenon and an integral part of the global supply and value chains within the space of just 50 years. The rapid expansion of Free Zones has been mainly driven by political decisions closely affiliated with national economic development strategies. However, it has been pointed out in various publications that FZs attract not only legitimate business, but also illicit activities that take advantage of regulatory exemptions in FZs and the lack of oversight therein.

With a view to responding to growing Customs and private-sector needs, and to ensuring the adequate application of Customs procedures and surveillance in Free Zones, the WCO has developed Practical Guidance on Free Zones (hereafter “FZ Guidance”). The latter is based on the findings of WCO Research Paper No. 47¹, which was endorsed by the December 2020 Policy Commission after in-depth discussions in the Enforcement Committee and Permanent Technical Committee.

Given the fact that organized crime, and even terrorist organizations, are involved in illicit activities inside some FZs, relaxed Customs procedures and controls in FZs should not be their key advantage at the expense of the safety and security of trade and people. Customs’ failure to conduct risk-based background checks on FZ applicant tenant companies, their key employees, compliance records and goods could become a significant enabling factor for illicit trade related to FZs. Nevertheless, further facilitation benefits within FZs could potentially be provided to tenant companies meeting the globally established Authorized Economic Operator (AEO) criteria in the WCO SAFE Framework of Standards (SAFE Framework), with the necessary adjustments to reflect FZ characteristics and national AEO programmes.

¹ WCO Research Paper No. 47: “Extraterritoriality” of Free Zones: The Necessity for Enhanced Customs Involvement” is publicly available at http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/research/research-paper-series/47_free_zones_customs_involvement_omi_en.pdf?la=en.

Given its knowledge and expertise regarding AEO implementation, together with its intelligence on relevant risks and trade security, Customs should be the authority which conducts security risk assessments and AEO validation to grant tangible benefits in FZs, in close cooperation with FZ Authorities and FZ operating bodies.

The aim of this document is to provide information to help Customs administrations in their efforts to apply the AEO concept to FZ stakeholders, in particular to FZ Authorities and FZ companies, based on the FZ Guidance, taking into consideration their roles, characteristics and business types.

II. Risks pertaining to FZs

It has been pointed out in existing papers² that FZs attract not only legitimate business, but also illicit activities whereby criminals take advantage of regulatory exemptions in FZs and the lack of oversight therein. Those papers have urgently called for high levels of control over goods and activities inside FZs. Some have also stressed the need for Customs to be involved and to be empowered to control goods and activities inside FZs.

The analysis of WCO Customs Enforcement Network (CEN) data, and the results of the WCO online survey in 2018, reveal that the variety of offences is also notable, including: tax evasion; illicit trade in counterfeit products, drugs, weapons and cultural goods; and money laundering.

Chart 1: CEN data - Seizures inside FZs - (total 626 seizures*)

*After excluding one unusually-large reporting country

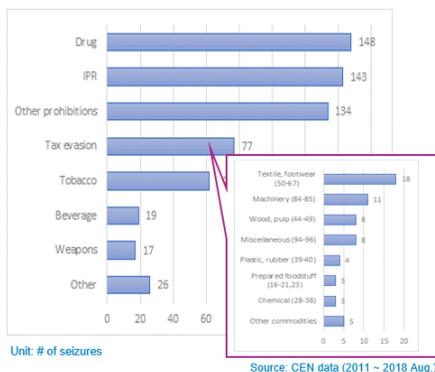


Chart 2: CEN data -Seizures of goods coming from another country's FZs - (total 85 cases)

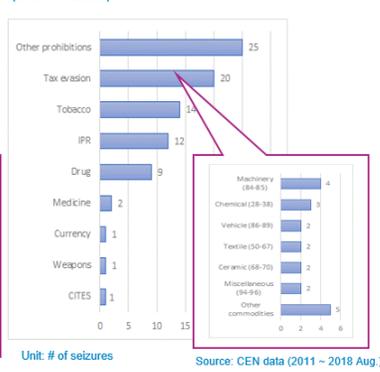
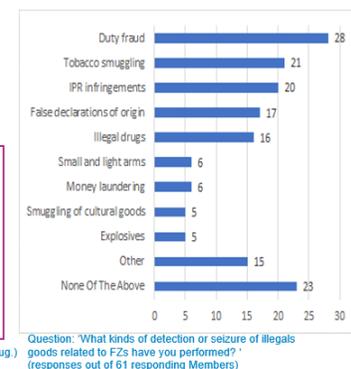


