

## WTO PLURILATERAL NEGOTIATIONS ON TRADE-RELATED ASPECTS OF ELECTRONIC COMMERCE

# The business case for a permanent prohibition on customs duties on electronic transmissions

### SUMMARY

The moratorium on customs duties on electronic transmissions (“moratorium”) has become an indispensable aspect of the modern trading system and a central piece in the 70+ year long-term trend towards an international trading system as free as possible from barriers to the global exchange of goods and services.

It is now time to make the moratorium permanent by prohibiting customs duties and formalities on electronic transmissions.

In the context of ongoing World Trade Organization (WTO) negotiations on electronic commerce, as well as the upcoming Ministerial Conference, the International Chamber of Commerce (ICC) emphasises the following:

1. For the Joint Statement Initiative on E-Commerce (JSI) process, global business views agreement on a permanent prohibition as a necessary signal by JSI participants of commitment to a high standard outcome.
2. Within the broader WTO Membership, a decision by the General Council in December 2019 to extend the moratorium is essential for digital trade.
3. Customs duties and formalities on electronic transmissions are virtually impossible to implement and enforce.
4. The calculation of tariffs for electronic transmissions is unworkable: an ad valorem assessment will not work for the majority of electronic transmissions; a non-ad valorem assessment will have highly distortive impacts on the digital economy.
5. The moratorium’s economic benefits far outweigh any potential tariff revenue from digitalised goods and services, including for developing and least developed economies. This is especially the case given that there are more efficient and practical behind-the-border options for revenue collection.
6. WTO Members, in particular developing countries, have legitimate concerns regarding revenue loss from the digitalisation of the economy. But traditional tariff measures and formalities are not the answer. Achieving global consensus on direct and indirect tax regimes based on international best practices is the optimal way to deal with this public policy concern.

### I. CONTEXT

Since the [Declaration on Global Electronic Commerce](#) at the Second Ministerial Conference in 1998, WTO Members have continued the practice of not imposing customs duties on electronic transmissions (the “moratorium”).

The moratorium has enabled digital trade to flourish, preventing the creation of trade barriers and burdensome customs duties or tariffs. The moratorium has helped consumers access new products and services, and enabled businesses, in particular micro, small and medium-sized enterprises (MSMEs), to access new markets. It also made a powerful statement: the default position with new forms of trade arising after the conclusion of the WTO Agreement is with no tariffs.

As a result, digital trade has been an immense economic driver: enhancing productivity, innovation and competitiveness and reducing the cost of doing business in an increasingly digitalised world.

## II. ICC PROPOSAL

### a. On the Joint Statement Initiative

ICC joins many of the WTO Members participating in the JSI process in calling for a permanent prohibition on customs duties on electronic transmissions.

There have been efforts by Asia-Pacific Economic Cooperation countries to make the moratorium permanent through the Pathfinder Initiative, and many countries have made similar commitments in trade agreements. It is now time for JSI countries to signal their commitment to a flourishing digital economy by agreeing to a legally binding permanent prohibition on customs duties on electronic transmissions.

Such a prohibition will give the private sector the necessary confidence to build the technology infrastructure of the future and will demonstrate a commitment on the part of JSI participants to lead in the development of innovative digital trade policies.

Indeed, a permanent prohibition is viewed by global business as an essential element of any high standard outcome.

ICC proposes the following model provision as one example of how a permanent prohibition could be given effect:

#### Customs Duties

1. Members shall not impose customs duties or customs formalities on or in connection with electronic transmissions, including content transmitted electronically, between a person of a Member and a person of another Member.
2. For greater certainty, paragraph 1 shall not preclude a Member from imposing internal taxes, fees or other charges on electronic transmissions, provided that such taxes, fees or charges are imposed in a manner consistent with the rules as set out in the WTO Agreements.

### b. Within the Broader WTO Membership

Conscious of the need to continue the legal effect of the moratorium beyond 31 December 2019, ICC calls for a decision of the General Council in December 2019, ideally to extend the moratorium to the 13th WTO Ministerial or, at a minimum, through to the 12th WTO Ministerial in June 2020 to provide an opportunity for further negotiations.

