



Digital Trade in the U.S.-Mexico-Canada Agreement

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Introduction. The future of the digital economy depends on U.S. leadership. At the Joint Economic Committee’s (JEC) June 2018 [hearing](#) on *The Need for U.S. Leadership on Digital Trade*, Chairman Erik Paulsen [outlined](#) America’s important role:

... [W]e must be vigilant to preserve the principles that have already led to greater prosperity throughout the world in the digital trade arena.

And that means addressing swiftly and clearly the excessive burdens foreign governments place on American digital products so that we are not unfairly disadvantaged and can compete on merits.

That also means negotiating new agreements that protect not just America's economic interest but allow the free exchange of culture and ideas throughout the world. The world is a better place, thanks to American ideas in commerce. Keeping the global digital marketplace open means continuing the fight for that better world.

The proposed [United States-Mexico-Canada Agreement](#) (USMCA) is a step in the right direction. It builds on previous negotiations aimed at modernizing trade rules that led to the U.S.-South Korea (KORUS) and the Trans-Pacific Partnership (TPP) free trade agreements (for which the United States withdrew). And importantly, USMCA strengthens the language that protects the heart of the digital economy.

The USMCA prohibits taxation and restriction of cross border data flows, ensuring customers get full access to new and innovative products. It further prevents onerous localization requirements and ensures that each country’s regulators justify new regulations. The USMCA balances these freedoms with legitimate public policy objectives such as the need for law enforcement within each country to access data when necessary.

Background. The Trump administration has renegotiated two free trade agreements: KORUS and USMCA. Unlike KORUS, the North American Free Trade Agreement (NAFTA)—the predecessor of USMCA—lacked important sections on digital trade, and many of the existing sections did not reflect the

Key Points:

THE USMCA -

- **Modernizes NAFTA by including a chapter on digital trade.**
- **Prohibits tariff-based restrictions on data flows.**
- **Restricts regulations on data localization and arbitrary privacy rules.**
- **Limits liability of third-party platforms.**
- **Lowers the *de minimis* and requires and creates a streamlined customs process for low-valued shipments.**

modern economy. NAFTA was negotiated in the early 1990s, when the internet was still a nascent technology and had not yet transformed the way the world conducts commerce. Because the agreement reflected trade in the conventional goods and services of that time, NAFTA lacked protections for businesses selling digital services or products in Canadian and Mexican markets. The renegotiation of NAFTA has brought the agreement into the 21st century by focusing on evidence-based regulation, adding rules to protect the digital economy, and leveraging new technologies to secure trade.

The Office of the U.S. Trade Representative (USTR) negotiated a comprehensive digital chapter during the TPP discussions. Strengthening and implementing these provisions in new trade agreements is important to expanding U.S. exports in digital goods. Ambassador Robert W. Holleyman, a former Deputy USTR, made this point at the JEC's June 2018 hearing on digital trade:

The TPP, and now [the Comprehensive and Progressive Agreement for Trans-Pacific Partnership], contain a series of provisions we dubbed "the Digital Two Dozen" – which can serve as a template for our future trade negotiations. USTR has advanced substantially similar provisions in the NAFTA negotiations with Canada and Mexico. We must continue to do so and secure this new model for the future of digital trade in North America and beyond.

The USMCA, which is intended to replace NAFTA, includes new chapters on digital trade and stronger intellectual property rights (IPR). Many of the new provisions go beyond the chapters in KORUS or the TPP negotiations.

Control of data. Services are becoming increasingly tradeable as the digital economy creates new modes of connecting professionals. American businesses have become the largest exporters of services, constituting [\\$798 billion of trade in 2017](#) and generating a trade surplus of \$255 billion. Expanding exports of services through the digital economy may be the best opportunity for the U.S. to reduce its trade deficit. As Sean Heather, Vice President for Global Regulatory Cooperation at the U.S. Chamber of Commerce, testified at the JEC's 2018 digital trade hearing:

... the potential for service industries to engage in international trade is almost untapped. One in four U.S. factories export, but just one in every 20 providers of business services does so. Just 3% of U.S. services output is exported, according to the Peterson Institute for International Economics.

The lifeblood of service exports is the flow and storage of data. According to the [Bureau of Economic Analysis](#), more than half of all services exported are potentially delivered using digital communication. As technology improves communication, the export of services is expected to grow. Many countries, however, erect barriers to protect traditional industries or nascent domestic technology under the pretense of cybersecurity concerns. As Rachel Fefer of the Congressional Research Service [noted](#) in her testimony:

Governments must often attempt to balance a number of legitimate policy objectives related to digital trade, including ensuring national security, promoting innovation and competition, and guaranteeing citizens' privacy. However, legitimate policy objectives

may also be cited as a rationale for actions that are actually intended to protect the domestic market from international competition.

