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**Research Report**

## Governing digital trade – a new role for the WTO

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## Governing Digital Trade – A New Role for the WTO

### Summary

Digitalisation is transforming the economy and redefining trade. Recently, members of the World Trade Organization (WTO) have started to discuss how trade policies and rules should be adapted to address this transformation. For example, in January 2019, 76 WTO members announced the launch of “negotiations on trade-related aspects of electronic commerce”. The scope of these e-commerce negotiations is yet to be defined, but to ban tariffs on electronic transmissions will certainly be on the priority list of WTO members such as the United States (US) and the European Union (EU).

The idea of banning tariffs on electronic transmission originated at the WTO’s Ministerial Conference (MC) in 1998, when Members declared that they would “continue their current practice of not imposing customs duties on electronic transmissions”. This temporary moratorium on e-commerce tariffs needs to be regularly extended, requiring a decision made “by consensus”. Members have repeatedly extended the moratorium on tariffs on “electronic transmissions”, most recently at the latest WTO MC in 2017. But the WTO e-commerce moratorium is increasingly disputed:

First, while net exporters of digital products and services, typically industrialised countries, understand the tariff ban to apply to digital content, net importers interpret it as referring only to electronic carriers (e.g. CDs, electronic bits), which means that they regard themselves as permitted to impose customs duties on the content of online trade.

Second, while net exporters like the US and the EU propose a permanent ban on e-commerce tariffs in order to provide greater certainty to consumers and business, arguing that the resulting revenue losses are small, net importers like India and South Africa underline that they suffer much

greater revenue losses than industrialised countries and have to bear the brunt of the moratorium.

Third, while industrialised countries argue that the ban on tariffs on electronic transmissions would reduce market distortions, developing countries are concerned that a permanent moratorium would limit their options to protect domestic products and services traded online.

Fourth, the moratorium has stirred a debate about how to create a level playing field between domestic and foreign suppliers of digital products and services.

We argue that WTO members should take the ongoing debate as an opportunity for the WTO to play an important role in redefining trade in a digitalised economy. To take up this challenge, we recommend the following:

- (a) WTO Members should seek agreement on what the e-commerce tariff moratorium covers and what it does not.
- (b) Concerns about who wins and who loses in the wake of the moratorium require deep-dive reflections. WTO members should thus not rush to make the moratorium permanent. They should consider extending it for (at least) another two years at MC12 and use this time to prepare a fully fledged agreement to replace the temporary decision and which could be called the Agreement on Digital Products and Other Services (ADPOS).
- (c) The WTO secretariat should actively engage in the ongoing broader discussions about taxation in the digitalised economy. New evolutions of international and national tax reforms and data-driven digital trade offer unprecedented opportunities for the WTO to reshape the trade agenda. But the WTO may be left behind in addressing the future of trade in a digitalised economy if it does not respond strategically.

### Electronic transmissions: content or carrier?

One key impediment to a constructive debate about the future of the WTO moratorium on the imposition of custom duties on electronic transmissions is that its scope is unclear. Although the term “electronic transmissions” is widely used in the ongoing debate on this moratorium, no WTO agreement or decision has ever clearly defined it. In order to have a meaningful debate about the WTO moratorium on customs duties on “electronic transmissions”, it is imperative to clarify the exact meaning and scope of this term.

One highly important conceptual and policy-relevant question is whether “electronic transmissions” in the WTO moratorium refer to the carrier medium (e.g. CDs, electronic bits) or the content value of “electronic transmissions”. In the former case, the moratorium would not prohibit members from levying tariffs on the content that is transmitted electronically.

The United States (US) and the European Union (EU), and other developed members who are net exporters of digital products and services, interpret the term “electronic transmissions” as referring to the content of digital trade. Other countries, who are net importers of digital products and services, instead understand the term as referring to electronic carriers, not their content, so that they are able to levy tariffs on the content of burgeoning online trade.

Net-importer Indonesia, for example, flagged the ambiguous scope of the term “electronic transmissions” and stated in 2017 that, according to its understanding, the moratorium shall not apply to the content of the transaction, on which duties may thus be levied (WT/MIN(17)/68). This understanding of “electronic transmissions” is actually not as radical as it might appear – and other countries might make use of it as well, thereby eroding the scope of the WTO e-commerce tariff moratorium. Firstly, it is normal practice of customs offices to distinguish the value of the carrier medium from the value of the content (G/C/W/128). Secondly, in the limited number of domestic legislations that mention “electronic transmissions” the definitions of the term refer to a process of “transfer” of content, rather than the content itself. For example, in the US Code Title 19. Customs Duties, the term “electronic transmission” is defined as “the transfer of data or information through an authorized electronic data interchange system consisting of, but not limited to, computer modems and computer networks” (19 USCS § 1401). Being a net exporter of digital content is a key reason why the US takes a different position at the WTO than in its domestic legislation.

