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Unlocking Growth through Trade

Trade agreements to move the digital economy

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Insights

- The current COVID-19 crisis is fueling rapid growth in digital services as more and more businesses move online in order to reach their customers. This transformation is enabling businesses to reach new markets, making digital trade critical to global economic recovery.
- This paper finds that in order to modernize trade policy to reflect the needs of the digital economy, future trade agreements must address issues related to small business access, data flows, digital tariffs, digital financial services, and market access restrictions, while also encouraging greater international cooperation.

The current COVID-19 crisis is fueling rapid growth in digital services as more and more businesses move online in order to reach their customers (for more on this, please see recent *Forbes* and Visa Economic Empowerment Institute articles). This digital transformation is enabling businesses to reach new markets, making digital trade critical to global economic recovery.

Multilateral commitments on digital trade have not kept up with significant advances in technology and subsequent growth in digital services. Conversations at the World Trade Organization (WTO) for modernizing multilateral agreements are currently underway but face a number of challenges. Despite this, several countries are leading the way with innovative bilateral and regional trade agreements, creating new rules for the digital economy. Here, we examine how these forward-looking trade agreements can bolster the global economy and improve digital equity, while providing a roadmap for future digital trade initiatives.

Modernizing trade to fit the needs of the digital economy

The foundational rules of the global trading system, overseen by the WTO, predate the rise in popularity and importance of the internet and subsequent digital technologies that have made full use of it (e.g., smartphones and their applications).[1] To ensure coverage of new technologies and services and, more importantly, policies that enable cross-border flows of those technologies and services, a number of countries have in recent years signed bilateral or regional digital trade agreements that complement existing rules.

The earliest and most prominent of such agreements is the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). The CPTPP has a number of commitments on digital trade ("Electronic commerce" in the text), including prohibitions on data localization and protections for data movement, mandated disclosure of source code, and tariffs on digital goods and services. While the CPTPP covers a wide range of digital services, it falls short of being a model agreement as its digital trade commitments do not extend to digital financial services. The CPTPP does, however, provide some market access commitments for financial services, and includes protections on the "transfer of information in electronic or other form,"[2] though there are some limitations on the applicability on this (Gallaher et al., 2020).

The United States-Mexico-Canada Agreement (USMCA) builds upon the CPTPP and goes further in expanding commitments for digital financial services. While the United States is not a signatory to the CPTPP, it has incorporated similar digital trade provisions into the USMCA's financial services and digital trade chapters, but with some important distinctions. For instance, the USMCA includes financial services in its commitments on data flows.[3] Further, it guarantees market access and prevents discrimination against international providers for a variety of digital services, including a number of digital financial services (including electronic payment services), across all parties to the agreement.[4]

The United States has used the USMCA's digital trade chapter as a template for other negotiations, including the recently signed US–Japan Digital Trade Agreement, which similarly includes broader commitments on digital financial services.

The Digital Economy Partnership Agreement (DEPA) between Chile, New Zealand, and Singapore moves even further toward addressing gaps in digital trade agreements with commitments to actively cooperate on policies related to emerging technology issues (e.g., artificial intelligence, digital identity). The DEPA also makes strides in broadening the scope of digital trade commitments, but unfortunately, like the CPTPP, still does not extend commitments to digital financial services. The DEPA's section on digital payments, however, does include some innovative commitments to support the development of "safe and secure cross-border electronic payments" by adopting internationally accepted standards, promoting interoperability, and encouraging innovation.[5] Importantly, the DEPA is the first trade agreement to promote open banking[6] through the voluntary use of open application programming interfaces (APIs). The DEPA also looks to expand access to digital financial services by encouraging cooperation and development within the fintech industry.[7]

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[1] Commitments at the WTO level that may apply to digital trade are stitched together across multiple chapters covering different industries, and not through a single "digital trade" chapter as in recent trade agreements we discuss in this paper. For instance, commitments on data movement might be covered in the General Agreement on Trade in Services (GATS) Annex on Telecommunications, whereas commitments on digital financial services such as payment services might be found within the GATS Annex on Financial Services and related schedules.

[2] Consolidated TPP Text, Chapter 11—Financial Services, Annex 11-B, Section B: Transfer of Information.

[3] See Articles 17.17 and 17.18 of the US-Mexico-Canada Agreement.

[4] Ibid., Articles 17.3.3 and 17.5.1.

