Washington State Digital Trade:

Barriers and Opportunities

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The Digital Economy Revolution

Today's digital economy is enabling business and society in ways not previously envisioned. In a relatively short time, computer technology leapt from simply being a productivity tool to becoming an essential and accessible hub of social and commercial interaction. The digital economy is reshaping how Washington State companies connect across borders, creating new ways for businesses of all sizes to reach new markets and customers through trade. Business and society often struggle to keep up with the rapid pace of economic and social change. This is especially true with international trade, as our institutions and accords must catch up with a new era in trade and business. Nowhere is this more important than how we modernize trade agreements in order to harness the opportunities digital trade present.

What Is "Digital Trade?"

Digital trade encompasses the movement of products, services, and information across borders over the internet. It includes the flow of data that enables countless technologies that power online stores and sites, global production and distribution, the development of smart manufacturing that utilize autonomous systems and artificial intelligence, and numerous other technology platforms and applications.

For consumers, digital trade may take the form of a mobile banking app, ordering from an online store, using cloud services to manage personal information, or booking a ride share or vacation rental. For businesses, digital trade includes the use of cloud services and online communication tools to coordinate work across geographies, implementing real-time monitoring technology to optimize supply chains, using the internet to market or sell goods or services, or receive payments electronically.[1]

This movement of data is critical to enabling production and supply chains across geographies.[2] For example, a manufacturer operating a factory overseas likely collects data on output or the condition of equipment that is then analyzed in the U.S. and used to inform business decisions. These types of cross-border data flows are the foundation of many modern business operations. Another example is the data collected for financial services and insurance actuarial tables that are critical to the work of insurance providers.

Businesses of all sizes and from all sectors use digital technology to trade. The internet, the move to cloud technologies, and the reliance on online commerce has changed the game for all organizations, especially small and medium-size enterprises. Our reliance on technology and digital commerce underscores the need for expanding existing rules to address current and emerging challenges. It is critical that trade policies be updated and modernized to account for these important changes.

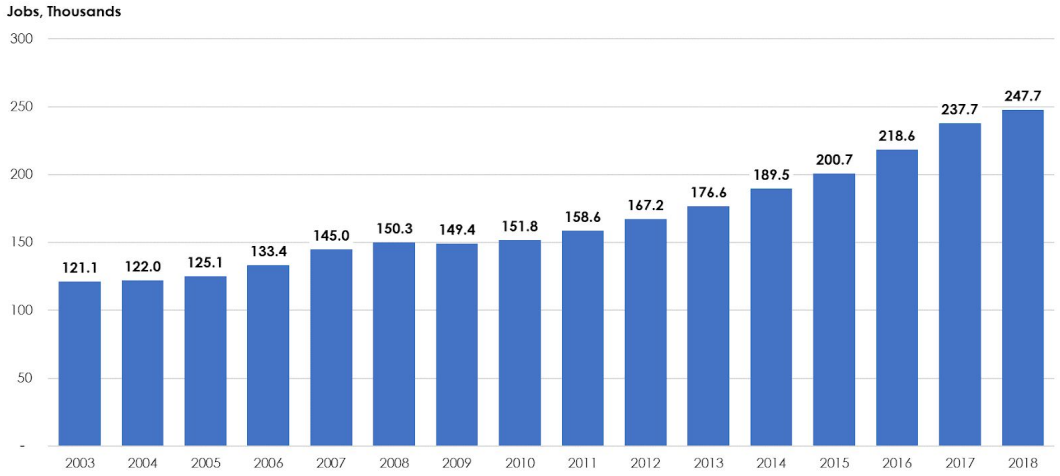
Digital Trade and the Washington State Economy

The internet and computing technology have significantly defined our global economic environment. That is especially true in the state of Washington where the world's top global

technology companies work closely with scores of new businesses and start-ups providing goods and services to customers throughout the world.

The tech sector is a major driver of the state's economy, promoting job growth, exports, and wealth generation. In 2018, there were roughly 247,700 workers employed in information, communication, and technology (ICT) jobs in Washington State (**Exhibit 1**).[3] The ICT industry includes voice and data systems, cloud computing, software development, electronic retail, internet publishing, and certain types of manufacturing.

Exhibit 1. ICT Jobs in Washington State, 2003-2018



Sources: U.S. Bureau of Labor Statistics, 2019; Washington Technology Industry Association, 2015; Community Attributes Inc., 2020.

The ICT sector is instrumental in driving digital trade. In addition to major corporations like Microsoft and Amazon, leading companies in the sector include Zulily, F5 Networks, Zillow, Redfin, ExtraHop, Tableau Software, Big Fish Games (with mobile and PC games played in 150 countries[4]), and Remitly, a platform for sending international remittance payments. All sectors and businesses of all sizes are cultivating international customers through online transactions and the tools that computing technology is bringing to society.

This dominance of technology in the region has helped spur digital commerce in the state. Based on government data, between 2014 and 2018, Washington State's annual digital export volume was $2.87 billion, approaching 5 percent of all digital export volume in the United States.[5]

Digital Trade's Impact: Washington Tech Sector and Beyond

Digital trade is dependent on software and physical ICT products such as semiconductors, cell phones, cloud computing, and cloud services. Cloud computing delivers a myriad of benefits to businesses of every size, across every industry. It helps companies scale quickly by facilitating faster transactions, and helps them improve productivity across their operations by delivering insights powered by Artificial Intelligence (AI) and machine learning. In Washington State, e-commerce enabled by cloud computing has driven investment in an extensive system of

warehousing and trucking, rail, and other shipping modes. The rapid development of e-commerce has led to large investments in fulfilment centers and supporting infrastructure.

