New Industrial Revolution: Upgrading Trade and Investment Frameworks for Digitalization

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Major Challenges Faced by G20 Members

- Multilateral progress on the governance of the digital economy and trade remains sluggish, with possible serious consequences for the global economy and development. Processes currently in course, such as those at WTO, need strengthening. Such attention also needs to effectively address the risks of a widening digital divide. Plurilateral and regional approaches raise the potential for innovation in this domain, but such approaches must be understood systemically in relation to their sustainable development impacts.

- New gaps in trade governance have been exposed as the digital economy continues to grow and new technologies emerge and are rapidly deployed. Policymaking in this area requires more and effective international interagency coordination and greater involvement of country capitals.

- Misallocation of taxable profits is exacerbated by lack of adequate frameworks that address the digitalization of economy and trade, and there is lack of consensus about political and technical solutions.

Specific Recommendations for the G20 in 2018

- The G20 presidency should convene trade ministers with a priority focus on providing direction for global governance actions that address the multifaceted relationship between digital technologies and trade, the digital divide, and the incorporation in rule-making and implementation of distributive ledger technologies and artificial intelligence, among other strategic trade-related issues.

- G20 trade ministers or the Trade and Investment Working Group should sign a **Buenos Aires Memorandum for Cooperation on Digitally Enabled Trade** with the following elements:
  - Incorporating senior trade officials in G20 digital ministers’ meetings and discussions related to digitally-enabled trade, and vice versa, with a view to keeping the digital trade agenda well coordinated in the capitals of G20 economies.
  - Set up a **G20 Trade and Investment Package to Enhance Digital Connectivity**. This package would contribute to infrastructure for digital development, one of three G20 priorities in 2018. The package may also call for liberalisation and facilitation of trade in goods and services that are pertinent to digital access and connectivity, public and private partnerships to address digital divide challenges, and strengthening aid for trade and other forms of technical assistance to low income countries.
  - Prepare a succinct document of non-binding **Guiding Principles for Global Digital Economy Policymaking**, similar to the G20 Guiding Principles for Investment Policymaking at the 2016 Hangzhou Summit. The principles can be based on **A Roadmap for Digitalisation** (G20 2017) and **G20 Digital Economy Development and Cooperation Initiative** (G20 2016).
The G20 should reaffirm the facilitating role of the World Trade Organization (WTO) in global governance on digitally-enabled trade, and suggest a WTO Facility on Digitally-Enabled Trade as a focal point to initiate information-sharing, cooperation, and coordination among international agencies related to digitally-enabled trade.

In line with the July 2018 report of the G20-mandated OECD Action Plan on Base Erosion and Profit Shifting (BEPS) work, a priority of the international community is how to maintain coherence of the international tax system in light of the persistent disagreement on how to best address the tax challenges of digitalization. Towards this end, the G20 should set up an ad-hoc Intergovernmental Panel on Taxation in the Digital Economy, similar to the Intergovernmental Panel on Climate Change (IPCC), to provide technical and scientific reports that allow G20 political leaders to make holistic solutions to the cross-cutting issue of digital economy and tax policies by 2020.

Challenge

The G20 has devoted increasing attention to the opportunities and challenges posed by digital transformation of the global economy in the wake of the New Industrial Revolution. The G20 recognised the importance of the “internet economy” in 2015, and in 2016 it advanced a G20 Digital Economy Development and Cooperation Initiative and developed an e-commerce growth strategy under the newly established Trade and Investment Working Group (TIWG). In 2017 the G20 organised the first digital ministers’ meeting with a roadmap for digitalisation and suggested G20 priorities on digital trade (see Appendix 1).

Three major challenges confront the G20 in 2018 and beyond:

The Multilateral Process on Digital Trade Remains Stagnant, although a Coalition of WTO Members Shows Interest in Negotiating Market Opening and New Rules

Last year, G20 digital ministers reaffirmed the importance of digital trade and identified three G20 priorities for digital trade: measuring digital trade; international frameworks on digital trade; and the development dimension of digital trade.

With respect to agreeing to a fitting multilateral framework the opportunity was missed at the 11th WTO Ministerial Conference (MC11) in Buenos Aires in December 2017, probably the single most important global trade event following the G20 Hamburg summit. With its full membership in attendance, the highest decision-making body of the WTO failed to reach multilateral agreement on the area of digital economy, except for outwardly endorsing the practice of not imposing duties on cross-border electronic transmissions and passing to
economy, except for routinely extending the practice of not imposing duties on cross-border electronic transmissions and agreeing to continue the discussion under the e-Commerce Working Programme, set up two decades ago.