In light of the deadlock of multilateral trade negotiations, the number of Preferential Trade Agreements (PTAs) has been rising, and many of them include chapters on e-commerce or digital trade. It is arguably because of the ambiguity of the term “electronic transmissions” in the WTO that major economies such as the US, the EU and Japan choose not to use this term in drafting their PTAs. Instead, to avoid confusion, they write that parties shall not impose customs

duties on “digital products” or the “delivery” of content that is “digitally coded and electronically transmitted” or “transmitted by electronic means” (see Box 1).

#### Box 1: Customs duties related to e-commerce in preferential trade agreements (PTAs)

E-commerce or digital trade chapters are included in a rising number of PTAs. For more clarity, PTAs that involve the US, the EU and Japan do not borrow “electronic transmissions” from the WTO; instead, they use the term “digital product” or “delivery” and put the focus on the content value rather than the carrier medium.

i) In the newly inked United States–Mexico–Canada Agreement (USMCA), the three North American economies use the term “digital product” and define it as a “computer program, text, video, image, sound recording, or other product that is digitally encoded, produced for commercial sale or distribution, and that can be transmitted electronically”. USMCA stipulates that parties do not impose customs tariffs on “digital products transmitted electronically”.

ii) In the Comprehensive Economic and Trade Agreement (CETA), the EU and Canada use neither “electronic transmissions” nor “digital products”; instead, they use “a delivery” which refers to “a computer program, text, video, image, sound recording or other delivery that is digitally encoded”. Both parties agree that a party “shall not impose a customs duty, fee, or charge on a delivery transmitted by electronic means”. This is consistent with the EU’s position in the WTO to define electronic transmission as content value transmitted by electronic means, and define such content as a service, thus regulated in the GATS framework.

iii) In their bilateral PTA, Japan and Switzerland also use “digital products”, rather than “electronic transmissions”, which makes this the first PTA that includes “plans, designs” as part of digital products; another feature of this PTA is that both parties define digital products as products that are “digitally coded and transmitted electronically”, which is narrower than the wording in the USMCA, where digital products are defined as products that “can be transmitted electronically”.

iv) The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) entails an inconsistency that reflects the confusion among parties about the definition issue. In early sections of CPTPP, the agreement introduces a definition for a “digital product”, but in the section about customs duties, the agreement does not use “digital product” but “electronic transmission, including content transmitted electronically”.

On the way to the WTO MC12, Members may not be able to agree on a definition of the term “electronic transmissions”, as the divide between developed and developing Members is likely to be widened rather than narrowed. In this case, the moratorium will be further shaken and shattered. Against this background, WTO Members should not stick to this ambiguous one-page moratorium with a blurry lens. Instead, to address the issue of customs duties on e-commerce, they should focus on developing a fully fledged agreement with a clear focus on the content of digital trade (see below).

### Who gains and who loses?

While the WTO moratorium helps to reduce market distortions by limiting trade barriers for e-commerce, many developing countries are concerned that the moratorium has put them in a disadvantaged position. First, their revenue losses due to the moratorium are dozens of times larger than the revenue losses for developed economies. Tariff rates are higher in developing countries who are net importers of the relevant products. A WTO study uses a list of digitalisable products, and estimates that the global tariff revenue loss is US\$ 756 million annually, of which 92% is lost by the developing countries (WTO, 2016). An UNCTAD study covers a broader range of digital products, including both digitalisable products and digitalised goods, and estimates that potential tariff revenue losses for the developed countries amount to US\$ 212 million annually, while corresponding losses to the identified developing countries are US\$ 8 billion (UNCTAD, 2019).

### Loss of policy space?

Developing countries are also concerned about the loss of policy space to protect certain types of domestic manufacturing and services. By referring to the future of 3D printing, Indian and South African envoys to the WTO argued in their statement in November 2018 that the moratorium on tariffs on electronic transmissions may water down custom duties on all industrial products that can be 3D printed, and take away existing protection for those services sectors that can be delivered electronically.

### Level playing field: domestic tax, tariff, or both?

In addition, there is a concern about fair competition and a level playing field between domestic and foreign suppliers. The moratorium currently leads to de facto discrimination against domestic suppliers, and can be detrimental to infant digital firms. Domestic digital products and service providers pay domestic consumption taxes, while the foreign suppliers pay neither tariffs nor domestic consumption taxes for similar products and services where they are imported and consumed. Due to this tax disadvantage for domestic firms, the moratorium has resulted in the offshoring of domestic digital firms, which drains domestic tax revenues and jobs.