Chart 3: WCO Online Survey on FZs (2018)

(unit: # of responding Members)



Given that not only Customs, but also existing papers, have underlined the important role played by Customs in FZs' development, as well as in surveillance of cargo movements, and given the need for due diligence and compliance record checks of FZ-related companies, Customs administrations should be heavily involved in validating FZ operating

² The Financial Action Task Force (FATF) (2010), the International Chamber of Commerce (ICC) (2013), Interpol (2013), Viski et al. (2016), The Economist (2018), the Organization for Economic Co-operation and Development (OECD) (2018), and McKinsey & Company (2019). The literature is referenced in WCO Research Paper No. 47.



companies and tenant companies in order to contribute to these companies' safety and security, as well as competitiveness.

III. Expanding the AEO concept and strengthening partnerships in FZs

The AEO concept is a means of securing and facilitating global trade, while providing incentives which benefit both Customs and traders that have decided to work in partnership.

FZ Guidance suggests expanding the AEO concept to FZ stakeholders, and strengthening partnerships with them as one of the key elements in ensuring the effective and efficient management of FZs.

Guidance for Customs approval of FZ operators and companies operating in FZs *(Practical Guidance on FZs)*

- ✓ Customs should be involved in and be responsible for reviewing applications by companies wishing to operate in FZs as tenants.
- ✓ Customs should be involved in the permission procedure for commercial and other activities related to Customs procedures and controls in FZs.
- ✓ Customs should use Authorized Economic Operator (AEO) validation criteria to verify compliance levels, as well as check for records of any infringements and monitor compliance, in close cooperation with FZ Authorities and FZ operating bodies.
- ✓ Customs should provide periodic training to companies on responsibilities and compliance in FZs, and provide opportunities to exchange and share the necessary information.
- ✓ In addition, Customs should take any appropriate actions to revoke approval if non-compliance, illegal activities or losses of goods are observed.

This Note focuses on how to apply the AEO concept to the FZ supply chain, and in particular to FZ operating companies and tenant companies, by understanding their roles and specific business models, in order to establish an AEO cooperation framework between FZs and Customs for their mutual benefit.

IV. Expanding the AEO concept to FZ operating bodies and FZ tenant companies

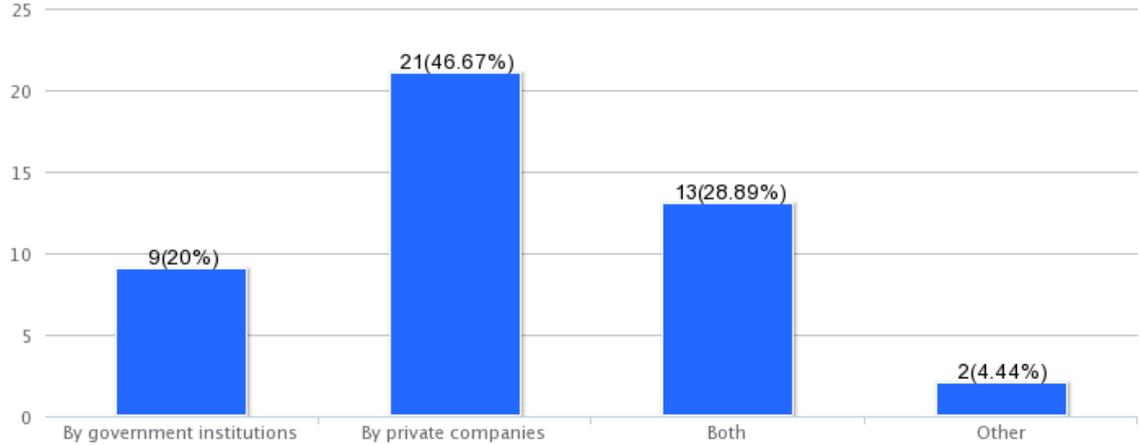
A Free Zone is a geographically designated area where goods may be imported, stored, handled, manufactured, or reconfigured and re-exported. Free Zones are generally organized around major seaports, international airports, and national frontiers.