The impact of digital trade goes well beyond just the ICT sector and hits all sectors and businesses of all sizes. The emergence of e-commerce and the pervasiveness of the internet have, in a very real sense, made all businesses more technology-reliant companies. From the dairy farmer who relies on data to improve production of the herd or the manufacturer creating efficiencies through transforming the shop floor, digital commerce has changed the game for everyone. Scores of Washington State small businesses—companies like Trade Tech, an Issaquah-based trade logistics company, Dry Fly Distilling, a Spokane-based distillery, Seven Seas Export in Kirkland ships egg products overseas, and K2, a Seattle-based ski equipment company—rely on digital trade to make their businesses work and grow. However, critical barriers exist that limit these Washington State businesses from realizing the full opportunities and potential of digital trade.

Overcoming Barriers to Digital Trade

Many of our current trade agreements and accords simply do not address some of the core barriers to digital trade that currently exist. When the North America Free Trade Agreement (NAFTA) was signed in 1992, e-commerce and digital trade were just beginning to take hold (Amazon would be founded as an online bookstore two years later in 1994). Subsequent trade deals have included e-commerce provisions but have not kept pace with the growing importance of digital trade in the global economy.

The growth of digital trade has created opportunities for Washington businesses to develop relationships with new customers in markets throughout the world. However, structural, legal, or regulatory obstacles often stunt these opportunities. Many of these barriers, including restrictions on cross-border data flows, server localization requirements, customs red tape at borders, uneven liability regimes, and forced technology transfer, inhibit or outright block digital products and services.

The United States-Mexico-Canada Agreement (USMCA) is the first U.S. trade agreement to contain a digital trade chapter.[6] The agreement establishes an international standard for digital trade that will be important for future free trade agreements. It builds on elements from the recently implemented Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which has an e-commerce chapter that also includes cutting-edge provisions on digital trade. The CPTPP evolved from the TPP which never entered into force due to the withdrawal of the U.S.

Key features of USMCA's digital trade chapter include:

- **Allows duty free digital products.** USMCA allows for electronically transmitted products such as music, movies, TV shows, video games, and eBooks to be sold across borders without customs duties.[7] These types of provisions are particularly important to Washington State's economy as it is home to software exporters like Tableau, video game producers (such as Valve and Big Fish Games), and online distributors movies, music, and eBooks.

- **Prohibits data localization.** Data localization laws are the "principal instrument for protectionism in the information age," according to the Council on Foreign Relations.[8] These laws require companies to store customer data in the same country the customers live in. For example, data localization laws would require an American bank to build dedicated servers in a foreign country to store data on those customers. This can make it particularly difficult for smaller companies to build and manage these servers. USMCA prohibits the implementation of these "data localization laws" to allow data to flow freely across borders, reducing costs for businesses and consumers. These updates can also protect financial services from data localization requirements.

- **Facilitates Customs and Trade.** USMCA includes provisions that cut red tape and speed border clearance for low-value shipments enabled by e-commerce. The agreement raises Canada's and Mexico's de minimis thresholds where no duties are assessed and shipments receive expedited treatments.

- **Provides Liability Protections.** Non-IP civil intermediary liability protections enable trade by allowing online platforms to host user-based content like customer reviews that help enable small business exporters. Like U.S. law, the provision encourages good actors by ensuring online platforms can moderate harmful content.

New agreements like the USMCA as well as the U.S.-Japan Trade Agreement take important steps in other areas to help modernize our trade agreements to address barriers to digital trade. These areas include provisions that: restrict governments from requiring companies to disclose proprietary computer source code and algorithms;[9] encourage cooperation on cybersecurity, spam prevention, personal data protection, and storing government data in machine-readable formats; address digital taxation issues; and eliminate barriers to cross-border data transfer.[10]

Emerging Digital Trade Issues

Washington State digital trade may be affected by several trade disputes the U.S. is presently engaged in, one of which is the dispute with France over a new tax on digital services. In July of 2019, France enacted a 3% tax on digital services rendered by large companies, whether French or foreign. Around 30 companies, most of them American, would meet the revenue thresholds and be affected by the tax.[11] After a USTR investigation found that the tax unfairly discriminates against U.S. technology companies, the Trump administration threatened up to 100% tariffs on $2.4 billion worth of French products such as cheese, champagne, and cookware.

Until the end of 2020, the U.S. and France have agreed to a truce, suspending the payment of the 3% digital tax and the Trump administration's threatened 100% tariff on French goods.[12] This was done to give the OECD more time to finalize a global standard. However, Italy has enacted a similar tax and the United Kingdom, Canada, Austria, and India have proposed their own digital services taxes.[13]

Barriers that are now being dealt with through new agreements like the USMCA and the CPTPP, as well as emerging issues like the digital services tax, are best addressed through multilateral cooperation rather than through a patchwork of different regulations and tax regimes that could

hinder digital trade. This multilateral approach can give businesses the clarity and stability needed to take full advantage of the opportunities of digital trade.

Washington State Digital Trade: A Way Forward

Digital trade will continue to define the way we conduct international commerce for years to come. For Washington State businesses to reap the full benefits of e-commerce, trade policies and agreements need to be updated to reflect today's trade environment.

Businesses are responding to the challenges and opportunities of digital trade by investing in and supporting workforce development through an emphasis on STEM programs. This focus on science and technology through education and training can help Washington State companies better compete in an increasingly digital world.

When considering the clear barriers to digital trade that are limiting growth and opportunities for Washington businesses and workers, recent agreements like the USMCA offer encouraging signs on how to deal with these issues. Multilateral and plurilateral negotiations and agreements, such as the negotiations on e-commerce currently underway at the World Trade Organization (WTO), can build on this progress and unlock digital trade's full potential to drive growth across our region.

Endnotes

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