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DIGITAL TRADE RULES FOR THE 21ST CENTURY

Clark Packard

INTRODUCTION

The architecture for today's rules-based trading system was largely the result of the creation of the General Agreement on Tariffs and Trade (GATT) in the late 1940s, which reduced tariffs and provided basic rules to facilitate the nondiscriminatory trade of goods across borders. Although it is far from perfect, since then, the system has worked relatively well. As a result of multiple rounds of multilateral negotiations, new rules were written and more countries joined the system. However, with the rise of the internet and digital transactions, a new rules-based regime is now necessary to facilitate the continued expansion of trade and to confront the challenges of the 21st century.

In the mid 1990s, the completion of the Uruguay Round of negotiations was the last major advancement in the multilateral rules-based regime. Its most significant achievement was the transformation of the GATT rules and system into today's World Trade Organization (WTO). In so doing, it also modernized the GATT system by adding new disciplines including trade-in-services, investment and intellectual property. It also created a more effective dispute settlement system.[1] However, one missed opportunity in the process was the failure to create a basic framework for commerce done over the Internet. Such an omission was understandable given that the digital revolution was in its infancy at the time.

Today, however, the internet has fundamentally reshaped commerce. Explosive growth in digital technologies has expanded opportunities for businesses and consumers. It has also reduced transaction costs, enabled specialization and expanded markets—much in the same way trade liberalization after World War II did. In fact, a recent WTO study estimated that "e-commerce transactions totaled $27.7 trillion (USD), of which $23.9 trillion was business-to-business."[2] This is an enormous figure, but further growth is threatened by digital industrial policies and protectionism that aim to erect walls around global commerce. For this reason, the time has come to establish strong, market-oriented rules that allow digital trade and e-commerce to expand to meet the demands of the 21st century.

The good news is that, in the coming years, U.S. policymakers and trade negotiators will have ample opportunities to push for forward-looking rules to govern digital trade. Moreover, as part of the recently completed United States-Mexico-Canada Agreement (USCMA), the three parties agreed on a strong set of digital trade rules that provide a worthwhile template for future negotiations, including those at the WTO.

Since the collapse of the Doha Round, large-scale efforts to further liberalize trade have stalled, which has pushed countries into regional and bilateral trade negotiations outside the WTO framework. At the World Economic Forum's 2019 confab in Davos, Switzerland, 76 WTO members, including the United States, the European Union, Japan and China, announced they would begin negotiating new rules for e-commerce.[3] As many question whether the WTO can serve as an indispensable forum for liberalization, the e-commerce issue presents an opportunity for members to rise to the current challenges facing the rules-based system in the same way previous generations of trade negotiations and policymakers rose to the challenges of their time. In light of this, the present brief will lay out concrete recommendations for policymakers and trade negotiators to consider as they begin negotiating at the WTO and in future bilateral and regional free-trade agreement negotiations.

POLICY RECOMMENDATIONS

Prohibit data localization

As Gary Hufbauer and Zhiyao (Lucy) Lu of the Peterson Institute note: "Data localization refers to the practice of requiring firms to locate their computing facilities in domestic territory as a precondition of conducting business in that territory."[4] Governments use data localization requirements for myriad reasons, but they are another form

of protectionism, because they are inherently designed to favor domestic firms over foreign ones. As R Street has noted in the past, "restricting data flows impedes the growth of downstream jobs and entrepreneurial opportunities while fostering inefficient domestic industries dependent on rent-seeking and government privilege."[5] Other recent research highlights the heavy toll such measures inflict upon the global economy.[6]

In recent years, policymakers in the United States have increasingly recognized this problem and taken affirmative steps to stop its spread. First, in 2015, Congress passed Trade Promotion Authority (TPA), which establishes trade negotiating objectives in exchange for expedited consideration of any trade agreements negotiated by the executive branch. TPA added a new objective directing the United States Trade Representative (USTR) to target data localization requirements in future negotiations.[7] In the recently enacted USMCA, the three parties agreed to prohibit data localization requirements.[8] Likewise, the United States and Japan recently concluded a minor deal that covered a few sectors of the economy and, as part of that agreement, the countries pledged not to enact data localization requirements.[9] This is a good first step, but regrettably these prohibitions will only apply to the United States, Mexico, Canada and Japan.

