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BusinessEurope's views on Digital Trade

KEY MESSAGES

- 1 Digital trade has become a fundamental factor in the development of global economy. It concerns the economy as a whole, fostering employment, entrepreneurship, innovation and growth.
- 2 However, barriers to digital trade do exist and there is a growing tendency towards digital protectionism that needs to be addressed. Typical restrictions include tariff measures, investment limitations, limitations on cross-border data flows and forced data localisation.
- 3 It is important that the existing international framework – based on WTO rules and other international agreements – is reinforced and the potential for an agreement on digital trade, preferably multilateral, is promoted. A stand-alone chapter on digital trade should also be included in all EU trade agreements.

WHAT DOES BUSINESSEUROPE AIM FOR?

- *This position paper looks at the existing legal framework on digital trade, outlines barriers to digital trade that should be tackled and discusses how a potential agreement on digital trade could be structured.*
- *For BusinessEurope, an agreement on digital trade, should fulfil a number of principles, namely: recognise free cross-border flow of data as a horizontal principle and aim at creating a global level playing field.*

KEY FACTS AND FIGURES

McKinsey, 2016:	Global cross-border data flows have multiplied by a factor of 45 between 2005 and 2014.	Cross-border data flows also play an important role in the increase of global GDP, counting for \$ 2,8 trillion.
Brookings Institute 2014:	In 2012, the EU exports of digitally deliverable services increased from \$ 465 billion to \$ 748.8 billion.	Digitally deliverable services represent 24.8% of total EU exports.



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BUSINESSEUROPE'S VIEWS ON DIGITAL TRADE

UNDERSTANDING THE EXISTING LEGAL FRAMEWORK AND PROMOTING GLOBAL SOLUTIONS

Introduction – Setting the scene

The exponential development of the internet and new technologies in the past decades have given a significant boost to digital trade. A comprehensive definition of digital trade would necessarily have to include transactions in ICT goods and services, digital products and digital services, movement of people and transfer of data. All four elements are interconnected and interdependent – it is clear that any type of trade today cannot happen without flow of data. It is also important to clarify that while cross-border e-commerce is an important part of digital trade, the latter is much broader and the two concepts should not be confused.

Digital trade concerns the economy as a whole, not only the IT sector. It is conducive to services and e-commerce and, at the same time, a major enabler and value-added factor to traditional manufacturing. Digital trade helps improve productivity as well as the quality of goods and services provided, benefiting workers and consumers alike. It also fosters entrepreneurship and opens up opportunities for the participation of SMEs in Global Value Chains.

Digital trade is inextricably linked with data flows. Research conducted by the McKinsey Global Institute in 2016¹, indicates that global cross-border data flows have multiplied by a factor of 45 between 2005 and 2014, jumping from 4,7 Tbps to 211,3 Tbps. The same report also shows the important role of data flows in the increase of global GDP. Compared to a scenario where no trade takes place, econometric research indicates that global flows of goods, foreign direct investments (FDI) and data have increased current global GDP by roughly 10%, accounting for \$ 7,8 trillion. Data flows alone, account for \$ 2,8 trillion of this effect.

It is also important to note that internet penetration facilitates the digitalisation of trade and has the potential to especially benefit developing countries and SMEs. As transaction costs are significantly reduced due to lower fixed costs, such as physical infrastructure, information and marketing costs, economies of scale become less of an issue. According to the World Bank, a 10% increase in broadband penetration results in a 1,21% rise in economic growth in developed countries and 1,38% in developing countries². Furthermore, according to UNCTAD³, e-commerce is rapidly expanding in

¹ Digital Globalisation – A new era of global flows, McKinsey Global Institute, March 2016

² Qiang and Rossotto, 2009

³ Information Economy Report 2015 – Unlocking the potential of E-commerce for Developing countries, UNCTAD, March 2015



developing countries, in Asia and Africa in particular. It is expected that the share of Asia and Oceania in B2C e-commerce between 2013 and 2018 will increase from 28% to 37%, while that of the Middle East and Africa will increase from 2.2% to 2.5%. At the same time, the share of Western Europe and North America is expected to drop from 61% to 53%. Therefore, there is a huge potential that still needs to be explored and facilitated in developing economies. Digital trade offers the opportunity to businesses to export much easier to new markets.