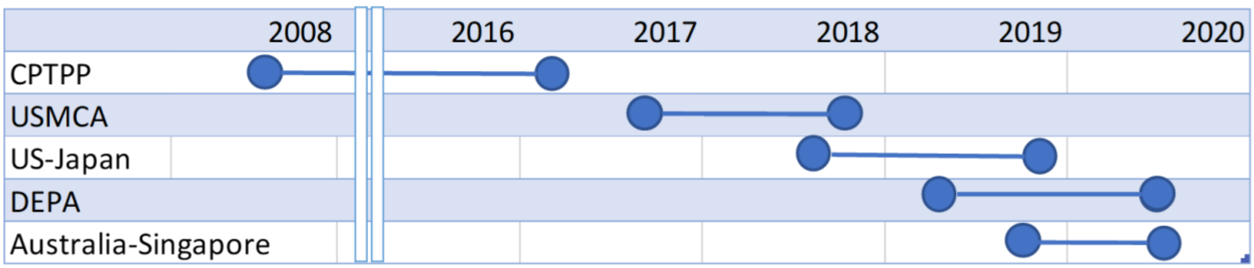
[5] Digital Economy Partnership Agreement (DEPA), Article 2.7.1.

[6] *Open banking* refers to consumers sharing their banking data with third-party applications and firms in order to access new and innovative financial services.

[7] DEPA, Article 8.1.

Finally, the Australia–Singapore Digital Economy Agreement (DEA) incorporates some of the most comprehensive commitments on digital trade to date, including commitments on data flows, inclusion of digital financial services, and a broad range of considerations for emerging technologies. The agreement also expands the focus areas of cooperation to include standards development and conformity assessment and encourages vehicles for regular dialogue between governments and industry stakeholders on emerging technologies such as artificial intelligence, data privacy, and small business participation in trade.

Other recent trade agreements also contain digital trade commitments, though many are less ambitious in scope than the agreements mentioned above. For instance, the recently signed Regional Comprehensive Economic Partnership (RCEP) agreement between 15 countries in the Asia-Pacific region also includes some commitments on data flows. However, the RCEP includes more exemptions to digital trade commitments than the CPTPP (including for digital financial services), and the digital trade chapter ("electronic commerce") is itself exempt from the RCEP's dispute settlement chapter, raising doubts about the enforceability of commitments.[8]



Description: A horizontal timeline showing five recent trade agreements; CPTPP runs from 2008 to 2017; USMCA runs from August 2017 to November 2018; US-Japan runs from September 2018 to December 2019; DEPA runs from May 2019 to June 2020; and Australia-Singapore runs from October 2019 to June 2020.

The building blocks for future agreements

In the agreements described above, certain elements emerge as central to ensuring future growth in the digital economy. In order to modernize trade policy to reflect the needs of the digital economy, future agreements must address issues related to small business access, data flows, digital tariffs, digital financial services, and market access restrictions, while also encouraging greater international cooperation. We explore these issues further below.

Small business considerations

Navigating the complexity of the global digital economy can be challenging for any enterprise, but for small businesses with limited resources, trying to navigate trade rules, accessing capital and credit, and connecting with external partners can be downright overwhelming. This is especially true during the current health and economic crisis, which is disproportionately affecting small businesses. And although many small businesses are facing challenging circumstances, the rapid move toward digitization also presents a chance to expand to new markets, which will support growth and resiliency among small businesses in the future.

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[8] The RCEP Electronic Commerce chapter prescribes bilateral discussions for disputes on digital trade issues. If bilateral discussions fail, parties may refer the matter to the RCEP Joint Committee, but "no Party shall have recourse to dispute settlement"; see RCEP, Chapter 12, Article 12.17: Settlement of Disputes.

Therefore, it is essential for future agreements to have special considerations for small businesses. Some recent agreements include such considerations, focusing on commitments to increase cooperation, information sharing, and participation in platforms to assist small businesses with international trade.[9] The Asia-Pacific Economic Cooperation (APEC) Micro, Small and Medium Enterprises (MSME) Marketplace is one such platform, which connects small businesses across the 21 member economies with various trade promotion agencies and foreign suppliers and financing opportunities. The MSME Marketplace also provides comprehensive information on regulations, tariffs, and non-tariff barriers across markets and includes several training and education resources.

