

THE DYNAMIC GAINS FROM FREE DIGITAL TRADE FOR THE U.S. ECONOMY

Daniel Griswold

*Codirector, Program on the American Economy and Globalization
Mercatus Center at George Mason University*

US Congress Joint Economic Committee
Public Hearing

September 12, 2017

Thank you, Chairman Tiberi, Ranking Member Heinrich, the members of the Committee for holding this hearing on the important topic of digital trade.

The Mercatus Center at George Mason University is the world's premier university source for market-oriented ideas—bridging the gap between academic ideas and real-world problems. The Mercatus Center conducts research of consequence that advances public understanding of the institutions that affect the freedom to prosper, and offers public policy solutions to overcome the barriers that prevent individuals from living free, prosperous, and peaceful lives. I am a senior research fellow at the Mercatus Center, where I am the codirector of the Program on the American Economy and Globalization.

More and more each year, Americans are using the World Wide Web to exchange data across borders; import and export goods, services, and digital products on internet platforms; and manage global supply chains. The boom in digital trade across international borders, along with exponential growth in cross-border data flows, has important implications for the US economy and trade policy. With the right policies in place, digital trade can boost US economic growth, benefiting the vast majority of Americans. On the topic of digital trade, I wish to make three main points:

1. Digital trade is transforming the “how” of international trade, lowering costs and increasing volume.
2. The expansion in digital trade fuels economic growth, both globally and at home. Small and medium-sized enterprises in particular stand to benefit from this boom in digital trade.
3. Removing existing barriers to trade would be beneficial in enhancing these gains—particularly those, like the *de minimis* threshold for customs paperwork, that disproportionately burden smaller businesses and new entrepreneurs.

For more information or to meet with the scholar, contact
Amber Porter, 703-993-5851, aporter@mercatus.gmu.edu
Mercatus Center at George Mason University, 3434 Washington Blvd., 4th Floor, Arlington, Virginia 22201

The ideas presented in this document do not represent official positions of the Mercatus Center or George Mason University.

BY ANY DEFINITION, DIGITAL TRADE IS BOOMING WORLDWIDE

Digital trade is defined as the digitally enabled exchange of goods and services across borders that can be either digitally or physically delivered. The great enabler is the internet and internet-based technologies that allow the transmission of vast amounts of data around the world at almost zero marginal cost. A recent study by the McKinsey Global Institute calculates that global cross-border internet traffic has soared 500-fold since 2000, and will expand another 8-fold by 2025.¹

Digital trade can take many forms, ranging from video streaming to ordering merchandise through online platforms. Delivery of purely digital products such as e-books, movies, music, software, and video games is a component of digital trade. For example, one-third of Netflix customers who stream videos are located outside the United States.² The internet can facilitate the delivery of traditional services, such as the sending of architectural plans to a foreign customer or the online booking of a hotel or an Airbnb rental overseas. More than half of US services exports are now delivered digitally.³ Digital trade can mean the transmission of a computer-aided design file to a 3D printer, where the product, say a spare part or a pair of designer shoes, is made on location for the final customer. It can be digital communication through social media or through voice-over-internet protocols, such as Skype.

Digital trade also occurs when customers around the world order products for direct delivery through such platforms as Amazon, Alibaba, and eBay. Amazon now generates 40 percent of its net revenues from sales abroad. This phenomenon is also empowering small and medium-sized enterprises to sell and source in global markets. On eBay, 97 percent of commercial sellers are exporting goods to foreign customers.⁴ The number of US companies that are exporting their goods and services to customers abroad has increased by more than 50 percent since 1997, according to the US Census Bureau.⁵

Digital trade is also transforming global supply chains. Because of the vastly enhanced ability to communicate, global companies are able to coordinate delivery times, track inventory, and reduce losses in shipment. The use of “digital wrappers” such as radio-frequency identification (RFID) tags allows companies to track the time and location of goods throughout the supply chain. Adoption of blockchain technology is reducing the cost of financing trade while facilitating “just in time” inventory and reducing customs delays at ports. The US International Trade Commission estimates that the internet reduces trade costs of US exports and imports in digitally intensive sectors by 26 percent on average.⁶