The importance of digital trade and, in this regard, the need to ensure free cross-border flow of data, establish rules on e-commerce and address data privacy issues are widely recognised. If we look at the EU's position on the issue, in its "Trade for All" Communication of October 2015, the European Commission refers to the digital revolution, describing digital trade as an offensive interest for the EU, creating many opportunities for companies, including for SMEs, and consumers. A digital trade strategy will further reinforce the EU's position, which is the largest exporter of services and one of the biggest exporters of digitally enabled services. In 2012, EU exports of digitally deliverable services increased from \$ 465 billion to \$ 748.8 billion, representing 24,8% of total EU exports, above the US exports of digitally enabled services, which were at \$ 569.2 billion⁴. The inclusion in the EU's trade agreements of provisions on digital trade, including on data flows, is not contradictory to the EU's data protection regime. All the EU proposals should be in line with EU legislation on the protection of personal data ensuring compliance with data protection standards and rules in force in the country of residence of the data subjects.

Whilst digital trade is becoming an increasingly strategic area, consumers and governments have legitimate concerns about privacy. The importance of being careful about how exceptions addressing these concerns are construed should also be acknowledged. Nevertheless, we have witnessed a worrying trend towards digital protectionism, with governments sometimes tending to use regulation to promote domestic interests in a discriminatory way, thus creating unnecessary barriers for economic operators. The EU's "Trade for all" Communication also recognises this problem and announces that *"the Commission will seek to use FTAs and the TiSA to set rules of e-commerce and cross-border data flows and tackle new forms of digital protectionism, in full compliance with and without prejudice to the EU's data protection and data privacy rules"*⁵. The key is to find ways to address these critical issues of trust while continuing to facilitate access to the cutting-edge technologies that foster innovation and growth.

In this context, the WTO, as the guardian of the multilateral trade rules, has an important role to play. It must be ensured that its rule book is updated accordingly to reflect the needs of digital trade and create a level playing field at global level. WTO members have indeed identified the area of digital trade as a priority in the post-Nairobi Work Programme and are currently engaged in discussions to increase their understanding on this issue and potentially agree to launch negotiations on an agreement on digital trade.

In this position paper, BusinessEurope takes a look at the existing legal framework on digital trade – including e-commerce, outlines barriers to digital trade that should be

⁴ The importance of the internet and transatlantic data flows for US and EU trade and investment, Global Economy & Development, Working Paper 79, Brookings Institute, October 2014

⁵ "Trade for All" Communication, European Commission, October 2015



tackled and discusses how a potential agreement on digital trade could be structured. Finally, the position paper offers BusinessEurope's recommendations.

A. The existing framework – an analysis

1. Multilateral level

- GATT

All forms of trade in goods, including through electronic platforms, is protected under the principles of non-discrimination – National Treatment and Most-Favoured Nation (MFN) Treatment – outlined under the General Agreement on Trade in Goods (GATT). The GATT also prohibits local content requirements.

TRIMS

The Trade-Related Investment Measures (TRIMS) Agreement bans local content requirements as well. The TRIMS Agreement could also be an inspiration on developing ways to address investment barriers to digital trade.

- GATS

The General Agreement on Trade in Services (GATS) was a result from the Uruguay Round and came into force in 1995. It includes provisions that apply to digital trade and transfer of data. For instance, the Annex on Telecommunications allows access to and use of public telecommunications transport networks and services, with the exception of cable or broadcast distribution of radio or television programming.