## III. THE ECONOMIC CASE FOR A PERMANENT PROHIBITION

The imposition of customs duties leads to declines in domestic output and productivity, increases in unemployment and inequality.<sup>1</sup>

This holds even more for industries undergoing high levels of innovation, such as many involved in the digital economy. One-sided, inward-looking analyses presuppose that a new raft of protectionist tariffs in the absence of the moratorium will protect nascent industries in developing countries such as, for instance, the 3D printing industry.<sup>2</sup> What this overlooks, however, is that the unilateral imposition of tariffs on electronic transmissions will likely lead to countermeasures by affected third countries, directly interfering with the ability of MSMEs in developing countries to scale and access international markets.

According to a comprehensive scenario modelling study undertaken by the European Centre for International Political Economy (ECIPE),<sup>3</sup> potential tariff revenue losses are far outweighed by the GDP losses that would accrue from the unilateral imposition of tariffs (“Scenario 1”, an optimistic outcome) or, what is more likely, the reciprocal imposition of tariffs (“Scenario 2”).

Under Scenario 1, tariffs on electronic transmissions (using the average tariff rates assumed by UNCTAD on a Most Favored Nation basis) lead to immense GDP losses. The projected GDP loss for the Indian economy,

<sup>1</sup> See, eg, Furceri, D et al, ‘Macroeconomic consequences of tariffs’ (IMF Working Paper WP/19/9) 6.

<sup>2</sup> See, eg, Rashmi Banga, ‘[Growing Trade in Electronic Transmissions: Implications for the South](#)’ (UNCTAD/SER.RP/2019/1) 32.

<sup>3</sup> European Centre for International Political Economy, ‘The Economic Losses from Ending the WTO Moratorium on Electronic Transmissions’ (ECIPE Policy Brief No. 3/2019).

for instance, is US\$716 million as against expected tariff revenue of \$US39 million.<sup>4</sup> Further investment (domestic and foreign direct), jobs and welfare losses are also suffered.

As the ECIPE paper notes, if one or a small number of countries impose tariffs on electronic transmissions, “it is a political fallacy to assume that a broader group of WTO Members would not follow suit and begin to consider their own tariffs”.<sup>5</sup> Net losses are even more pronounced in Scenario 2. The GDP losses for India, for instance, would amount to US\$1.9 billion, against expected tariff revenue of US\$31 million.<sup>6</sup>

In addition to these losses, there would also be considerable losses in domestic taxes.<sup>7</sup> Considered in totality, the projected economic losses from the imposition of tariffs on electronic transmissions far outweigh projected revenues.

#### IV. WILL THE UNILATERAL IMPOSITION OF CUSTOMS DUTIES ON ELECTRONIC TRANSMISSIONS FRAGMENT THE INTERNATIONAL TRADING SYSTEM?

Bans on the imposition of customs duties on electronic transmissions are plentiful within bilateral, regional and mega-regional trade agreements. Fifteen APEC members, for instance, have entered into agreements containing a ban since 2008.<sup>8</sup> Some agreements contain affirmations of the moratorium as agreed in WTO Ministerials.<sup>9</sup> Many, however, are truly “WTO-plus” obligations, creating permanent bans on the imposition of customs duties on electronic transmissions between parties to the relevant agreement.

A notable feature of these agreements is that they have increasingly aligned with the spirit and substance of the moratorium. Its lapse would therefore create a further added degree of complexity on the interaction between the multilateral trading system and the growing web of bilateral and regional trading agreements. Ironically, given its widespread adoption in preferential trade agreements, suspending the moratorium at this juncture will actually contribute to the ‘spaghetti bowl’ phenomenon.

*Mega-regional example: Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)*

##### Article 14.3: Customs Duties

1. No Party shall impose customs duties on electronic transmissions, including content transmitted electronically, between a person of one Party and a person of another Party.
2. For greater certainty, paragraph 1 shall not preclude a Party from imposing internal taxes, fees or other charges on content transmitted electronically, provided that such taxes, fees or charges are imposed in a manner consistent with this Agreement.