The rapid expansion of FZs has been mainly driven by political decisions closely affiliated with national economic development strategies. Some FZs are publicly owned; however, the World Bank has reported on the growing number of privately owned, developed and

operated FZs worldwide over the past 15 years³. The WCO online survey on FZs in 2018 shows that nearly 50% of FZs are operated by private companies.

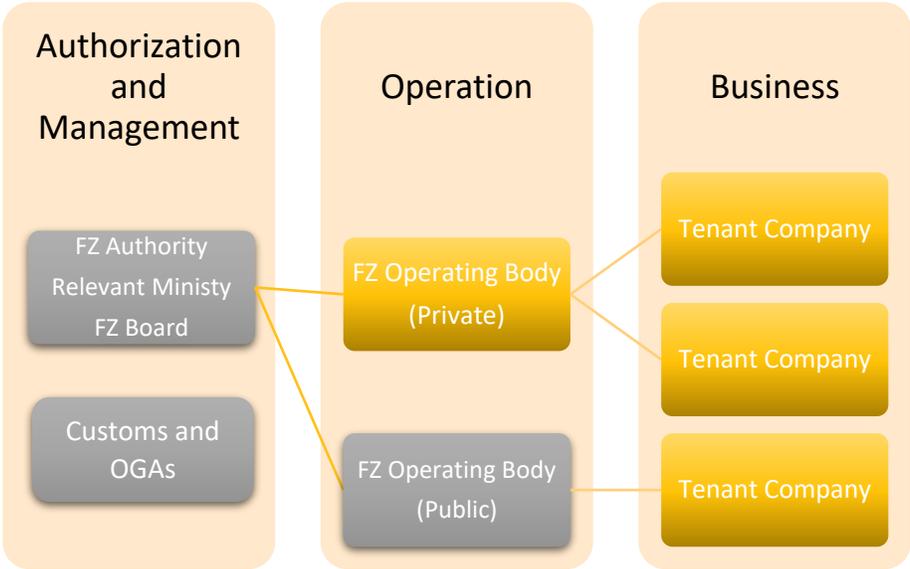
Chart 4: FZ operations (Source: WCO FZ online survey in 2018)

Are FZs operated by private companies or governments?



Typically, FZs are authorized and managed by a FZ Authority, relevant Ministry, or FZ management board, and FZ operations performed by a FZ operating body, which could be the private sector, public sector or some kind of combined mechanism.

Chart 5: FZ management and operations



The WCO’s Compendium of Authorized Economic Operator Programmes indicates that Customs administrations have been making efforts to cover operators across the whole

³ World Bank 2010 “Special economic zone: performance, lessons learned, and implication for zone development”.



supply chain, including: importers/exporters, manufacturers, warehouse operators, port operators, terminal operators, airport operators, carriers, freight forwarders, Customs brokers, express carriers and postal operators. In addition, a few Customs administrations have stated that their AEO programmes also cover FZ companies and FZ parks.

Furthermore, the WCO online survey on FZs (2018) shows that Customs administrations which apply the AEO concept in FZs amount to less than half of the respondents.

Given that FZ tenant companies receive many attractive benefits, including relaxed Customs procedures and controls, and that the unlimited duration of cargo storage is a main characteristic of FZs (see Standard 14 in Specific Annex D2 to the RKC), Customs administrations are facing various challenges in managing increasing volumes of cargoes and adapting to new types of business – including the growing use of FZs. As a consequence, Customs are facing a pressing need to establish partnerships with FZ stakeholders to achieve effective and efficient border procedures in a rapidly changing environment.