As the United States begins negotiating free-trade agreements with the United Kingdom, the European Union and others, as well as at the WTO, it should be a forceful advocate for prohibitions on data localization in all sectors. Such policies face stiff resistance from China (data localization was specifically omitted from the recently-enacted "Phase One" deal between the United States and China), India and others, but such prohibitions are integral to the expansion of the internet-based economy.

Bar digital services taxes and tariffs on digital content

As American-based multinational corporations (MNC) have come to dominate the commanding heights of the internet economy, cash-hungry governments across the globe have been clamoring for a piece of the revenue pie. For example, France recently enacted—then postponed under threat of tariff retaliation by the United States—a digital services tax (DST), with revenue thresholds that essentially only target the profits of American MNCs like Google, Apple, Facebook and Amazon.[10] The European Union (EU) and other governments are currently also considering such discriminatory taxes.[11] There are ongoing multilateral negotiations at the Organization for Economic Cooperation and Development (OECD) over these types of issues, but they are beyond the scope of this paper.

As Hufbauer and Lu explain, the EU's DST proposal discriminates against American firms in a variety of ways that include the establishment of a very high revenue threshold and a structure designed "to capture the business models of US digital firms but not so many EU digital firms."[12] Given this, the DST drafts are tantamount to discriminatory tariffs on American firms.[13] However, such taxes violate WTO rules. Under the General Agreement on Trade in Services (GATS), WTO members obligated themselves to what is known as "National Treatment" for trade-in-services—digital ones among them. Indeed, "[a]n overarching commitment within [GATS] framework was the venerable principle of national treatment," which establishes that WTO members cannot discriminate between imported and domestically produced goods and services.[14] Given this, drafting DSTs that are designed to discriminate against American MNCs providing like services, is a violation of these countries' GATS obligations.

Likewise, ever since the WTO's Ministerial Conference in 1998, including most recently at the 2017 Ministerial Conference in Buenos Aires, WTO members have pledged not to impose tariffs on electronic transmissions.[15] Creating a tariff on services delivered via electronic transmission violates the current WTO practice of not imposing customs duties on such transactions. The United States would have a strong case to make within the dispute settlement system at the WTO that the various DST iterations are inconsistent with WTO obligations.

While utilizing the dispute settlement system makes sense if WTO members move forward with DSTs, the United States is being proactive. In the recently completed mini deal with Japan, the two countries specifically prohibited discriminatory treatment of digital products and extended the deal to cover tax measures like DSTs.[16] Nondiscrimination is a bedrock principle of the rules-based trading system and should be protected to the greatest extent possible. Accordingly, in both future bilateral and regional negotiations and at the WTO, the United States must advocate for a similar measure to prohibit discriminatory taxes against American MNCs. Likewise, the United States should urge countries to make permanent the ban on customs duties on electronic transmissions, and prohibit tariffs on digital content similar to the prohibitions contained in the USMCA.[17]

Protect online intermediaries

The explosion of the Internet has been one of the greatest innovations of the last 25 years. Much of the growth in the digital revolution is the result of the relatively light-touch and laissez-faire approach to internet regulation that U.S. policymakers have embraced. It is not a coincidence that the most innovative internet companies were built and continue to be based in the United States. A primary reason for this

is a technical concept that provides liability protection for online platforms (known as intermediaries) for the content posted onto their sites by users. In the United States, this comes from laws like the Digital Millennium Copyright Act and Section 230 of the Communications Decency Act.