GATS commitments are characterised by technological neutrality. This practically means that technologies – and services – developed since 1995 are therefore covered in the GATS provisions. This has also been confirmed in a number of decisions made by the WTO Dispute Settlement Body. However, some issues still exist, namely on the classification of emerging digital / ICT services under the GATS Central Product Classification (CPC). Furthermore, the mode of supply of digital services needs to be clarified (mode 1 – cross-border supply or mode 2 – consumption abroad).

- Understanding on Commitments on Financial Services

Concluded also during the Uruguay Round, the Understanding on Commitments on Financial Services enables WTO members to take specific commitments in the field of financial services under the GATS. The Understanding includes a provision on transfer of information, which covers transfer of data by electronic means.

Although this Understanding should apply to all WTO members, in practice it applies only to those who have undertaken the commitment under their schedules. As regards the EU, such commitments are also found in all EU FTAs since the conclusion of the EU-Korea FTA.



- WTO Work Programme on e-commerce

During the 2nd WTO Ministerial Conference that took place in Geneva, in May 1998, WTO Members decided to establish a Work Programme on e-commerce, with an aim to examine all trade-related issues pertaining to global electronic commerce. It was noted that, in this process, the economic, financial as well as the development needs of developing countries would be taken into account. This Work Programme requires the joint efforts of the WTO bodies, including the Council for Trade in Goods, the Council for Trade in Services, the TRIPS Council and the Committee on Trade and Development.

Furthermore, a moratorium on customs duties on electronic transmissions was introduced, which since then is being renewed every 2 years, in the respective WTO Ministerial Conferences. This is a significant contribution to the liberalisation of trade in this area. In this regard, there are many voices who support that the WTO members should agree to make this moratorium permanent.

Although the discussions on the e-commerce Work Programme have not progressed fast in the past years, it seems that the renewed interest of WTO members on this issue and digital trade more generally, may reinvigorate the discussions. In this regard, BusinessEurope welcomes the proposal made by the EU and Canada, listing several topics that could be addressed. These include: (1) the development of rules and disciplines, (2) promoting trade liberalisation, (3) trade facilitation, (4) boosting transparency. BusinessEurope also welcomes the strong interest expressed by developing countries in particular towards the proposals of the EU and Canada. It remains to be seen how the e-commerce Work Programme could contribute to a broader Agreement on Digital Trade.

2. Plurilateral level

- ITA

The Information Technology Agreement (ITA) was established during the 1st WTO Ministerial Conference that was organised in Singapore, in December 1996. ITA liberalised trade in the IT sector by eliminating duties in products such as computers, semiconductors, or telecommunications equipment. The number of the initial participants – 29 – grew significantly and reached 81, accounting for about 97% of worlds trade in IT goods.

53 of the ITA parties agreed during the 10th WTO Ministerial Conference in Nairobi, in December 2015, on the expansion of the agreement and to eliminate tariffs in 201 additional products. Trade flows of these products is valued at \$1.3 trillion per year, while with this expansion, the ITA should now cover a market worth more than \$3 trillion, representing around 18% of the world's merchandise imports.

The structure of ITA is on Most-Favoured Nation (MFN) basis, which means that all WTO members can benefit from the elimination of duties in IT products, even if they are not parties to the Agreement.



- TiSA

Negotiations for the Trade in Services Agreement (TiSA) were launched in 2013 and currently include 23 WTO members, which account for around 70% of world trade in services. The purpose of the agreement is to further liberalise trade in services, including in e-commerce, telecommunications and financial services.

TiSA is a plurilateral agreement, but it is not on MFN basis and negotiations do not take place under the WTO framework. This means that only its members will be able to benefit from the liberalisation achieved after the entering into force of the agreement. However, the structure of TiSA is open, allowing more WTO members to join in the future.

Horizontal Provisions: All principles applied in the GATS context (such as National Treatment) will also apply throughout TiSA. Furthermore, a specific Annex on transparency will be introduced.

E-commerce: TiSA will include an Annex on E-Commerce, which would cover open networks, unsolicited commercial communication (spam), interactive computing and international cooperation elements, and other areas.