Since the AEO programme is a Customs-Business partnership programme, and with a view to ensuring the safety and security of the whole supply chain, it is essential to consider expanding the concept of AEO partnership to the entire FZ supply chain. In particular, this should involve inclusion of the following FZ players, which are relatively new to Customs as AEO partners:

- FZ operating bodies (private); and
- All FZ tenant companies operating inside FZs.

i. FZ operating body

In the FZ Guidance, “FZ operating body” is defined as a corporation, partnership, or person that operates a FZ under agreement and authorization by FZ Authorities.

It is considered that the main tasks of the FZ operating body could be similar to those of warehouse operators, terminal operators and port/airport operators in terms of the need to control the entrance, exit and storage of cargo in those areas (see Chart 6 below). Thus, expanding the AEO concept to encompass FZ operating bodies would not be a challenge if Customs utilize the experience, expertise and high-level technology applicable to these traditional operators, in particular regarding eligible benefits and security criteria.

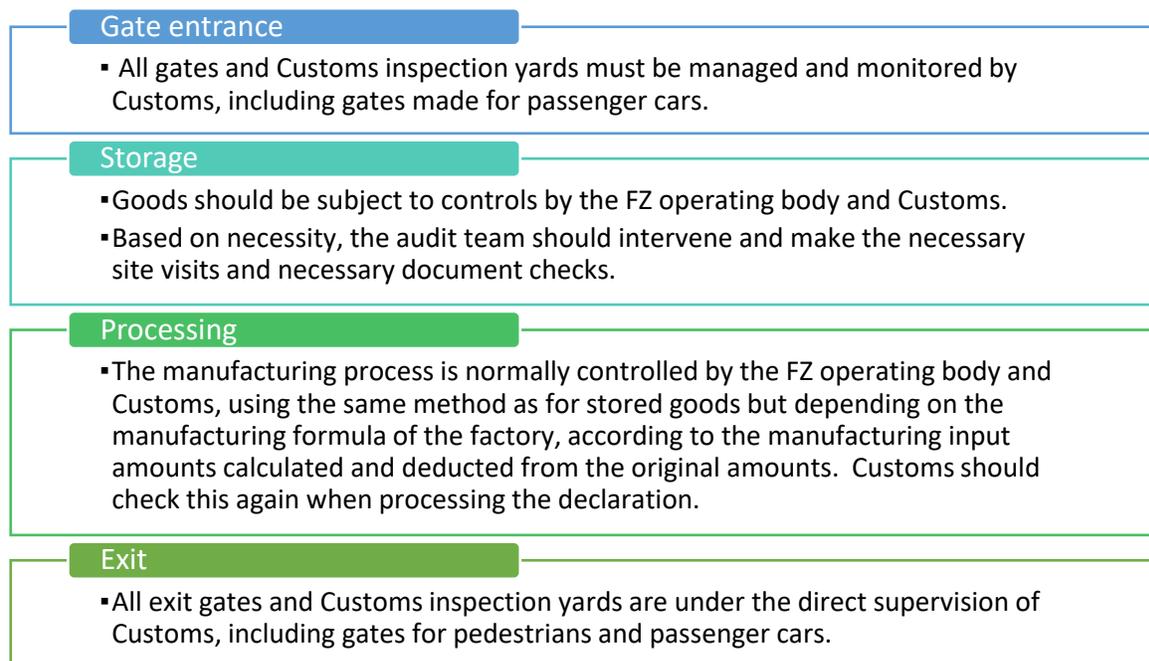
However, the possible influence of some notable characteristics of FZs, such as bigger-sized areas, variety of operations, number of cargoes and companies therein, and longer or unlimited storage, should be carefully measured when applying the AEO concept to FZ operating bodies. Due consideration should also be given to current challenges posed by lack of Customs involvement in FZs and the company approval process, and fewer Customs controls during the storage period compared to, for example, Customs warehouses.