These laws establish that content creators are responsible for their online speech and actions, rather than the platforms on which the content was posted. Such strong intermediary liability protections are integral to the internet ecosystem, as they enable internet service providers and platforms to allow their users to freely share content, stream videos and a myriad of other tasks without fear of being sued for defamation or copyright infringement. Take YouTube, for example. It is estimated that YouTube users "upload 100 hours of video every minute."[18] Without liability protection, YouTube would be enmeshed in scores of frivolous lawsuits based on users' content or burdened with astronomical compliance costs. However, thanks to 230-like protections, it can spend its money on research and development, and continuing to push the frontiers of innovation.

However, it is not just major corporations like YouTube, Google and Facebook that benefit from these intermediary liability protections. As the Electronic Frontier Foundation notes: "CDA 230 also offers its legal shield to bloggers who act as intermediaries by hosting comments on their blogs. Under the law, bloggers are not liable for comments left by readers, the work of guest bloggers, tips sent via email or information received through RSS feeds."[19] This freedom has been enormously beneficial to the growth of the Internet, yet sadly, it is largely unique to the United States.

Under the terms of the USMCA, the United States, Mexico and Canada wisely established provisions mirroring Section 230 of both the Communications Decency Act and the Digital Millennium Copyright Act.[20] As the USTR begins to negotiate new bilateral, regional and plurilateral agreements, including at the WTO, the United States must remain firmly committed to these provisions. With many analysts sensing an emerging competition with China over technology supremacy in the 21st century, policymakers should recognize the importance of the permissive American system founded in large measure on intermediary liability protections.

Prevent trade secret disclosure and forced technology transfer

Although a temporary detente was reached at the beginning of 2020, the United States and China have been engaged in a full-blown trade war since 2018. Even after the recently announced reprieve, tariffs on imports from China are still about six times higher than they were before the spat between Washington and Beijing began.[21] Tariffs and trade tensions remain elevated between the world's two most powerful economies, but the trajectory of this relationship has been trending toward confrontation for some years.

With military, national security and commercial implications, technological supremacy is at the heart of the conflict between the two countries. In 2018, the USTR released its report documenting the number of ways in which China's trade policy practices discriminate against and unfairly burden American firms.[22] The report formed the basis of the Trump administration's aggressive, unilateral tariffs on imports from China. It largely focuses on technology and the ways in which Beijing coerces the transfer of technology from American firms to Chinese ones, including through foreign ownership restrictions (joint venture requirements and equity caps); licensing of technologies on discriminatory, non-market terms to favor domestic Chinese firms; investment in American firms for the purpose of obtaining technology and intellectual property; and cyber intrusions into networks of American firms to access trade secrets and vital information.[23]

Many of these practices alleged by the USTR are prohibited by WTO rules. For example, Article 7.3 of China's Accession Protocol, the binding commitments Beijing made when it joined the WTO, specifically prohibit China from conditioning importation or investment on the transfer of technology.[24] Despite these prohibitions, the Trump administration opted not to address most of its concerns using the WTO's dispute settlement system. In fact, instead, Trump made active efforts to cripple the dispute resolution arm itself.[25]

As part of the USMCA, the participating countries agreed to prohibit conditioning of market access on the transfer of source code.[26] Such bans on forced source code transfer are good, but they should go further to cover other trade secrets and other forms of forced technology transfer. As the United States negotiates digital trade rules at the WTO in particular, it therefore must push for more concrete, expanded and enforceable prohibitions on such practices—mainly as a check on China's protectionist impulses.

CONCLUSION

Due in large measure to the United States' permissive regulatory regime, the free-and-open Internet has paid enormous dividends for America and the world. Over the last 25 years, the nature of commerce has changed, but the rules guiding trade across borders have not kept pace. By pushing for new rules, grounded in a commitment to nondiscrimination and the free flow of goods and services, the United States is well positioned to replicate the type of indispensable leadership it showed in the creation of the rules-based trading system in the late 1940s, and to create a new frontier for commerce in the 21st century.

ABOUT THE AUTHOR

Clark Packard is a resident fellow and trade policy counsel in the Finance, Insurance and Trade program at the R Street Institute, where he researches international trade and investment policy.

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