Digital trade is not changing the “why” of trade, which is still driven by comparative advantage and other factors that economists have studied for decades, but it is transforming the “how.” As the Organisation for Economic Co-operation and Development notes in a recent study, “The age of digitally enabled trade is not just about digitally delivered trade, it is also about more physical, traditional or GVC [global value chain], trade enabled by growing digital connectivity increasing access to foreign markets for firms in a way that would previously have been unimaginable.”⁷

¹ Susan Lund and James Manyika, *How Digital Trade Is Transforming Globalization* (Geneva: International Centre for Trade and Sustainable Development and World Economic Forum, January 2016), 1.

² Lund and Manyika, *How Digital Trade Is Transforming Globalization*, 3.

³ Rachel F. Fefer, Shayerah Ilias Akhtar, and Wayne M. Morrison, *Digital Trade and U.S. Trade Policy*, Congressional Research Service, June 6, 2017, 6.

⁴ Lund and Manyika, *How Digital Trade Is Transforming Globalization*, 6.

⁵ US Census Bureau, “Profile of U.S. Importing and Exporting Companies, 2014-2015,” accessed September 6, 2017, <https://www.census.gov/foreign-trade/Press-Release/edb/2015/index.html>; US Census Bureau, *A Profile of U.S. Exporting Companies, 1996-1997*, April 28, 1999.

⁶ US International Trade Commission (USITC), *Digital Trade in the U.S. and Global Economies, Part 2*, August 2014, 65.

⁷ Javier López González and Marie-Agnes Jouanjean, “Digital Trade: Developing a Framework for Analysis,” *OECD Trade Policy Papers*, no. 205 (2017): 4.

HOW DIGITAL TRADE IS BOOSTING US ECONOMIC OUTPUT

The explosion of digital trade in the past two decades has expanded US and global output and promises to fuel more growth at home and abroad for decades to come. The efficiencies that the digital revolution has brought to trade are exposing more markets to global competition, forcing producers to become more efficient and innovative. They are also reducing the costs of trade, allowing businesses and consumers to redirect resources to more rewarding uses.

Digital trade is having a measurable and positive effect on the US economy. According to a comprehensive 2014 study by the US International Trade Commission (USITC), “The combined economy-wide effects of enhanced productivity and lower costs of trading goods across borders that result from digital trade in certain digitally intensive industries resulted in an estimated 3.4 to 4.8 percent increase in U.S. GDP (\$517.1–\$710.7 billion in 2011).” The USITC estimates that, because of the advance of digital trade in the past two decades, US real wages in 2011 were higher by 4.5 to 5.0 percent, with no net job losses in the overall economy. The USITC notes that the impact could be even more positive if the estimates were able to quantify the spillover effects of the digital technologies in non-digitally-intensive sectors.⁸

Digital trade encourages the exchange of information and ideas and rewards the creation of new products, enhancing innovation in the United States and worldwide. As a 2016 report for the World Economic Forum concludes, “Beyond this economic impact, the free flow of data is, itself, a significant driver of innovation. It allows the sharing of ideas and information and the dissemination of knowledge as well as collaboration and cross-pollination among individuals and companies.”⁹

The McKinsey Global Institute’s analysis finds that, in 2014 alone, cross-border data flows accounted for a \$2.8 trillion increase in global GDP.¹⁰ “Both inflows and outflows matter for growth,” the report notes, “as they expose economies to ideas, research, technologies, talent, and best practices from around the world.”¹¹

