

The Coronavirus Pandemic Highlights the Critical Importance of Digital Trade

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KEY TAKEAWAYS

Digital freedom has minimized economic disruptions and helped to maintain some sense of normalcy during COVID-19 containment measures.

Some policymakers are using the crisis as an opportunity to advance restrictive digital policies, such as digital taxation.

The United States should encourage digital trade to spark constructive free-market competition and ensure private-sector growth for post-pandemic economic recovery.

The coronavirus pandemic has circumscribed people's physical contact and movement to an unprecedented degree. However, it has exponentially amplified the exchange of information, products, and other services through digital connections within the United States as well as around the world.

The global expansion of the Internet, reinforced by rapid advances in information technology and the related growth of global value chains, has expanded the range of services tradable digitally within national borders and far beyond them. Various companies in almost every industry are using and relying on digital services that are often supplied across borders to enhance efficiencies and to compete better globally.

Not surprisingly, growth in trade in services through digital platforms has outpaced merchandise trade for the past decades, and the coronavirus

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pandemic will likely amplify this upward trend. Digital trade has long made traditional trade more efficient, enhancing the benefits that the freedom to trade has already brought to millions of people in the United States and around the globe. Recent trade agreements, including the United States–Mexico–Canada Agreement (USMCA) and the U.S.–Japan Digital Trade Agreement, have provisions to prevent restrictions on digital trade. Continuing the efforts to advance digital trade, a key dimension of the general freedom to trade, will help enterprises to minimize and overcome disruptions caused by the coronavirus pandemic.

Digital Freedom: An Integral Dimension of Economic Freedom

Digital freedom has been vital for minimizing economic disruptions as a result of COVID-19 containment measures. The crux of digital freedom is the freedom to exchange information. It is such freedom that has allowed people to shop for their groceries online, conduct video conferences with colleagues, have video appointments with medical professionals, or simply access the Internet to learn about the best practices in the current situation.

Information, or data, has become an extremely valuable commodity. Information supports businesses and consumers. For businesses, data can support the production process and make it more efficient. For example, customer responses to products can be used to determine trends in purchasing and whether investment is needed to improve or discontinue a product or increase production. Collecting such data allows firms to meet their customers' needs more effectively.

Businesses have seen greater digital trade opportunities during the pandemic. Producers that have automated production and distribution systems have not been afflicted with the same pain as other companies.¹ As a result, businesses are laying the groundwork to become more digitalized.²

DriveItAway, Inc., offers an app that allows cars to be delivered to consumers for test drives and potential purchases. The company has been slowly working to run internationally but the pandemic has hastened the demand for the expansion. In the first week of April 2020, DriveItAway secured a Canadian distributor who immediately showed the app to a vehicle manufacturer as a way to help with inventory buildup. This would be a solution for those who want to buy cars but may not be able, or comfortable, going to a showroom.³

Route4Me, a company that provides businesses with software to maximize the efficiency of the routes used to distribute products, has seen a

massive boom due to the pandemic.⁴ It is companies like Route4Me that can help businesses to digitalize their cross-border supply chains, easing the difficulties experienced by people during the COVID-19 pandemic.⁵

Many companies have been forced to close stores in response to stay-at-home orders. Assuming that trade freedom is maintained, companies will likely make more use of online platforms to sell their products overseas, making e-commerce more important than ever.⁶ Supply chains will also become more digitalized. For example, “The Footwear Distributors and Retailers of America has been working to provide its members key tools they need to digitize their supply chains like 3-D printing to shorten lead times.”⁷

In a rapidly evolving e-commerce environment, economic dynamism enhanced by free-market policies that sustain economic freedom requires an open and free Internet. Indeed, digital freedom is the backbone of digital trade, which is driving the expansion of services trade. In this challenging time, services trade in conjunction with merchandise trade can maintain some sense of normalcy as people adjust to the ever-changing circumstances, particularly in the context of e-commerce.

Digital Protectionism

Crises are sometimes used by policymakers to accelerate the implementation of their agendas. One example is how some governments are ramping up efforts to use digitalization as a tool to isolate domestic industries from foreign competition by imposing barriers on digital transactions and communications. Most recently, these include pushes to end the World Trade Organization (WTO) moratorium on customs duties on electronic transmissions, and for the implementation of digital taxes.

WTO Moratorium on Customs Duties on Electronic Transmissions.