This underlines that the debate in the WTO about the e-commerce tariff moratorium should be seen in the context of a broader debate about taxation in an ever more digitalised economy. A recent report by the OECD does not address the tariff issues directly, but the proposed reforms related to permanent establishment, significant economic presence and profit generation without physical presence are certainly relevant to how WTO will handle imports and exports of digital contents (OECD, 2018).

Being aware of this broader context, WTO members need not only to discuss the e-commerce tariff moratorium and update it with a more comprehensive trade agreement about tariffs and rules governing trade delivered online, but also to pay attention to emerging domestic taxation schemes that

tax imports transmitted electronically. For example, in 2017, the Australian government started levying a Goods and Services Tax (GST) on “digital products and other services” imported by consumers in Australia. According to the Australian taxation office, digital products and other services cover streaming or downloading of movies, music, apps, games, e-books as well as services such as architectural or legal services. Australia is by no means alone in this endeavour. Our analysis of legal documents revealed that over 40 WTO members are levying consumption taxes (a sales tax or a value-added tax, VAT) on imports transmitted electronically, including the EU, Japan, Indian, South Africa, New Zealand, South Korea, Russia, Saudi Arabia and Turkey. The main reason to tax foreign suppliers of digital goods and services is to gain revenues and to level the playing field because domestic businesses were already paying such taxes.

Sales taxes should be levied on all products circulated in domestic markets, including imported goods. Normally, when imported goods pass customs clearance, customs offices will charge tariffs (if the tariff is not zero) and collect domestic sales tax on behalf of domestic tax offices. But imported digital goods and other services have so far not been captured in domestic taxation schemes because they did not pass through customs offices as other imports do. This discrimination has put domestic digital firms in importing countries in a disadvantaged position.

Against this background, the emergence of taxes on imported digital products and services has raised three interesting issues for the WTO. First, concerns about tax avoidance and unfair competition by foreign suppliers of digital products and services are so substantial that over 40 WTO Members have already taken measures to respond. In the trade context, the WTO cannot just shrug off the concerns of a large group of members about their loss of tariff revenue and industrial protection in digitalised sectors. Both domestic and international concerns are obviously about the content value, not about the carrier medium cost. Second, domestic taxation methodologies may also offer some useful experiences with tackling tariffs at the border, given the mentioned challenges of new business models. Third, domestic sales taxes are in general not relevant to the WTO, but one key question is whether the effects of these domestic taxations have already made the e-commerce moratorium obsolete. Why is setting up a tariff line for digital goods and services a problem, while domestic taxation schemes cover imported digital goods and services? These questions have rarely been raised in the policy and academic communities so far, but should be discussed as a matter of urgency.

### The role of the WTO – ways forward

The debate about the moratorium on electronic transmission might be challenging, but it can be an excellent opportunity for WTO Members to redefine the future of trade in the digitalised economy. In light of the above analysis, this Briefing Paper suggests three ways forward for the upcoming WTO MC12 and for the WTO negotiations on e-commerce:



- a) WTO members should try clearly to define the term “electronic transmissions” in the tariff moratorium, and clarify whether electronic transmissions refer to “content value” or “carrier medium”. Without addressing this conceptual question, all ongoing debate will just beat about the bush. Members have diverging views on this issue because net exporters are in favour of interpreting the term as referring to content value while net importers may follow Indonesia’s interpretation to define “electronic transmissions” as carrier medium to be able to tackle the issue of revenue losses and related problems. This divergence may lead to difficulties in arriving at a consensus on an agreed definition.
- b) Since the definition, and also the rent-capture issues, have not yet been adequately addressed, WTO members should not rush to make the e-commerce tariff moratorium a permanent decision. Instead, WTO Members should extend the moratorium for (at least) two years at MC12. WTO members should use this period as a transition phase to negotiate and turn this temporary moratorium into a fully fledged agreement. This could be called the Agreement on Digital Products and Other Services (ADPOS) and could be either an independent agreement or fall under the umbrella of the e-commerce negotiations. This new trade agreement would entail a list of digital products and services with zero tariffs, and details on customs clearance procedures, implementation periods, and dispute settlement, etc. Lessons from the WTO Information Technology Agreement (ITA) approach used in 1996 could be useful, meaning that the original list in the ADPOS is considered to be a “living list” that can be expanded or modified according to changing technological and economic situations.
- c) Members should also mandate the WTO secretariat to actively contribute to the ongoing broader discussions about taxation in a digitalised economy and data governance that take place in the OECD and other political and academic contexts. Moreover, the WTO secretariat should regularly report to the General Council and the Ministerial Conference about new developments in taxation systems and the potential implications for the work of the WTO.

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