It is notable, however, that several coalitions of governments came forward at the MC11 with joint statements indicating their intention to advance a number of pending issues, including a Joint Statement on Electronic Commerce. According to this statement, a group of more than 70 WTO members voiced their common intention to "initiate exploratory work toward future WTO negotiations on trade-related aspects of electronic commerce" (WTO 2017).

In spite of this new resolve and several years of informal dialogues engaging delegations outside the WTO on issues ranging from the digital divide to the potential of digital trade for small and medium-sized enterprises, the topic continues to elicit ambivalent reactions from a number of countries on substantive, strategic, and negotiation issues. For example, several low-income countries are concerned about their possible further marginalisation, including as a result of non-inclusive negotiation processes. (ICTSD 2018).

Digital Trade-Related Regulations Have Evolved in Recent Years, but Important Gaps Remain Between Trade Governance and Internet Governance

In 2017 the G20 reaffirmed three key principles of internet governance that had been agreed the previous year. First, G20 members recognised the importance of freedom of expression and the free flow of information, ideas, and knowledge. Second, G20 members expressed support for information and communications technology (ICT) policies that preserve the global nature of the internet. Third, G20 members recognised that applicable frameworks for privacy, personal data protection, and intellectual property rights must be respected as they are essential for strengthening trust in the digital world and for meeting legitimate policy objectives.

But bridging internet governance and the governance of international trade enabled by the internet remains an unsolved challenge at the global level. Lack of definitional clarity has created confusion and even confrontation between countries at the negotiation table as countries use different terms interchangeably (e.g. e-commerce, digital trade, and digitally enabled trade).

The authors of this policy brief find that “digitally-enabled trade” is a more nuanced and accurate term that captures not only conventional trade in goods and services in the digital age, but also cross-border trade as affected by digital technologies, including emerging foundational ones and their applications: from distributive ledger technologies (DLT) and blockchain, to artificial intelligence (AI) and internet of things (IoT) .

Given the lag in updating trade governance with the realities of digitally-enabled trade, and the stagnancy in the WTO in this area, nations have continued to use bilateral and regional trade agreements (RTAs) as a laboratory in the quest for fitting international regulatory approaches.

Progress has been made bilaterally and regionally to bridge trade governance and internet governance, with a view to addressing digital transformation of the traditional economy and new economic activities and business models. In the period 2001–2017, there were 69 RTAs that include a standalone chapter on e-commerce, which means digitally enabled trade, according to their notification to the WTO, with more than half of them featuring provisions on custom duties elimination, consumer protection, authentication methods and e-signatures, and paperless trading (Wu 2017). Regarding the level of depth and coverage of e-commerce-related issues, the newly signed Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP; formerly the Trans-Pacific Partnership) features prohibitions on imposed computing facility localisation requirements, obligations to allow cross-border information transfers, and extensive source code protection regulation.

However, even the largest economies are not in agreement with respect to data flow rules and net neutrality, which are critical for digitally enabled trade and trade governance. For example, the US and the EU share a broadly similar vision about data flows, as reflected in the EU–US Trade Principles for Information and Communication Technology Services, agreeing on open networks, use on a technologically neutral basis, free flow of information internally and across borders, no requirement for ICT service suppliers to use local infrastructure or to establish a local presence as a condition of supplying services, and competitive access to markets in authorisations and licences. [1] The EU, however, is silent on data localisation and emphasises privacy, as shown in the Canada–EU Comprehensive Economic and Trade Agreement. Moreover, a rift is emerging with the US, which seems to be eroding net neutrality, a concept that the EU embraces. And, while both jurisdictions are concerned about tax base erosion, the US preference is to provide incentives to bring US-owned assets home, while the EU’s is to withhold the tax on income earned in Europe.
China does not share the view of either the US or the EU in some respects. Although China has signed up to e-commerce provisions in several free trade agreements, its commitments only reaffirm its existing obligations in the WTO. On internet governance, China’s main legislation is the Cybersecurity Law, which came into effect on 1 June 2017. This Chinese law essentially sets three major rules: mandatory storage of physical data in mainland China; mandatory security inspections of equipment before installation; and mandatory law enforcement assistance and data retention regulations (Ciuriak and Ptashkina 2018).

Reconciling these different approaches with the G20 principles of the global nature of the internet and the legitimate rights of citizens and consumers, and maximising the use of digital trade and data for inclusive economic growth, is a challenge. One the one hand, new developments in various economies and regions provide valuable examples and experience of connecting digitally enabled trade with the broader backdrop of internet governance. On the other hand, fragmented development poses challenges of market distortion and uncertainties for business and society.