Furthermore, some FZ operating bodies conduct screening of businesses and persons wishing to operate in a FZ, and of their admissible activities and operations, without

involving relevant agencies such as Customs, then giving applicants approval to operate in the FZ.

In this regard, it is critical to apply the AEO programme to FZ operating bodies in order for Customs not only to establish robust relationships with them, but also to ensure the compliance of all tenant companies, and that these too meet the AEO criteria. For some Customs, establishing a connection between the FZ IT system and the Customs IT system is a prerequisite for gaining AEO status, and this seems to be very effective in ensuring the compliance of FZs as a whole.

Chart 6: FZ daily operations



ii. FZ tenant company

“FZ tenant company” means a company operating inside a FZ. Such operations include, but are not limited to, trading, processing (grading, repacking, labelling, distribution, manufacturing, etc.), logistics and other services related to trade/logistics. The tenant company normally needs to register and is given a licence by the FZ Authorities, in close consultation with relevant authorities, including Customs administrations.

FZ tenant companies can be export-oriented manufacturing companies availing themselves of the characteristics of FZs, such as duty free and long or unlimited duration of storage. It has been observed that distributors, and even e-commerce platforms, are utilizing FZs for grading, repacking and labelling purposes, and not for manufacturing operations.



Since many Customs administrations already apply the AEO concept to importers, exporters (which can be manufacturing companies), and distributors, extending the concept to FZ tenant companies is not a new initiative.

Rather, as stated in WCO Research Paper No. 47 and the FATF report (2010), lack of due diligence and compliance record checks during the initial phase of admitting companies into FZs is one of the elements enabling illegal activities in FZs. Customs should consider expanding the AEO concept by utilizing current experience and expertise in applying it to tenant companies, based on necessary cooperation with FZ Authorities and FZ operating bodies.

Customs should conduct risk-based background checks to prohibit legal or national persons convicted of illegal activities from operating within FZs, and take appropriate action to revoke permits if they observe any non-compliance, illegal activities or loss of goods.

V. Data exchange mechanisms with AEO partners

As seen in Chart 7, FZ operating body and tenant companies can be recognized as a source of data necessary for Customs procedures and controls in FZs. Such data sharing with Customs, in turn, could realize tangible AEO benefits, such as simplification and facilitation of Customs procedures, and minimum cargo security inspections to support AEOs' ongoing business development.

Thus, Customs should explore opportunities for engaging with FZ operating bodies and tenant companies to establish AEO partnerships and to explore possible data exchange mechanisms.

Chart 7: Image of FZ system (Source: PTC presentation by CrimsonLogic/GeTS, 28 September 2019)



VI. Establishing conditions and criteria for e-commerce AEOs

In order to ensure the integrity of the AEO programme, the general conditions and criteria regarding compliance and security should be met by the AEO partners.

It is recommended that Customs consider the specific features of FZs, such as bigger-sized areas, number of cargoes and companies therein, longer or unlimited storage and lack of Customs involvement and controls in FZs, along with possible data exchange mechanisms.

Annex IV⁴ to the SAFE FoS provides 13 broad categories of criteria. This Secretariat Note identifies some additional FZ criteria (see below), based on the criteria used for applying the AEO concept to warehouses, and on suggestions taken from FZ Guidance. “AEO Implementation and Validation Guidance”⁵ can also be helpful when establishing criteria for validating FZ operators as AEOs.

Customs-identified security standards and best practices identified by the SAFE Framework, with additional security standards for expanding the AEO concept to FZ stakeholders:

A. Demonstrated Compliance with Customs Requirements

- Taking any appropriate actions to revoke approval if non-compliance, illegal activities or losses of goods are observed.

B. Satisfactory System for Management of Commercial Records

- Having a transparent IT system for managing commercial records as accurately as possible, including transport documents such as the B/L, inventory books, financial records and other records related to cargo movements, inventories and company operations inside FZs.

C. Financial Viability

D. Consultation, Co-operation and Communication

- Having Customs be involved in and be responsible for reviewing applications by companies wishing to operate in FZs as tenants.
- Having Customs be involved in the permission procedure for commercial and other activities related to Customs procedures and controls in FZs.