Small businesses are also likely to benefit disproportionately from many of the same digital trade commitments that benefit larger businesses. This includes, as discussed further below, not only those that reduce market access barriers and prices for digital services (e.g., commitments on data flows, prohibitions on tariffs), but especially those that provide for cross-border data flows and prohibit server localization, which can enhance the productivity of small businesses through the use of cloud-based and other data-based services.

Trade commitments on data flows

The free flow of data is critical to the functioning of the global digital economy: It ensures that buyers and sellers can seamlessly connect anywhere around the world. Additionally, the free flow of data helps protect merchants and consumers from fraud and cyberattacks by enabling companies to ensure data resilience, data recovery, and general business continuity by placing data centers around the world (Meltzer and Lovelock, 2018). Many products and services, including cloud-based technologies designed to enhance business productivity and lower costs for small businesses, rely on the free flow of data.

Of course, many governments around the world are concerned that advances in digital technologies and the increasing ease of data collection may endanger consumer privacy and security. Furthermore, some national actors have argued that data is an economic asset and, therefore, the free flow of data across borders could endanger a country's economic growth and sovereignty. Therefore, some governments have enacted controls on data, such as data localization, which prohibits the flow of data across borders or requires certain data to be stored locally.

Data protection and the preservation of the privacy rights of individuals in this era of unprecedented technological advancement are concerns of our time and are being grappled with by regulators and legislators everywhere. While there are many solutions under debate, data localization is not the answer. Often data localization requirements do more harm than good without increasing consumer protection and security. Recent studies have supported the fact that data flows are essential for economic growth, and data localization would therefore negatively impact local economies.[10] As more and more countries pursue localization—often as a protectionist measure—the economic damage to domestic firms, consumers, and economies is likely to be even more severe.

Therefore, ensuring the free flow of data in future commitments on digital trade is essential to ensuring agreements are mutually beneficial and stem the tide of digital protectionism. Future agreements also need to ensure the free flow of data is balanced with a respect for local laws and regulations regarding consumer privacy. A key area of focus for those agreements will be to ensure interoperability between markets governed by differing privacy regimes and prevent de facto localization.

[9] For instance, see DEPA Article 10-1, where members agree to: (a) "continue cooperation with the other Parties to exchange information and best practices in leveraging on digital tools and technology to improve small to medium enterprises' (SMEs) access to capital and credit, SMEs participation in government procurement opportunities and other areas that could help SMEs adapt to the digital economy; and (b) encourage participation by the Parties' SMEs in platforms that could help SMEs link with international suppliers, buyers and other potential business partners."
[10] For instance, a recent McKinsey report estimates data flows have contributed over 10 percent to global GDP over the past decade (Manyika et al., 2016).

Prohibiting digital tariffs

Since 1998, WTO members have agreed to not impose tariffs on "electronic transmissions," which, while not explicitly defined, is generally understood to include anything from emails to digital streaming services.[11] However, a growing chorus of voices at the WTO want to end this "moratorium" on digital tariffs, arguing that new tariffs are a critical way to raise government revenues and protect local industries.

The current moratorium ensures that digital services are affordable, accessible, and competitive, and any future digital trade agreement should therefore include similar prohibitions on tariffs. Any effort to impose tariffs on digital services would undoubtedly raise costs for consumers. It could also impair access in certain markets, as compliance costs (i.e., the effort companies would need to undertake to ensure proper accounting of tariffs) could prevent companies from bringing services to market. Additionally, tariffs could significantly tip the scales in favor of local providers over international ones, hurting overall competition and innovation, and potentially creating local monopolies.

In terms of finding new revenue streams for governments due to forgone tariff revenues, taxing electronic transmission will likely have a net negative economic impact. A recent Organisation for Economic Co-operation and Development (OECD) study (Andrenelli & Lopez-Gonzalez, 2019) found that forgone revenue is quite small (0.08 to 0.23 percent of overall government revenue), and losses to consumer welfare would far outweigh any increases in government revenue (roughly US$940 million in gained welfare compared with US$73 million in lost revenue, globally).

Inclusion of digital financial services

Digital financial services are critical to enabling cross-border commerce. The obvious ways in which financial services and trade support each other is through trade financing as well as cross-border payments—e.g., paying for goods and services from suppliers or accepting payments from consumers abroad. Cross-border supply of financial services also plays a significant role in commerce, both domestically and internationally. Examples of cross-border supply of financial services include services to accept and make payments (both domestically and abroad), access to credit through multinational banks, and value-added services (fraud and security services and clearing and settlement services, among others).