The growth of digital trade plays to America’s comparative advantage. The United States remains the global leader in creating digital products and online platforms and exporting digital services. According to a June 2017 report from the Congressional Research Service (CRS), 10 to 15 percent of global e-commerce is now cross-border, with the United States and the European Union leading the trend. In 2014, according to the CRS report, “the United States exported \$399.7 billion in digitally deliverable services, and imported \$240.8 billion, creating a surplus of \$158.9 billion. Digitally delivered services accounted for more than half of all U.S. services trade, according to the Department of Commerce.”¹²

Reaping much of the benefit of digital trade have been small and medium-sized US enterprises (SMEs). The internet has allowed a growing number of American-based SMEs to reach a global customer base while also sourcing intermediate goods and services abroad. Unlike Fortune 500 companies, SMEs cannot easily establish a physical presence overseas or invest in the systems necessary to manage a global enterprise. Instead, the internet has allowed these so-called micro-multinationals to reach global customers through their websites and common online platforms such as eBay and Amazon. They can process payments digitally and ship products directly to individual customers around the world through private and postal package delivery services.

⁸ USITC, *Digital Trade in the U.S. and Global Economies, Part 2*, 17–18.

⁹ Robert Pepper, John Garrity, and Connie LaSalle, “1.2 Cross-Border Data Flows, Digital Innovation, and Economic Growth,” World Economic Forum, accessed September 6, 2017, reports.weforum.org/global-information-technology-report-2016/1-2-cross-border-data-flows-digital-innovation-and-economic-growth/.

¹⁰ James Manyika et al., *Digital Globalization: The New Era of Global Flows* (McKinsey Global Institute, March 2016), 10.

¹¹ Manyika et al., *Digital Globalization*, Preface.

¹² Fefer, Akhtar, and Morrison, *Digital Trade and U.S. Trade Policy*, 6.

The internet has also helped SMEs to overcome search costs and informational asymmetries that can inhibit transactions across international borders. Global customers can now compare prices, not just among top-brand producers but among smaller, niche providers. Online reviews posted on such platforms as TripAdvisor, Amazon, and Google Maps facilitate cross-border trade by reducing uncertainties and protecting customers from inferior products and services or outright fraud. And the benefits are not just on the export side. Digital trade has allowed SMEs to source components and business-to-business services in global markets, allowing them to better control costs and enhance the competitiveness of their exports.

As a result, SMEs are engaging in global trade as never before. In its annual profile of US exporting and importing companies, the US Census Bureau has tracked a significant rise in US firms buying and selling in global markets. From 1997 to 2015, the number of US companies that were exporting their products to at least one foreign market increased from 189,670 to 294,834, with 97.6 percent of the identified exporters being SMEs. In fact, more than 100,000 of the exporting companies employed fewer than 20 workers.¹³ A survey by the McKinsey Global Institute found, “Even the smallest enterprises can be born global: 86 percent of tech-based startups we surveyed report some type of cross-border activity. The ability of small businesses to reach new markets supports economic growth everywhere.”¹⁴

The impact of digital trade on the US economy is not a one-time shift but an ongoing process that enhances the dynamic, long-term growth potential of the US economy. By reducing costs, spurring competition, and expanding markets, digital trade creates ongoing gains in efficiency that fuel productivity gains. By facilitating the spread of ideas and collaboration, digital trade contributes to product innovation. By playing to America’s competitive strengths, digital trade allows us as a nation to use our physical, intellectual, and human capital in ways that permanently boost our gross domestic product and general living standards.

REMOVING BARRIERS TO DIGITAL TRADE

Despite the dramatic growth and beneficial impact of digital trade, a number of barriers remain that prevent Americans from reaping its full advantages. The US International Trade Commission, in its 2014 analysis of digital trade, concludes that the elimination of remaining foreign barriers to digital trade in digitally intensive industries would likely generate an additional \$16.7 billion to \$41.4 billion in annual US economic output (a 0.1 percent to 0.3 percent increase in US GDP). Real wages for US workers would likely be 0.7 percent to 1.4 percent higher, with the creation of as many as 400,000 full-time equivalent jobs.¹⁵