E. Education, Training and Awareness

⁴ The details of Customs-identified best security standards and best practices can be found on pages 3 to 14 of Annex IV to the SAFE Framework at <http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/safe-framework-of-standards.PDF?la=en>.

⁵ A new link to the AEO Implementation and Validation Guidance will be provided after its publication (in June 2021).



- Establishment of mechanisms for education and training of personnel regarding security policies in FZs, recognition of deviations from those policies and understanding what actions must be taken in response to security lapses.
- Such education should cover the understanding of any prohibitions, including, but not limited to, narcotic drugs, IPR-infringing goods, goods linked to duty or origin fraud, light arms and small weapons, explosives, goods linked to money laundering, and smuggled cultural heritage.
- Establishment of notification system to detect consignments suspected of containing such illegal goods, regardless of whether the goods are intended for domestic consumption, transit/transshipment or other purposes.

F. Information Exchange, Access and Confidentiality

- Connection of FZ operating body's IT system and/or company's IT system storing the data on cargo movements, inventories and company operations inside FZs with the Customs IT system.
- Submission of the periodical reports, including the balance of cargoes, raw materials and a list of inventories, to Customs.

G. Cargo Security

- Adequate self-management mechanism of cargoes stored in FZs.
- Periodical audits by FZ operating bodies and/or with Customs to be reported to Customs.
- Acceptance of Customs ex-officio onsite checks when Customs consider these necessary.

H. Conveyance Security

I. Premises Security

- Following Customs basic construction standards and other standards to be implemented in FZs for Customs control. This covers Customs checkpoints, enclosed fencing surrounding the FZ, Customs inspection areas, video surveillance systems, installation of non-intrusive inspection (NII) equipment, the information network to be interfaced with Customs, etc.

J. Personnel Security

K. Trading Partner Security

L. Crisis Management and Incident Recovery

M. Measurement, Analyses and Improvement

VII. Benefits for FZ AEOs

The success of an AEO programme is based on several elements, including facilitation benefits being provided to AEOs. The benefits should be tangible, meaningful, transparent and measurable.

Annex IV to the SAFE Framework provides a non-exhaustive list of benefits in two broad categories: general benefits and operator-specific benefits⁶. Currently, operator-specific benefits are listed for importers, exporters, warehouse operators, Customs brokers, port operators, carriers, and logistics operators.

Given that Customs procedures outside FZs have been substantially simplified through the use of technology (compared to the 1980s/1990s, when FZs became popular), relaxed Customs procedures/controls in FZs should not be the key advantage at the expense of the safety and security of trade and people.

However, further facilitation benefits within FZs could be provided to FZ stakeholders meeting the globally established AEO criteria. For this purpose, each Customs administration should cooperate with FZ stakeholders, in particular FZ Authorities, FZ operating bodies and FZ tenant companies, to understand their roles in FZs and the different business models that they operate.

This Note identifies some possible operator-specific benefits for FZ operating bodies and FZ tenant companies (see below). These benefits could, together with the general benefits in the SAFE Framework, provide guidance to Customs administrations in developing their own list of benefits, in close consultation with relevant FZ stakeholders.

It should also be noted that these players could benefit from additional trade facilitation through Mutual Recognition Agreements (MRAs) with partner countries when exporting their cargoes from FZs.

Operator-specific benefits for FZ operating bodies

- A. Faster approval of new Free Zone within a specified number of days after submission of complete documents or only by notification;
- B. Faster approval of new tenant companies within a specified number of days after submission of complete documents or only by notification;
- C. Waiver of past record verification usual for granting a FZ authorization;
- D. Waiver of solvency certificate requirement;
- E. Waiver/reduction of financial security and other related requirements for warehousing licence;
- F. Extended validity of FZ authorization (corresponding to the AEO validity period);
- G. Automatic renewal of FZ authorization.