Data flows and data localisation: Provisions on data flows are crucial to ensure that TiSA achieves the intended high-levels of liberalisation in trade in services. However, for some of the parties of the agreement, for instance the EU, this is a sensitive topic because of issues related to data privacy. The EU still needs to internally approve and then present their proposal on the issue of data flows.

The future of TiSA is currently unclear since its parties were not able to reach a political agreement before December 2016. Despite the challenging environment, we believe this agreement is very positive for European business and should be considered a priority.

3. Regional and bilateral trade agreements

- TPP

Chapter 14 on e-commerce of the Trans-Pacific Partnership⁶ introduces innovations on the way trade agreements tackle the issue. It ensures free access to and flow of data for the conduct of business by a service supplier or investor (excluding financial institutions), while maintaining the right of States to regulate for public policy objectives, such as data privacy and national security.

⁶ The Transpacific Partnership (TPP) is a Free Trade Agreement signed by Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and the United States. Despite some of the TPP parties, including Japan, having already ratified the Agreement, its future remains unclear due to a change of policy furthered by the President-elect of the US, Donald Trump, who, in January 2017, signed an executive order withdrawing the US from the TPP.



It also prohibits data localisation as well as the imposition of requirements on companies to share source code when they enter a market⁷. Customs duties on electronic transmissions are also eliminated, as well as for digital products, except for broadcasting. The parties of the TPP are also required to cooperate on consumer protection, as well as on data privacy and cybersecurity.

It is important to note that the provisions of Chapter 14 of TPP do not apply to public procurement.

Other TPP Chapters (Chapter 9 – Investment, Chapter 10 – Cross-border Trade in Services, Chapter 11 – Financial Services) also include additional and complementary stipulations to Chapter 14 commitments.

- Provisions included in EU Free Trade Agreements

The EU-Korea Free Trade Agreement (KOREU) was the first to include provisions in data flows, but only regarding financial services. Most recently, the EU has concluded Chapters on e-commerce in the Comprehensive Economic and Trade Agreement (CETA) with Canada and in the Free Trade Agreement (FTA) with Vietnam.

With regards to CETA, the EU and Canada recognise the role of e-commerce on increasing economic growth and trade opportunities and they permanently eliminate customs duties on electronic transmissions and their contents, which in principal refers to digital products. CETA also reiterates the right of its parties to regulate for the protection of personal information of e-commerce users, taking into account international standards on data protection. Furthermore, CETA promotes transparency in domestic regulatory frameworks, interoperability of systems as well as measures to facilitate the use of e-commerce by SMEs. The EU and Canada have also agreed to maintain dialogue on issues pertaining to e-commerce. It is important to note that in the event of inconsistency between the Chapter on e-commerce and other chapters of CETA (e.g. Investment, Services), it is the other Chapters that prevail.

In the EU-Vietnam FTA, the parties recognise that e-commerce can increase trade opportunities in many sectors and agree to cooperate and maintain a regulatory dialogue on the issue, including in areas such as the recognition of electronic signatures, the liability of intermediary service providers, unsolicited electronic commercial communications (spam) and consumer protection. Furthermore, neither the EU nor Vietnam can impose customs duties on electronic transmissions.

The provisions included in CETA and the EU-Vietnam FTA constitute a good basis for further developing rules under the EU's FTAs. BusinessEurope would like to see in future EU Agreements more comprehensive and ambitious chapters on digital trade, including provisions on e-commerce.

⁷ However, exceptions apply for critical infrastructure. This may leave a loophole for government measures that may constitute barriers.