*Regional example: US-Mexico-Canada Agreement (USMCA)*

##### Article 19.3: Customs Duties

3. 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.
4. For greater certainty, paragraph 1 does not preclude a Party from imposing internal taxes, fees, or other charges on a digital product transmitted electronically, provided that those taxes, fees, or charges are imposed in a manner consistent with this Agreement.

<sup>4</sup> Ibid 9.

<sup>5</sup> Ibid 11.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid 13–15.

<sup>8</sup> APEC, 2016 Committee on Trade and Investment Report to Ministers (November 2016), Appendix 26-1: Pathfinder Initiative Proposal for a Permanent Customs Duty Moratorium on Electronic Transmissions, Including Content Transmitted Electronically —Submission by Australia, Brunei, Canada, Chile, Japan, Korea, Mexico, New Zealand, Peru, Singapore, the United States, and Chinese Taipei.

<sup>9</sup> See, eg, Australia-China FTA art 12.3.1.

#### Article 10.4: Digital Products

5. A Party shall not apply customs duties or other duties, fees or charges on or in connection with the importation or exportation of digital products by electronic transmission.

Note: The obligation in paragraph 1 does not preclude a Party from imposing internal taxes or other internal charges provided that these are imposed in a manner consistent with Article III of GATT 1994 and its interpretative notes as incorporated into this Agreement by Article 2.2

In addition to the above examples, Table 2 contains a non-exhaustive list of bilateral and regional trade agreements that include a ban on customs duties on electronic transmissions.

#### Table 2 trade agreements containing the moratorium (non-exhaustive)

##### Regional Trade Agreements

Additional Protocol to the Framework Agreement of the Pacific Alliance  
 Canada-Honduras FTA  
 Colombia-Northern Triangle FTA  
 EFTA-Central America FTA  
 EU-Central America Association Agreement  
 EU-Colombia-Peru TA  
 EU-Japan EPA  
 EU-Singapore FTA  
 Gulf Cooperation Council-Singapore FTA

##### Bilateral Trade Agreements

Australia-China FTA	Korea-US FTA
Australia-Hong Kong FTA	US-Bahrain FTA
Canada-Jordan FTA	US-Colombia TPA
Costa Rica-Singapore FTA	US-Morocco FTA
Chile-Colombia FTA	Singapore-Australia FTA
Japan-Switzerland EPA	Sri Lanka-Singapore FTA
Korea-Singapore FTA	

## V. CAN CUSTOMS DUTIES ON ELECTRONIC TRANSMISSIONS BE CALCULATED?

### a. Ad valorem assessments are unworkable

Putting aside the unsettled and critical issue of whether an electronic transmission constitutes a good, service, or 'bundle of rights' akin to copyright or intellectual property, calculating the economic value of an individual electronic transmission is in many instances an impossible task.

#### Hypothetical 1—Live-streaming a performance

Consider the hypothetical performer—famous Bollywood actress and singer-songwriter “Priyanka”. Priyanka is debuting a song and opts to livestream it to her millions of fans across several channels. The performance is transmitted electronically to her approximately 44 million Priyanka followers in more than 100 countries.

If an “electronic transmission” is considered an intangible good (an unsettled area of trade law and the working assumption of the Government Indonesia in its new Chapter 99 to the Indonesian Customs Tariff Book<sup>10</sup>), then there are potentially millions of electronic transmissions of Priyanka’s performance, transmitted to as many as 100 countries.

Assessing the economic value per view in this instance is not possible.

There are countless forms of electronic transmissions that are practically impossible to quantify and track, not to mention difficult to value from a customs valuation perspective. Consider the steady flow of emails necessary to facilitate business-to-business and business-to-consumer transactions. Ascribing an arbitrary economic value to these electronic transmissions to enable customs declarations premised on *ad valorem*

<sup>10</sup> Created pursuant to Perubahan Kedua Atas Peraturan Menteri Keuangan Nomor 6/PMK.010/2017 Tentang Penetapan Sistem Klasifikasi Barang Dan Pembenaan Tarif Bea Masuk Atas Barang Impor (Regulation 17).

duty assessments will create perverse, unintended consequences, potentially placing a direct disincentive on electronic communication and stifling digital innovation.

