PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Digital Flows: Challenge for the WTO

Gary Clyde Hufbauer

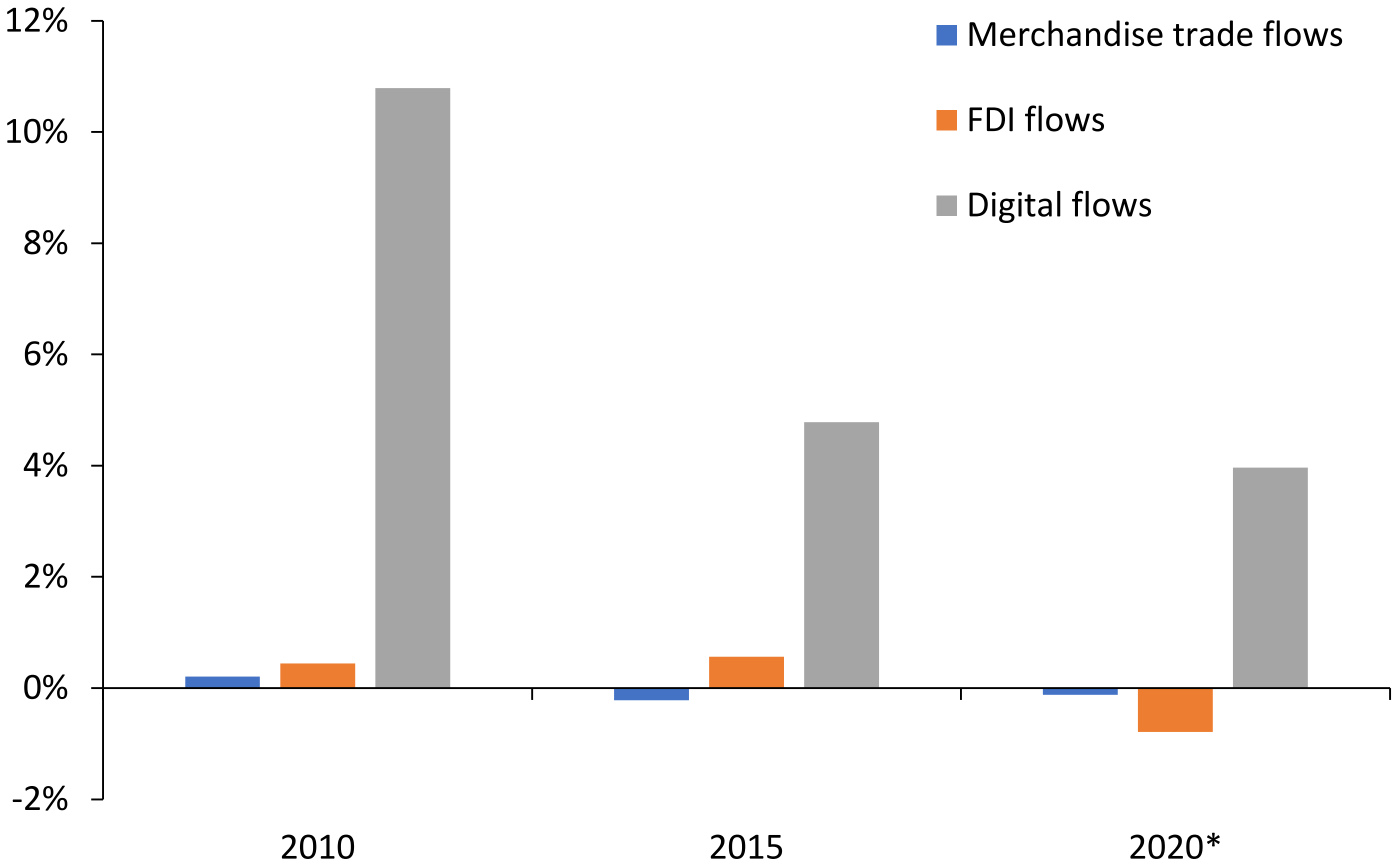
Nonresident Senior Fellow

April 11, 2019

Overview

- Growth of conventional trade and foreign direct investment (FDI) flows has slowed since 2011.
- Main culprit: fresh liberalization of barriers is sluggish or absent, even though opportunities to expand conventional trade and investment are substantial.
- Meanwhile, digital flows – everything from movies and music, to online classes, to engineering performance data – have exploded.
- **Based on McKinsey econometrics (2016), digital flows can compensate for lethargic trade and FDI flows in terms of bolstering world economic growth.**
- **Digital barriers threaten this prospect.**

Contributions of merchandise trade, FDI, and digital flows to world GDP over 5-year intervals



*: projections

Source: Hufbauer and Lu, "Can Digital Flows Compensate for Lethargic Trade and Investment?" November 28, 2018, PIIE.

Barriers to cross border digital flows

- Data localization hinders cross-border flows, requiring all data to be stored domestically in local facilities.

- Different approaches to data privacy and protection (particularly between EU and US) discourage free digital flows.

- Online censorship that blocks or filters digital content restricts market access of foreign firms (particularly in China).

Barriers to cross border digital flows (cont'd)

- **Taxes on digital flows are newest threat:**
  - ➢ The European Commission's digital service tax and digital profits tax would tax revenue and profits attributed to member states.
  - ➢ France plans a 3-5 percent digital services tax.
    - ✓ "What we have seen of the most recent French proposals, we view them as highly discriminatory against U.S. businesses ... Various parts of our government are studying whether that discriminatory impact would give us rights under trade agreements, WTO, treaties." Chip Harter, Deputy Assistant Secretary, US Treasury.
  - ➢ Similar taxes are on the drawing boards in Australia and Asia.
  - ➢ These taxes violate the permanent establishment concept and WTO rules.

Current commitments under the WTO