B. Barriers to digital trade

In the past years, and despite calls for abolishing protectionism⁸, the world experiences a wave of measures⁹ that affect trade in general and digital trade more specifically. Typical barriers include but are not limited to:

- Tariff barriers: The moratorium on customs duties on “electronic transmissions” is very positive and should be extended indefinitely. Unfortunately, some countries continue to impose high tariff rates on ICT products. To note as well that as normal goods, these are also sometimes subject to anti-dumping.
- Investment limitations: Local content requirements, local presence, import substitution are some of the measures in this category. They usually take a sectoral angle – for example, requirement of local presence and / or local ownership of companies in the telecommunications sector. They can also be implemented in a horizontal manner however – for instance, nationality restrictions on Board Members in companies.
- Free cross-border flow of data and forced data / IT infrastructure localisation: Measures imposed by governments demanding often blanket local data and server requirements on companies and services. However, this type of legislation not only significantly increases operation costs for companies, which may then have an impact on the consumer price of the relevant good or service, but may also simply make the provision of services that require the flow of data not feasible. It is practically impossible for companies – even the largest multinational enterprises – to build and maintain data centres in every country they operate. Forced data localisation is a particularly sensitive domain, as the protection of personal data is often used as a justification for these measures. Although data localisation can indeed be justified in certain cases, free cross-border flow of data needs to be recognised as a horizontal principle.
- Substitution policies: Beyond localisation, governments may also pursue other strategies to promote home-grown ICT companies or technologies. For instance, they may exclude foreign firms from participating in local markets. Substitution policies can be developed through industrial policies or through forced Public-Private Partnerships and joint ventures as pre-requisites to access local markets. Procurement policies may also be used to promote State-Owned Enterprises.
- Source code and encryption requirements: Governments sometimes require foreign investors to deposit their commercial source code and/or encryption keys as a prerequisite to enter the market. These measures, which put in question innovation efforts and may constitute a breach of intellectual property rights (IPR) protection.

⁸ For instance, the G20 has repeatedly made calls to end protectionism. With regards to digital trade in particular, dedicated Taskforces have been created in the context of G20 & B20 Germany, which will result in concrete recommendations.

⁹ It is important to clarify that not all measures adopted by governments constitute barriers to trade. There are safeguards in place to be respected, including the protection of personal data. In this document, BusinessEurope only looks at measures that consist barriers to trade.



- Intellectual property rights: In order to protect domestic companies, countries sometimes take a national approach to IPR. As in many countries there is a lack of adequate IPR protection and enforcement (e.g. insufficient copyright and patent protection as well as lack of protection of trade secrets), this approach undermines the level and the efficiency of the protection that can be better reached through harmonisation.
- Domestic cyber standards: Some countries opt for domestic cyber standards that may differ (significantly) from internationally agreed standards. The result of this practice is complications in market access for foreign companies.
- E-commerce: Many countries impose restrictions and discriminatory rules on on-line sales and transactions. These may include the outright ban on the operation of foreign-owned e-commerce platforms. Furthermore, in some cases, goods that are available in shops may not be available for sales via the internet. Another barrier may be the inability to use for on-line sales certain types of credit or debit cards. These policies may also prevent operators in developing countries that do not have access to certain types of payment systems, to benefit from e-commerce. On-line payment licensing may also be used as a tool to discriminate against foreign suppliers.
- E-procurement: Can be a useful instrument in tackling corruption, improving the effectiveness of public administration and increasing transparency in public procurement markets. However, there may be limitations in foreign participation in tenders related to digital products and services, such as in telecommunications or software.
- Lack of dialogue and regulatory cooperation: Burdensome practices on electronic signatures, cybersecurity and unsolicited mail (spam) may pose challenges for companies and consumers engaged in digital trade. Furthermore, misleading practices may be implemented, especially in the area of e-commerce. In this regard, it is important that international dialogue is intensified in trade facilitation and the fight against counterfeited goods. Many new rules are being developed in the digital sector, such as on the “Internet of Things”. Therefore, it is important to promote regulatory cooperation at an early stage to avoid fragmentation of rules.
- State-Owned Enterprises (SOEs): Businesses are often concerned by unfair conditions of competition and the lack of a level playing field with regard to SOEs, as they can be used as vehicles of States to develop own policies that may discriminate against foreign investors.