### Hypothetical 2—Business to business data flows—service optimization

Consider South African haulage and logistics provider Cyril, who has recently purchased trucks for his business from a prominent European firm. The trucks are equipped with on-board connected devices and sensors that capture data on the truck's performance, component wear and tear, safety and handling.

This data is then transmitted to a data centre managed by the European vendor, where it is analysed and processed to provide real-time insights back to Cyril in South Africa. This data enables Cyril to optimise the performance of his fleet, avoid unnecessary downtime, reduce fuel waste, and assess and improve driver skill.

Cyril is but one of the European firm's many customers worldwide. Hundreds of thousands of trucks covering billions of kilometres every year send to and receive data from the European firm. This amounts to billions of bits of data crossing multiple jurisdictions as the basis for this value-added service.

Assessing the value per data point in this business-to-business package service is not feasible.

## b. Non-ad valorem assessments would be highly distortive

To undertake a non-*ad valorem* duty assessment, there must be some metric upon which an assessment can be made. Two methods of non-*ad valorem* assessment appear theoretically possible.

### 1. Number of bits

A possible form of assessment would be to base an applied rate of duty on the number of bytes or bits (series of zeroes and ones). Yet determining a customs duty based on file size will grossly distort the digital economy. If an incentive is placed on reducing file size many industries will be greatly affected, from advanced manufacturing to the creative industries.

Of note is that many developing countries claim a substantial trade surplus in their creative industries, including Indonesia and India.<sup>11</sup>

### 2. Units as a whole

Given the difficulties in assessing value as the basis for determining a duty, and the perverse and unwelcome side effects of calculating a duty based on file size, it may seem attractive to calculate duty based on a single 'unit', where that is taken to mean an intangible good (such as operating software or a movie).

To do this would disregard the last 20 years of Internet infrastructure development. When an intangible is transferred electronically to a particular destination, elements of the intangible are often sourced from servers located in multiple jurisdictions, a fact explored in further detail below.

## VI. IS THERE A SETTLED MEANING OF THE TERM “ELECTRONIC TRANSMISSIONS”?

The current conversation on the moratorium fails to acknowledge the lack of clarity surrounding the meaning of the term “electronic transmissions”. The key intellectual underpinning for new calls for a rethink of the moratorium on customs duties on electronic transmissions, a research paper from a member of UNCTAD's Secretariat,<sup>12</sup> written in her personal capacity, assumes that “electronic transmissions” means “[t]he online trade of digitizable products”,<sup>13</sup> or the “on-line deliver[y], e.g., of music, e-books, films, softwares [sic] and video games”.<sup>14</sup>

Indeed, the Government of Indonesia has taken this approach in its new Chapter 99 of the Indonesian Customs Tariff Book, as set out in Table 1.

<sup>11</sup> UNCTAD, '[Creative Economy Outlook: Trends in international trade in creative industries](#)' (UNCTAD/DITC/TED/2018/3) 25.

<sup>12</sup> See Rashmi Banga, '[Growing Trade in Electronic Transmissions: Implications for the South](#)' (UNCTAD/SER.RP/2019/1).

<sup>13</sup> Ibid 1.

<sup>14</sup> Ibid 3.

**Table 1—Indonesian Customs Tariff Book—Chapter 99**

No	Tariff line/ HS Code	Description of goods	Import duty
	99.01	Software and other digital goods transmitted electronically	
10827	9901.10.00	> Operating system software	0%
10828	9901.20.00	> Application software	0%
10829	9901.30.00	> Multimedia (audio, video, or audio-visual)	0%
10830	9901.40.00	> Supporting or driver data for machinery system	0%
10831	9901.90.00	> Other software and digital goods	0%

Yet the term itself remains unsettled and is potentially very broad, capable of encompassing:

- > internet publishing, web search portals, directories and information services
- > online retail services
- > online photographic, motion picture and sound recordings
- > digital advertising
- > data hosting, system (e.g. cloud) services and data transfers.

To explore how electronic transmissions work in practice, consider the online streaming of video content.

According to the [Cisco Visual Networking Index](#), video will account for 82 per cent of global Internet Protocol (IP) traffic by 2022. The following hypothetical example illustrates just how technically, legally and operationally complex it would be to levy customs duties on just one form of electronic transmissions: the data packets required to stream a movie.