Moreover, with the digital economy comes a free flow of ideas and exposure to cultures from around the world. Threatened by the loss of control, some governments have chosen to limit data flows in order to control information to their public. Chairman Paulsen [noted](#) this in his opening statement as well:

The benefits of digital trade include domestic economic growth, as well as spreading American ideas and culture across the world. Of course, to us, this is good. Yet there are others who consider the free flow of information, products, and ideas a threat to their control. And nearly three decades after the Berlin Wall fell, the way ideas and goods travel from one nation to another remains a contentious issue both politically and legally.

Balancing concerns of safety, freedom, and economic growth is essential to developing trade rules of the digital economy in a free world.

The key problems are forced localization requirements for servers, restrictions on digital trade and data flows, duties on electronic transmissions, and a lack of evidence-based regulations, which [Rachel Fefer](#) stressed and [Daniel Griswold](#), Director of Trade and Immigration at the Mercatus Center, also emphasized in the 2017 JEC hearing titled *the Dynamic Gains from Free Digital Trade for the U.S. Economy*. The USMCA addresses many of these issues in its Chapter 19.

Duties on electronic transmissions. Taxing the amount of data sent or received, such as \$1 per terabit of data, is the easiest method to restrict digital trade. Congress made this a priority in the [Bipartisan Congressional Trade Priorities and Accountability Act of 2015](#). In 2017 testimony before the JEC, [Daniel Griswold](#) highlighted the advantages of keeping data movement tax free. Article 19.3 in the USMCA prohibits the taxing of data moving from one country to another country:

No Party shall impose customs duties, fees, or other charges on or in connection with the importation or exportation of digital products transmitted electronically, between a person of one Party and a person of another Party.

The article explicitly states that non-discriminatory taxes within a country's own borders are not prohibited.

Restrictions of digital trade and data flows. Governments can impede data flows by blocking access to digital services, filtering information available to customers, and restricting electronic payment systems. These restrictions can prevent their citizens from viewing dissenting views or purchasing foreign products. The USMCA contains several articles in Chapter 19 that restrain governments' abilities to manipulate the flow of data. Article 19.4 specifies that signatory countries cannot discriminate among digital products based on origin but still allows treating categories of digital products differently, as long as this applies to all products, regardless of geographical origin:

No Party shall accord less favorable treatment to a digital product created, produced, published, contracted for, commissioned, or first made available on commercial terms in the territory of another Party, or to a digital product of which the author, performer,

producer, developer, or owner is a person of another Party, than it accords to other like digital products.

However, the articles do not constrain subsidies or grants to producers of digital products.

Ryan Radia, Research Fellow and Regulatory Counsel at the Competitive Enterprise Institute, promoted the principle of free data flows but warned that not allowing companies to provide different content to different markets could hurt consumers. Referring to the Digital Single Market directive in the European Union (EU), Radia [said](#):

If the European Union’s goal of achieving a digital single market ends up prohibiting content owners from offering customized packages of streaming video programming to residents of the EU’s diverse member states, many of these consumers will likely suffer.

Article 19.4 walks the line of ensuring data flows while allowing companies to customize packages, ensuring greater integration across the North American economy. Similarly, Article 19.10 recognizes that access to data is important and mutually beneficial, although it does not have prescriptive measures.

Forced Localization. Forced localization requires companies to store data generated from a country within its borders and interferes with scaling up data storage and processing. Many countries implement this policy on cybersecurity or privacy grounds, but it is often a means of developing in-country “server farms” that raise the concern of foreign governments stealing data. Ambassador Holleman [cited](#) forced localization as the emerging policy issue that impedes digital trade the most. Article 19.12 prohibits the forced localization of data by stating, “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 19.2, however, limits the scope of the digital trade chapter to exclude financial services, which is one of the largest sectors for data storage.

Although Article 19.12 is echoed in the financial chapter (Ch. 17), Article 17.18 is more nuanced, allowing regulators to require data localization if a business is unable to provide them with access to data. The USMCA attempts to balance the need for free flow of data with the demands of regulators and security. This is an improvement over the digital chapter negotiated in TPP, which simply excluded financial services from the data-localization provisions.

Lack of evidence-based regulations. Ensuring regulations achieve their desired results while retaining freedom of commerce can be difficult, particularly when governments use them to protect their markets. When regulators must prove a need for regulation, it is less likely to be arbitrary or protectionist.

Several Chapter 19 articles in USMCA require regulators in signatory countries to avoid unnecessary regulation and justify new regulations. Toward that end, Article 19.5 requires including stakeholders in the process of developing new regulations, while Article 19.14 encourages transparency and cooperation in rulemaking, including sharing information and experience with rules, policies, enforcement and compliance. Moreover, it encourages self-regulation systems for private industry. Article 19.15 encourages a risk-management approach to cybersecurity over prescriptive regulation and promotes relying on consensus standards to guard against cybersecurity threats rather than allowing unilateral, precautionary regulation.