C. Possible solutions – Examination of different types of potential agreements on Digital trade

- Multilateral Agreement – under the auspices of the WTO

Such an agreement would be binding for all members of the WTO. However, given the sensitivity of certain aspects of digital trade and different levels of development of WTO members, the agreement may not be able to cover all issues pertaining to digital trade in an ambitious manner. This could result in a multilateral but potentially



relatively weak agreement that will not be able to effectively address the needs on digital trade.

If we follow the currently on-going discussions among WTO members, it is not clear whether all of them are ready to commit in multilateral negotiations.

- Plurilateral Agreement – under the auspices of the WTO, following the ITA model

This type of agreement would bring together a number of WTO members – a ‘coalition of the willing’ – who share similar views and agree to proceed in negotiations for an agreement in digital trade. This would result in a deeper and more comprehensive trade liberalisation agreement, that would be able to cover more sensitive areas than those that could potentially be included in a multilateral agreement.

The provisions of this agreement would apply on a MFN basis, meaning that, despite limited participation, all WTO members would be able to take advantage from the liberalisation achieved. This brings a risk for ‘free riders’, which might leave room for unfair competition or trade diversion, especially if emerging economies are not parties of the agreement. However, concluding an agreement directly under the auspices of the WTO would have several advantages, such as access to WTO dispute settlement and reviews. It will also benefit from the WTO Secretariat’s expertise in facilitating negotiations, while the process of the expansion of such an agreement to more WTO members at a later stage would also be simplified.

Furthermore, the ‘critical mass’ criterion would normally also be fulfilled.

- Plurilateral Agreement – not under the WTO, following the TiSA model

In this case, a ‘coalition of the willing’, similar to the ITA-type agreement examined above, decides to proceed into negotiations for an agreement on digital trade. This Agreement would not be necessarily built on MFN basis, which eliminates the risk of ‘free riders’. If such a solution is chosen, European businesses would support that the architecture of the agreement should be such that in the future would allow it to be integrated in the WTO framework.

The ‘critical mass’ criterion would also need to be taken into account. Major discussions took place among WTO members on whether TiSA parties constitute the ‘critical mass’ on trade in services. In this regard, it is essential that all major players in the field of digital trade, including developing economies, participate in the agreement.

A TiSA-type agreement on digital trade could be very ambitious, leading to significant liberalisation in this area.

- Regional / Bilateral Agreements

Under this scenario, WTO members will continue their efforts to further liberalise digital trade through the conclusion of regional and bilateral trade agreements. A concern that may rise is that these agreements do not take a holistic view of the issue, therefore the risk for increased fragmentation in digital trade liberalisation remains.



For European business, provisions on digital trade negotiated under regional and bilateral trade agreements are to a certain extent necessary in order to fully address the specific needs of different countries and trading blocks. In this sense, they can be complementary to any multilateral or plurilateral framework, as long as they are in cohesion with the multilateral or plurilateral rules.

Conclusion – Recommendations

For BusinessEurope, the preferred option would be the launch of negotiations for a multilateral agreement on digital trade. Nevertheless, since this may not currently be a viable option, a plurilateral agreement following the model of ITA should be pursued. In the meantime, WTO members should also continue to include provisions on digital trade and e-commerce in their regional and bilateral agreements.

Independently of the chosen model, an agreement on digital trade should include a comprehensive definition of digital trade (including transactions in ICT goods and services, digital products and digital services, movement of people and transfer of data) as well as a number of principles:

- It should recognise free cross-border flow of data as a horizontal principle, while of course respecting safeguards, such as data privacy or national security
- It should create a global level playing field, namely by:
 - ensuring that foreign and local goods and services providers are subject to the same rules;
 - prohibiting forced localisation of data;
 - addressing concerns on forced access to source code and encryption issues;
 - respecting technological neutrality; and
 - recognising the need for regulatory cooperation.