### Hypothetical 3—Online Streaming

1. Nasra, based in Jakarta, subscribes to a streaming platform headquartered in the United States. She would like to watch a movie on her smartphone.
2. Under current technology, data are sent via packet switching—a process whereby data are divided into small units, called packets, and transmitted independently via the Internet. The size of a typical individual IP packet is anywhere from 1.5 to 64 kilobytes.
3. Browsing through the titles available to her, Nasra's smartphone receives electronic transmissions to the streaming platform's application on her smartphone. Those transmissions are stored on a third party's distributed system in the cloud, and are transmitted to Nasra's smartphone from Singapore, Hong Kong SAR, Mumbai and Sydney.
4. For Nasra's movie, there could be up to 5 million data packets, or electronic transmissions, sent to her smartphone. This number is not predetermined, as it is a function of the speed of her Internet Service Provider at any point in time—the streaming platform having developed sophisticated technology to determine the optimal video quality consistent with Nasra's internet connectivity. The higher the speed, the greater the number of total data packets.
5. When Nasra clicks play, the platform sends a signal to the 10 nearest servers to Nasra, a subset of the thousands of servers that the streaming platform maintains globally. Packets of data are received from Australia, Japan, Guam, New Zealand, South Korea and The Philippines, until the application determines that Singapore provides the more efficient connection.
6. Part-way through Nasra's streaming of the movie, the streaming platform engages in a routine redundancy check, momentarily suspending service through the region, causing the application to automatically receive data packets from a different geographic region, in this case from several countries within the European Union.
7. By the time Nasra has finished watching her movie, she has received millions of electronic transmissions from at least 9 separate jurisdictions.

This example serves to highlight the manifold complexities that arise when seeking to hypothesise a workable regime for levying customs duties on electronic transmissions. Given the carrier medium, regarding the entire movie as an individual electronic transmission is conceptually unsound. Given the underlying ICT infrastructure that supports it, a single certificate of origin or customs declaration for the entire movie is untenable. In this context, requiring customs formalities for every electronic transmission would be next to impossible to comply with, for businesses of any size.

Unilateral moves to define and characterise “electronic transmissions”, absent multilateral negotiation and agreement, will further fragment the international trading regime and strain already fraying dispute resolution processes.

## **VII. ARE CUSTOMS DUTIES ON ELECTRONIC TRANSMISSIONS TECHNOLOGICALLY AND ADMINISTRATIVELY VIABLE?**

Assuming the conceptual issues explored above can be overcome, it is an open question whether it would be technically feasible to operate a system for the collection of tariffs on electronic transmissions.

Given that “electronic transmissions” are the data making up an intangible good or service, customs declarations could run into the millions per good or service and be sourced from many jurisdictions. Requiring a custom declaration to accompany data flows would place an immense burden on the efficient functioning of global commerce and the free and open Internet upon which it relies. It would also place an enormous burden on customs bodies and could, assuming the value of electronic transmissions can be readily ascertained, impose administrative costs on customs bodies far outweighing the value of the electronic transmissions themselves.

## **VIII. A BETTER WAY TO ADDRESS REVENUE LOSS: NEGOTIATED AGREEMENT ON DIGITAL TAXATION POLICY**

States, in particular developing and least developed countries, have legitimate concerns regarding revenue loss due to digital transformation of economic activities. However, for the host of reasons explored above, customs duties are not the answer.

Countries can already implement non-resident VAT/GST on electronically supplied services. Most digital companies are already complying (through collection and remittance) in several countries. So long as the tax is applied on a level playing field with domestic service providers, revenue can be realised in a non-discriminatory way.

ICC recommends that this issue be approached through consensus-based multilateral discussions within the OECD [Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy](#), with its 131 Inclusive Framework members.

The WTO Secretariat should ensure that Members are apprised of developments in the OECD and other political contexts, including through reporting of these developments to the General Council and the Ministerial Conference.

We also believe it would be useful for those Members who have implemented VAT/GST on intangible goods and services supplied from firms with no domestic presence to provide information to all Members on how these policies have worked and what level of compliance they have seen.