Insight

Non-tariff Digital Trade Barriers

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Executive Summary

- The United States Trade Representative (USTR) recently withdrew U.S. support for digital trade proposals – first introduced in 2019 by the Trump Administration and currently under negotiation at the Joint Statement Initiative on E-Commerce (JSI) – that would have blocked World Trade Organization members from placing restrictions on the flow and trade of data.
- USTR justified its decision to withdraw from these JSI proposals as necessary to balance "the right to regulate in the public interest and the need to address anticompetitive behavior in the digital economy."
- Withdrawing from these free-trade proposals cedes the United States' ability to lead the way in global policy trends in e-commerce and data; it also leaves the United States vulnerable to discriminatory non-tariff barriers on U.S. firms that will diminish their opportunities to participate in the global digital economy.

Introduction

On October 25, 2023, the United States Trade Representative (USTR) withdrew U.S. support for digital trade proposals currently under negotiation at the Joint Statement Initiative on E-Commerce (JSI), one of the few active plurilateral negotiations at the World Trade Organization (WTO). The JSI digital proposals would prevent all WTO members from restricting the free cross-border flow of data between each other, prohibit members from imposing data localization requirements, and restrict members from forcing transfers of source code from firms of fellow WTO members. The proposals were created in 2019 to, as the WTO asserts, "achieve a high standard outcome that builds on existing WTO agreements and frameworks with the participation of as many WTO members as possible" on electronic commerce.[1]

USTR stated the motivation for its decision to withdraw from the proposals is to allow for additional discussions on "balancing the right to regulate in the public interest and the need to address anticompetitive behavior in the digital economy."[2] The move was praised by, among others, Senator Elizabeth Warren (D-MA), who claimed that the JSI proposals would have enshrined "digital rules favoring Big Tech companies," and were a "non-starter for the U.S. in any trade agreement…." USTR's decision, however, opens the way for foreign countries to place restrictions on cross-border data flows, data localization requirements, and forced transfer of source code. These sorts of restrictions would disproportionately harm U.S. firms by reducing their opportunities to participate in the global economy. Other countries could restrict U.S. firms' access to data generated from their operations or impose new and high costs to access that data. USTR's decision essentially gives other countries more room to determine global policy trends in e-commerce and data and to impose discriminatory non-tariff barriers on U.S. firms, large and small.

Non-tariff Barriers to Digital Trade

The JSI e-commerce proposals would have set a liberalized regulatory standard on digital trade for all 164 WTO members, reshaping digital trade policy around the world. Specifically, the proposals would have prevented all

members of the WTO from restricting the free flow of data across borders, imposing data localization requirements, and forcing transfer of source code.

These proposals would have provided immense benefits to WTO members. Cross-border data flows, for example, provide opportunities for small and medium-sized enterprises (SME) to participate in the global economy through the internet, allowing them access to global markets to conduct international transactions and collect and use the data generated from those transactions. USTR's decision to renege on the proposal to ensure the free flow of data allows countries such as China more room to implement discriminatory policies against U.S. SMEs by restricting their access to data and therefore hampering their commerce. If firms cannot access all their data, it may limit their ability to make effective operating decisions, potentially harming technological innovation. Big businesses have significantly more access to data than SMEs, putting smaller firms at an informational disadvantage if cross-border data flows are restricted.

Data localization regulations – which require local storage of data for international firms – are currently implemented in some form in over 100 countries including Australia, Brazil, China, and Japan, and may undermine cybersecurity and cause economic harm for businesses required to comply with them. These regulations prevent companies from utilizing universal data storage practices such as cloud computing, complicating the collection, storage, and analysis of data, potentially creating insecure operating processes. Companies subject to these regulations will also have to acquire new servers to hold data in the required locale.

Data localization policies pose a significant regulatory burden for firms operating in countries all over the globe, especially considering many countries have unique data storage requirements. While large firms may be able to ensure safe data management processes internationally and comply with unique international regulatory requirements, these digital trade barriers may be more difficult for SMEs with less capital and smaller workforces to overcome. Large firms will still be burdened, however, as research has shown they often process higher volumes of data leading to higher costs.

Requiring the transfer of source code to regulators may be a security risk for firms whose product relies on software code. Upon the transferal of code to regulators, the transfer process could be vulnerable to intellectual property (IP) theft. Once source code is received by regulators, they are responsible for its safety and security, and a breach of such data could threaten the security of valuable source code. Relying on governments to safeguard sensitive information increases the chances a firm's IP will at some point be leaked considering the rise in offensive cyber capabilities and increase in data breaches across the world. This may also reduce incentives for innovation and technological growth. Large firms may be able to recover from intellectual property theft, but it may be more difficult for SMEs to recoup their losses from such data breaches. With the artificial intelligence (AI) sector growing rapidly in size and importance, for example, forced source code transfers could undermine incentives for innovation.

Digital Trade Policy Outlook

Two of the largest trade agreements in the world, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Regional Comprehensive Economic Partnership (RCEP) – both of which include China but exclude the United States – have provisions that prohibit restrictions on cross-border data flows, requirements for data localization, and forced transfers of source code. As a response to USTR's decision to withdraw support from the JSI e-commerce proposals, G7 trade ministers vowed to "remain committed to tackling unjustified data localization measures," citing, among other reasons, the increased data management costs for SMEs produced by digital trade restrictions.

Among other trade frameworks is the Indo-Pacific Economic Framework (IPEF), which the Biden Administration is currently negotiating with countries such as Japan, South Korea, and the Association of Southeast Asian Nations members, among others. These nations are also members of CPTPP and RCEP. IPEF is the administration's strategy for economic engagement in Asia and is designed to counter China's growing influence in the region. Of note, IPEF contains a specific sub-section on digital trade with more specific details to be announced by the end of 2023. Unlike CPTPP and RCEP, and most other trade agreements, IPEF does not contain provisions to increase market access among its members.

The Indo-Pacific economies are among the fastest growing in the world and becoming more digitally integrated. The United States can lead and shape economic growth in an increasingly influential part of the world by setting precedents on digital rules that foster growth and innovation. USTR's decision to remove its support for the WTO proposal sends the wrong signal to U.S. allies and trading partners.

By abandoning negotiations at the WTO, USTR disadvantages U.S. tech firms of all sizes and undermines an opportunity for economic cooperation with U.S. allies. Not only does this decision create cover for countries already engaging in these harmful practices to restrict cross-border data flows, it undermines efforts the White House has made to collaborate with allies on other pressing policy issues such as AI development and semiconductor production.

Conclusion

USTR's withdrawal of its support from the JSI proposals will restrict companies' access to and use of critical data and produce negative impacts, especially for U.S. SMEs. This decision sends negative signals to U.S. allies, trading partners, and the global economy, and will allow other countries such as China to increase their influence and dictate digital trade at the expense of the United States' influence.

[1] https://www.wto.org/english/tratop_e/ecom_e/joint_statement_e.htm

[2] https://www.reuters.com/world/us/us-drops-digital-trade-demands-wto-allow-room-stronger-tech-regulation-2023-10-25/