The WTO moratorium on customs duties on electronic transmissions is an agreement by WTO members not to impose customs duties on electronic transmissions.⁸ Electronic transmissions are not defined by the WTO, but are commonly held to include digital music, video games, movies, software, e-mails, text messages, and the like.⁹ While the moratorium has been in place since 1998, the agreement is not set in stone—WTO members must vote to extend it every two years.¹⁰

Some developing countries are against the moratorium as it prevents them from collecting government revenue on digitalized goods. Potential revenue losses tend to be higher for developing countries because, even if import volumes are lower, they tend to levy higher tariffs on digitizable goods¹¹ than developed countries.¹² However, the estimated foregone revenue is small and

concentrated.¹³ The highest estimates show that potential foregone revenue as a share of total revenue amounts to a mere average 0.08 percent to 0.23 percent reduction in government revenue.¹⁴ Furthermore, those developing countries that have higher potential for foregone revenue rely the least on customs revenue as a source of overall government revenue.¹⁵

Customs duties on electronic transmissions are almost impossible to implement and enforce.¹⁶ Additionally, the calculation of tariffs on electronic transmissions is unworkable.¹⁷ To assign a value to a single electronic transmission is impossible in almost all instances.¹⁸ This makes it difficult to calculate a tax because an *ad valorem* duty is calculated in proportion to the value of the good or service in question. A non-*ad valorem* duty could theoretically be calculated by applying a rate to the number of bytes or bits but this would almost certainly incentivize businesses to reduce file sizes, which would adversely affect industries ranging from manufacturing to the creative industries.¹⁹ A duty could theoretically be based on a single unit, such as a video.²⁰ These non-*ad valorem* duties would be highly distortive to the digital economy because of how technically, legally, and operationally difficult it would be to levy duties on a single electronic transmission.²¹

The USMCA and the U.S.–Japan Digital Trade Agreement include provisions that prohibit customs duties on e-commerce, such as e-books, videos, games, and software. Digitalization has mitigated the effects of the pandemic by allowing many people to work from home, and by allowing many students to continue their schooling. The United States should continue to include the prohibition of customs duties on e-commerce in its trade agreements, and strive to work with WTO members to make the moratorium permanent.

Digital Taxation. Digital taxes are also a threat to digital freedom. These taxes have been floated by many countries and some have imposed them. Both India and the United Kingdom were scheduled to impose digital taxes on April 1, 2020. While many groups pleaded for postponing these taxes, India continued with the plans and implemented the tax.²² The United Kingdom has not yet implemented its digital services tax, but the proposal continues to move through the legislative process.²³

The Organization for Economic Co-operation and Development (OECD) has been hosting negotiations to change the international tax system. It has proposed changes that mirror individual countries' digital taxes by requiring that multinational businesses pay taxes based on where their consumers are located rather than where the business is located. The U.K. has stated that if the OECD reaches an agreement, the U.K. will repeal its digital tax and replace it with the OECD rules.²⁴

However, on June 12, Treasury Secretary Steven Mnuchin wrote a letter to the four European finance ministers stating that the United States is unable to agree “on changes to fundamental rules to tax more heavily only a limited group of predominantly U.S.-based companies.”²⁵ While it seemed that the U.S. would no longer participate in the ongoing discussions at the OECD to remake the international tax system, OECD Center for Tax Policy and Administration Director Pascal Saint-Amans rebutted the idea that the U.S. has formally left the negotiations.²⁶ In response to Secretary Mnuchin’s letter, many Euro-block countries threatened to move forward with their unilateral digital tax plans, and the U.S. threatened retaliatory tariffs.²⁷

Taxation has typically been based on physical location. However, as physical location can be ambiguous when it comes to the Internet, policymakers have claimed that physical location is no longer an appropriate standard. Physical location matters for tax purposes because local governments are better equipped with the cultural knowledge to estimate the impact of a tax on an industry.

Similar to France’s digital services tax, the United Kingdom’s digital services tax would be revenue-based. Revenue-based taxes are more economically inefficient than income taxes because they apply the highest effective tax rates to low-margin, high-volume industries, and, when assessed on a portion of business activity in one country, could be imposed on a firm that has no net income in the jurisdiction, yet is still required to pay the tax.²⁸ Digital services benefit consumers because they allow companies to tailor products to their customers. The digital tax is likely to cause companies to increase prices so that the cost falls on their customers. This adds risk and administrative burden to doing business in a foreign market, as well as expense, thus reducing trade freedom and competition in the digital sector.