Operator-specific benefits for FZ tenant companies

⁶ A non-exhaustive list of AEO benefits can be consulted on pages 14 to 21 of Annex IV to the SAFE Framework, via <http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/safe-framework-of-standards.PDF?la=en>.



- A. Availability of an e-payment option for collection of duties and taxes;
- B. Electronic application for authorization process and electronic validation procedures;
- C. Deferred payment of duties, taxes, fees, and charges or periodic payment of duties/taxes;
- D. Financial guarantee waivers, reductions or rebates;
- E. Faster disbursement of drawback amount;
- F. Faster processing of refunds and adjudications;
- G. Acceptance of self-certified copies of Free Trade Agreement (FTA)/Preferential Trade Agreement (PTA) origin-related or other certificates required for clearance;
- H. Paperless declarations with no supporting documents;
- I. Export permit can be obtained without carrying the cargo into Customs area;
- J. Direct Port Entry for factory stuffed containers meant for export;
- K. Notification of intention to release prior to goods' arrival, i.e. pre-arrival clearance;
- L. Pre-qualification for simplified procedures, including possibilities for a single-step process (simultaneous release and clearance) or a two-step process (release followed by clearance) for release/clearance purposes, according to the importer's preference;
- M. Involvement in the development of new policies and programmes related to FZs.

VIII. AEO validation for FZs

Given its abundant knowledge and expertise regarding AEO implementation, together with its intelligence on relevant risks and trade security, Customs should be the authority which conducts security risk assessments and AEO validation procedures to grant further facilitation measures in FZs, and monitor compliance in close cooperation with FZ Authorities, FZ operating bodies and FZ tenant companies.

It should be underlined that validating only a FZ operating body is not sufficient to prove the compliance level of a FZ as a whole. As clearly pointed out by the FATF report, illegal operations conducted in tenant companies' premises have been repeatedly reported, and Customs need to conduct due diligence and compliance record checks of tenant companies, based on the Customs intelligence network.

Furthermore, Customs can utilize the Customs-to-Customs intelligence exchange network through Mutual Recognition Agreements (MRAs) with partner countries when conducting validation of tenant companies which are operating globally.

IX. Conclusion

Customs should explore opportunities for engaging with FZ stakeholders, such as FZ operating bodies and FZ tenant companies, to establish AEO partnerships and to explore possible data exchange mechanisms, as stipulated in the WCO FZ Guidance.

In order to ensure the safety and security of the whole supply chain, it is essential to consider expanding the concept of AEO partnership to the entire FZ supply chain.

Validating only a FZ operating body is not sufficient to prove the compliance level of a FZ as a whole.

Customs should be the authority which conducts security risk assessments and AEO validation procedures to grant further facilitation measures in FZs, and monitor compliance in close cooperation with FZ Authorities, FZ operating bodies and FZ tenant companies.

It should be noted that AEO status requires continuous and effective cooperation among FZ supply chain parties – specifically, this involves taking into account their role in international supply chains and their specific business models.

Customs administrations should be receptive to the concerns of AEOs and determine, in consultation with them, a formalized method of communication which ensures that issues are properly received, addressed and resolved for the benefit of both parties. Identifying benefits, utilizing technology and assigning dedicated account managers who are specialized in FZ industry and can help FZ stakeholders coordinate and resolve Customs-related issues could be valuable in establishing mutual trust, based on an understanding of business models and of mutual responsibilities.

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Annex: List of WCO Instruments and Tools Related to the AEO Concept and to Free Zones

WCO Practical Guidance on Free Zones

http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/activities-and-programmes/free-zone/wco-fz-guidance_en.pdf?la=en

WCO SAFE Framework of Standards to Secure and Facilitate Global Trade (SAFE)

http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/frameworks-of-standards/safe_package.aspx

AEO Implementation Guidance

<http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/aEO-implementation-guidance.pdf?la=en>

WCO Compendium of Authorized Economic Operator Programmes

<http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/aEO-compendium.pdf?la=en>

WCO AEO Validator Guide

<http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/aEO-validator-guide.pdf?la=en>