Unfortunately, current agreements with digital trade commitments are limited in scope and often do not contain commitments on digital financial services. This, coupled with rising protectionism, means some markets will not be able to access critical services that enable digital commerce. For instance, even when countries have agreed to prohibit data localization through trade commitments, digital financial services are often excluded from this commitment. Similar to other digital services, requirements to localize data or use local infrastructure for transaction processing can be cost prohibitive for some firms, preventing them from delivering their products to consumers in some markets.

Some of these exemptions are predicated on the fact that digital financial services play an important role in broader financial system integrity. Indeed, as Singapore and the United States have recognized through their recent joint statement on financial services data connectivity, cross-border data flows are an increasingly important part of the solution to reinforcing the integrity of financial markets through strengthening cybersecurity, facilitating law enforcement, and supporting the development of new financial products.

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[11] See also ICC (2019).

Market access and national treatment

As firms seek to connect consumers and businesses with international markets, they are likely to run into a number of requirements to operate in various countries around the world. Often these requirements are standard for all businesses, local and international. However, in many countries, foreign businesses are subject to special requirements that local firms are not. In other countries, international companies are prohibited from selling their services across borders.

In order to both ensure that international firms can bring their services to markets around the world and enable local companies to eventually expand to new geographies, future agreements need to make sure that domestic and international digital service providers are treated the same—a commitment also known as national treatment. At a more fundamental level, market access commitments for digital services are needed to ensure that local firms can access those services from abroad that will best enable them to compete locally and internationally.

Greater international cooperation

Although digital trade agreements are undoubtedly essential in order to make explicit commitments and enable cross-border trade, ongoing coordination between relevant government agencies—both domestically and internationally—is necessary to address the complexities of digital technologies and how they are regulated. This constructive engagement between governments at an early stage can lay the foundation for rules that may be developed and applied locally, but greater interoperability from government-to-government cooperation can most effectively be scaled globally. Future agreements, therefore, need to establish a mechanism for engagement and coordination between relevant regulatory agencies.

For example, under the new Australia–Singapore agreement, both governments signed a series of memoranda outlining cooperation on a range of issues related to new technologies, such as artificial intelligence, digital identity, cross-border data flows, small business cooperation, and open data. Beyond this agreement, Singapore has also signed more than 30 fintech cooperation agreements with countries around the world to address some of the trickier issues facing cross-border digital financial services, including supervision and information sharing.

Looking to future agreements

Although regional and bilateral trade agreements have helped address gaps in access to digital financial services, significant progress at the multilateral level is still needed. One route to addressing some of these gaps would be through the Joint Statement Initiative on E-Commerce, which is a plurilateral effort among more than 80 WTO members to modernize digital trade. Any such agreement must be comprehensive and high standards. It would be incomplete if it did not address issues related to digital financial services, as these services are key enablers of cross-border e-commerce and digital trade.

After launching at Davos in 2019 and making some initial progress, e-commerce discussions have recently slowed, largely due to rising geopolitical tensions, the current pandemic-related crisis, and shifting WTO institutional priorities. All of these factors have also diminished the WTO's ability to make progress on other major issues as well. Nonetheless, these talks should remain a top priority for the WTO, as it remains a top priority for most members: In a recent survey of WTO delegates and the broader trade community—both inside and outside Geneva—nearly 80 percent of respondents rated concluding e-commerce and investment facilitation negotiations as the highest priority for the next ministerial conference.

Despite support among most members, progress at the WTO on expanding commitments on digital will be challenging. Given this, regional and bilateral agreements will likely outpace multilateral agreements for some time. Looking to future regional agreements, the ongoing US–United Kingdom negotiations could raise the bar for commitments on digital financial services. Given that the UK will need to negotiate several agreements with other important markets as its post-Brexit transition period comes to a close, as well as its large fintech sector, the results of these negotiations could set the tone for many future regional and bilateral agreements.

Furthermore, current regional agreements, such as the CPTPP and DEPA, could expand their membership, as well as their commitments on financial services, to more closely match those in the SADEA. The DEPA is open to any WTO member who can meet its high-quality commitments and includes a streamlined process for new member accession.[12] Further expansion of these agreements would likely lead to greater economic growth, and possibly even a high-quality agreement at the WTO, which is especially critical during the current crisis.

[12] See DEPA, Article 16.4: Accession.

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