India’s digital tax may be even more disruptive because of its broad definitions of e-commerce and expansive coverage. The Indian digital tax applies to all services as well as goods supplied over the Internet.²⁹

During this pandemic, e-commerce has become the lifeline of many businesses. Imposing taxes makes it costlier to do business, which are likely to be passed down to consumers, who are also struggling to make ends meet. Digital trade is creating some sense of normalcy. People can, for the most part, buy what they need online. Church services, happy hours, dates, and meetings are all able to be conducted online because of digital services trade. These taxes are problematic and put digital freedom in jeopardy.

While the U.S. may be right to leave the OECD negotiations to remake the international tax system, it is wrong to impose new tariffs.³⁰ Tariffs will

needlessly raise costs for American businesses who cannot afford to pay any more tariffs. The successive rounds of tariffs imposed over the past two years have left businesses' cash balances to dwindle.³¹ Temporary coronavirus shutdowns and lost sales are making it even more difficult to pay these increased tariff costs. This will inevitably result in higher prices for their customers and a slower economic recovery.³² Imposing tariffs will not solve the debate around the international tax system, but it will make Americans' lives more difficult during already challenging times. To impose tariffs and digital taxes during COVID-19 is arguably unjust.

What the U.S. Should Do

In a highly complex global economic environment, international trade is a constantly evolving phenomenon and process, increasingly facilitated by the advancement of information and communications technology. At the same time, the temptation to seek short-term advantages through measures that secure tax revenue for the government at the expense of consumers to isolate domestic firms from competition has been increasing. Particularly in the context of the current coronavirus pandemic, defending and advancing trade freedom is more critical than ever.

The U.S. government should encourage and enhance digital trade to spark constructive free-market competition and ensure private-sector growth for the post-pandemic global economic recovery. To that end, the Trump Administration and Congress should:

- **Support the extension of the WTO moratorium on customs duties on electronic transmissions.** The moratorium has been extended until the next ministerial conference is rescheduled. As soon as the meetings restart, the United States should continue its support efforts to extend the moratorium. The Administration should also work with partners to make the moratorium permanent. In late March 2020, Australia, Canada, Chile, Colombia, Hong Kong, Iceland, Singapore, South Korea, New Zealand, Norway, Switzerland, and Uruguay sponsored a submission to the WTO to laud the benefits of the moratorium. The United States was not a sponsor but has always been a staunch supporter and proclaimed that the moratorium be made permanent. The United States should engage with these WTO members to make the moratorium permanent by prohibiting customs duties on electronic transmissions.

- **Refrain from imposing retaliatory tariffs in response to digital taxes.** If the Administration imposes retaliatory tariffs, they will affect American businesses and consumers by making imports from the targeted countries more expensive. Imposing more tariffs during COVID-19 will not solve the debate around the international tax system and will make Americans' lives more difficult at a time when they need the freedom to trade the most. In March 2019, a study by Deloitte and Taj Société d'Avocats found that 95 percent of the French digital services tax will be paid by local consumers and domestic businesses that use the taxed digital platforms.³³ The United States should use its position to explain why new digital taxes will hurt the people of the countries that implement them, and refrain from punishing American consumers for the policy mistakes of those countries.
- **Prioritize digital trade in ongoing trade talks.** Constructive and forward-looking discussions on e-commerce will not only present a unique opportunity for all trade negotiations, but would particularly enhance the transatlantic partnership between the U.S. and the European Union. Engaging in talks on e-commerce will facilitate post-pandemic economic recovery. Washington should not waste the timely momentum to build upon the comprehensive digital trade achievements in the USMCA, which "contains the strongest measures on digital trade of any agreement." The modern digital trade provisions of the USMCA and the U.S.–Japan Digital Trade Agreement should serve as the basis for continuing the benefits of trade for consumers and producers.

Conclusion

Digitalization can allow a company to provide both a good and a service in the same transaction. Digital freedom is providing some sense of normalcy during stay-at home orders in response to COVID-19. When something is ordered online, it is not simply the good being transported but the services that underline the electronic transaction. During this pandemic, not only is services trade keeping merchandise trade afloat, it is cushioning the burden of the disruptions.

During and post pandemic, international cooperation is crucial. It is difficult for policymakers to continue engaging in the constant dialogue and compromise required to make difficult decisions. It is even more difficult during COVID-19, and it is vital that individuals' digital freedom is

protected. There is no doubt that finding and enforcing measures to ensure data openness will play an increasingly important role in trade negotiations and disputes in the future. COVID-19 will have lasting effects on the increasingly expanding range of services that firms and workers deliver digitally.³⁴ Policymakers should work to protect digital freedom so that digital trade continues to be embraced and able to flourish.

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