- **WTO Declaration on Global Electronic Commerce:** "……we also declare that Members will continue their current practice of not imposing customs duties on electronic transmissions." (WTO Ministerial Conference in 1998; Renewed in ministerial conferences in 2017.)
- **WTO Ministerial Joint Statement on Electronic Commerce, December 2017:** "We also recognize the important role of the WTO in promoting open, transparent, non-discriminatory and predictable regulatory environments in facilitating electronic commerce."
- **General Agreement on Trade in Services (GATS):** national treatment and MFN obligations cover different modes of supplying services (finance and telecom), including digital delivery.

Current commitments under BITs and PTAs

- **Bilateral Investment Treaties (Australia as an example):**
  - Non-discrimination obligations: national treatment and Most Favored Nation (MFN) treatment
  - Fair and equitable treatment:
    - ✓ Legal and regulatory stability; not be arbitrary
  - **Singling out US MNCs for tax violates these obligations**
- **Comprehensive and Progressive Trans Pacific Partnership (CPTPP):** no duties on electronic transmissions, non-discriminatory treatment of digital products, free flows of data, and ban on data localization.

Ongoing discussion

- In January 2019 at Davos, 76 WTO members including advanced and developing countries agreed to start talks on e-commerce.
  - ➢ Sharp divisions between China, EU and US on cross-border data flows, privacy protection, tax issues, and data localization need resolution.
- OECD Going Digital Summit in March 2019.
  - ➢ An initiative to build a framework for policies towards digital economy covering issues such as jobs and skills, high quality broadband access, trade and competition, data and privacy, and artificial intelligence.
- OECD and IMF cooperate to publish a handbook on measuring the impact of digital trade across macroeconomic statistics.

Role for the WTO

- A plurilateral agreement that bans localization, censorship, and taxation of digital flows (e.g., revenue taxes).

- A plurilateral agreement in coordination with OECD on the allocation of digital profits between countries, leaving the choice of corporate tax rate to each country.

- Establish a monitoring mechanism within the WTO to report on national policies that discourage digital flows.

Thank you!