Addressing Barriers to Digital Trade in Multilateral Trade Agreements

Those gains can be best realized by addressing barriers to digital trade in trade agreements with other nations. In the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (Pub. L. No. 114-26), Congress directed the administration to seek the removal of barriers to digital trade in future free trade agreements. Specifically, the administration was directed to seek agreements that would, among other objectives, ensure nondiscriminatory treatment of physical goods in the digital trade environment; prohibit forced localization requirements for servers; prohibit restrictions to digital trade and data flows; keep electronic transmissions duty-free; and ensure that legitimate regulations affecting digital trade are as nonrestrictive as possible.

¹³ US Census Bureau, “Profile of U.S. Importing and Exporting Companies: 2014-2015.”

¹⁴ Manyika et al., *Digital Globalization*, In Brief.

¹⁵ USITC, *Digital Trade in the U.S. and Global Economies, Part 2*, 19.

Those remain worthy objectives, and they were in fact contained in Chapter 14 of the Trans-Pacific Partnership (TPP) that the previous administration negotiated with 11 other Pacific-Rim trading partners. Specifically, Article 14.13 of TPP stipulated that “no Party shall require a covered person to use or locate computing facilities in that Party’s territory as a condition for conducting business in that territory.” Article 14.17 went the additional step of protecting source code: “No Party shall require the transfer of, or access to, source code of software owned by a person of another Party, as a condition for the import, distribution, sale or use of such software, or of products containing such software, in its territory.”¹⁶ Whatever the ultimate fate of TPP, its provisions on digital trade remain the best available template for future or renegotiated free trade agreements.

Raising the *De Minimis* Threshold for Customs Duties

To those objectives, let me add another important policy initiative that would enhance the favorable effects of digital trade. That would be to seek an increase in *de minimis* thresholds for customs now imposed by our trading partners. One of the best policy changes Congress has made recently for digital trade was Section 901 the Trade Facilitation and Trade Enforcement Act of 2015, which increased the US *de minimis* threshold from \$200 to \$800. The threshold means that individual shipments into the United States that are valued at less than \$800 are exempt from customs and taxes and from entry documentation requirements when appropriate.

That increase in the *de minimis* level has invigorated digital trade for millions of American consumers. Much of digital trade is conducted via small packages delivered directly from the business to the customer. If set too low, a *de minimis* level can impose disproportional costs on small-scale importers and exporters, cause delays in delivery times, and overburden customs authorities forced to clear a larger number of packages. For US Customs and Border Patrol (CBP), this can mean additional administrative costs that outweigh potential revenue collected and the diversion of resources away from risk-based management systems. The higher *de minimis* standard for customs is a win-win, providing American consumers and businesses with more affordable products through digital trade, while freeing CBP from unnecessary administrative burdens.

Unfinished business is the still-too-low thresholds in other countries. According to an analysis by the OECD, a large majority of our major trading partners enforce a threshold of \$200 or less. In Mexico, the threshold is the equivalent of \$300, in the European Union \$170, and in Canada an absurdly low \$20.¹⁷ Those thresholds inhibit the shipment of smaller packages from US suppliers to customers in those countries by subjecting them to unnecessary inspection and customs duties. As Congress stated in the 2015 customs reauthorization bill, it should be a goal of the US Trade Representative to “encourage other countries, through bilateral, regional, and multilateral fora, to establish commercially meaningful *de minimis* values for express and postal shipments.”¹⁸

Removing these last remaining barriers to digital trade, at home and in other countries, will allow more American consumers and companies to realize the full benefits of a more digitalized economy and global trading system.

¹⁶ Office of US Trade Representative, “TPP Final Table of Contents,” Chapter 14, Electronic Commerce, accessed September 6, 2017, ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text.

¹⁷ López González and Jouanjean, “Digital Trade,” 21.

¹⁸ Trade Facilitation and Trade Enforcement Act of 2015, Pub. L. No. 114-125, 130 Stat. 122 (2016).