Protection of personal data. As the digital economy spreads throughout the globe, individuals increasingly worry about who has access to their personal data. However, privacy concerns can be a pretense for protectionism. Sean Heather [warned](#) against this at the JEC's 2018 hearing on digital trade:

While privacy standards are necessary in order to ensure consumer protection, consumers and businesses also need to be able to move and access data. However, governments often enact data protection measures that interfere with these needs without a good regulatory justification, creating difficulties for companies conducting business in-country and worldwide.

Balancing privacy concerns with promoting digital commerce can be difficult. EU regulators err on the side of protecting data, but thereby can stifle digital markets. Ryan Radia [warned](#) in his testimony at the 2018 JEC hearing:

Just as U.S. leadership has helped steer the world toward freer trade and open markets, the United States should lead by example on privacy, and resist calls to adopt an overly precautionary approach that might endanger the freedoms that have enabled U.S. firms to connect the world through platforms that can help improve the lives of billions of people.

USMCA takes the middle ground by requiring that each country adopt rules to protect privacy while recognizing national differences in legal frameworks. Article 19.8 defers to a broader consensus by requiring countries to include guidance from international organizations:

... each Party shall adopt or maintain a legal framework that provides for the protection of the personal information of the users of digital trade. In the development of its legal framework for the protection of personal information, each Party should take into account principles and guidelines of relevant international bodies, such as the APEC Privacy Framework and the OECD Recommendation of the Council concerning Guidelines governing the Protection of Privacy and Transborder Flows of Personal Data (2013).

Article 19.8 also encourages transparency and cooperation among the countries by requiring the publication of rules and remedies around personal information and encouraging interoperability between each country in Article 19.8.6. USMCA does not steer signatory countries to a particular privacy policy as Ryan Radia suggested, but it goes beyond the provision established in TPP by prioritizing standards established by international organizations.

Limited legal liability for internet providers, social-media platforms. In his September 2017 testimony, Sean Heather [noted](#) that the U.S. government should including “appropriate and effective safe harbor mechanisms for intermediary liability.” The USMCA chapter on intellectual property rights does so by protecting third-party digital-content providers—such as internet providers and social-media platforms—from IPR infringement, provided they remove infringing content when notified by the rights-holder (Ch. 20.J.11). Article 19.17 limits the ability to sue companies providing interactive computer services—such a social media sites or forums—for hosting content created by its users:

... [N]o Party shall adopt or maintain measures that treat a supplier or user of an interactive computer service as an information content provider in determining liability for harms related to information stored, processed, transmitted, distributed, or made

available by the service, except to the extent the supplier or user has, in whole or in part, created, or developed the information.

This protects companies that store and deliver content created by users from legal actions and reassures social-media platforms operating in foreign markets. However, the USMCA also protects law enforcement's ability to prevent illegal activity from operating through an interactive computer service in Article 19.17.4, which balances the freedom for people to innovate without fear of protectionist policies with the need for law enforcement to guard against bad actors.

Protecting small businesses from taxes on e-commerce. The digital economy created a marketplace with fewer barriers to entry, which can provide more innovative and niche products, but small businesses are often deterred by a complex web of taxes, tariffs, and rules around the world. Governments help by setting a *de minimis* price threshold under which imports are exempted from customs duties. A high *de minimis* threshold reduces the burden on many small businesses selling to customers in foreign countries and limits the workload of customs offices. As Daniel Griswold [noted](#) in his testimony at the 2017 digital trade hearing:

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 [Customs and Border Control] from unnecessary administrative burdens.

The USMCA more than doubles the *de minimis* threshold for all taxes in both Canada and Mexico. The U.S. threshold for tax exclusion – including custom duties, sales taxes, or value added taxes – remains unchanged at US\$800, while Canada committed to C\$40 (around US\$31), up from C\$20 (around US\$15.5). Mexico committed to US\$50, up from just US\$1. *De minimis* customs thresholds for duty-free treatment were raised to approximately US\$117 (C\$150) for Canada and Mexico. Although the U.S. *de minimis* is currently much higher, the United States retained the right to lower their *de minimis* to the level of Canada and Mexico.

In addition, USMCA requires signatory countries to develop a special streamlined customs process for shipments with values under US\$2,500. It does not specify the exact process but does create a new category that reduces customs on low-value shipments, which would also help small businesses with international transactions.

Developing a better global digital economy. The USMCA accomplishes much of what a modern trade agreement should. We do not live in a static world, however, and should continue to look for further improvements. The “whole of government approach” [advocated](#) by Sean Heather offers the best way forward. It includes strengthening the USTR's Digital Trade Working Group, establishing in-country experts at embassies through the Digital Attaché program, creating a pool of digital expertise for Congress through the Digital Trade Caucus, and coordinating these efforts with the private sector. U.S. leadership produced the digital provisions in USMCA and lays the foundation for the work ahead to protect free digital commerce the world over.

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