Misallocation of Taxable Profits Is Exacerbated by the Digitalisation of the Economy and Trade, and there Is Lack of Consensus about Political and Technical Solutions

The current international income tax system established in 1920s is based on the “origin of wealth” principle. In a traditional economy, value-creating factors are relatively immobile and require intensive use of labour and tangible assets, generally justifying taxation at residence. The nexus (or permanent establishment) rule—“fixed place of business” or “dependent agent”—complements this principle in the case of non-resident enterprises performing a sufficient level of economic activity in a jurisdiction.

Profit allocation rules are also based on the “arm’s length principle” that guides the determination of the profits that will be subjected to taxation in every jurisdiction implied in cross-border multinational enterprises’ activities. The arm’s length principle requires comparable transactions to determine market prices for the internal transfer of goods and services. These principles for international taxation were complemented with bilateral tax treaties and multilateral trade agreements in order to avoid double-taxation and promote commerce.

However, the widely accepted arm’s length principle might lead to an inadequate allocation of profits within a multinational enterprise with digital lines of business or operations.

Determining appropriate prices in non-digitalised business is difficult—and even more so with regard to digital business, due to factors such as valuing intangible services and intellectual property. Technological advances and economic globalisation have transformed business models. Value creation is becoming less dependent on the physical presence of people or property, intangibles are becoming more important, and the place of taxation is becoming increasingly blurred, calling into question the effectiveness of traditional international taxation rules, especially concerning highly digitalised businesses, even if affecting the rest of the economy, due to the difficulties in ring-fencing the digital economy. Therefore, the absence of permanent establishments in digital value chains is instrumental in the misallocation of taxable profits.

There are a variety of national measures in place that demonstrate lack of consensus in this domain, and the G20 as a forum could strengthen cooperation and provide guidance in addressing the challenge of double non-taxation that have emerged with new business models and are not already covered by base erosion and profit shifting (BEPS) actions. In the meantime, the G20 could help to avert possible adverse consequences of uncoordinated actions on tax and commercial treaties investment, innovation, growth, compliance, administration costs, and welfare.


[2] Source taxation was applied only by virtue of separate distributive rules to income and capital gains derived from immovable property, dividends, interest, and royalties.

[3] The interim report of the Organisation for Economic Co-operation and Development (OECD) Task Force on the Digital Economy summarizes the work already done on this topic following the tax challenges identified in its base erosion and profit sharing (BEPS) action 1 report (OECD 2015), the implementation and impact of the BEPS package in this area, the uncoordinated and unilateral actions adopted in a
Proposal

This task force makes three proposals, on the basis of the challenges the world is facing and the opportunities that countries have to capitalise on digitalisation of their economies. G20 leaders can play a necessary, influential role in advancing strategic and holistic solutions.

**PROPOSAL 1:** The G20 should host a meeting of trade ministers with a priority focus on a G20 Buenos Aires memorandum for strengthened cooperation on digitally-enabled trade

As of early May 2018, there has not been a decision to convene a G20 meeting of trade ministers. This task force suggests the Argentine presidency should convene a meeting of trade ministers for three reasons.

First, in the midst of emerging economic nationalism and high risks of erosion of WTO's trade order, it is critical to provide a space for G20 trade ministers to meet and exchange views about their vision, principles, scenarios, and concerns about international trade cooperation. They can provide guidance to the technical work of the TIWG and prepare for the political discussions on trade and investment at the leaders’ summit. Otherwise, there will be large gaps between technical work and political discussions, which could slow the process of leaders focusing on consensus around digital trade policy cooperation.

Second, trade ministers can develop trade and investment policy guidance that addresses the challenges of digital access and connectivity which is a key bottleneck for low income countries in particular. Infrastructure for development is one of the three key priorities of this year’s G20 (highlighting digital access and connectivity, two major infrastructure bottlenecks). This can be a concrete step to continue to work on the development dimension of the digital economy that was highlighted in the 2017 G20 declaration.

Third, a meeting of trade ministers can be a critical platform to bridge trade policies and other G20 work streams, such as digital ministers, agriculture ministers, and development ministers, with a view to making holistic policy recommendations for leaders. With selected ministers from non-G20 economies, G20 trade ministers can bridge the economies of G20 and small and medium-sized countries from the Americas and other regions, allowing the G20 to benefit from non-G20 perspectives and contributing to trade cooperation and consensus-building for the digital economy to be supportive of the 2030 Agenda for Sustainable Development.

In this context, this policy briefing suggests that G20 trade ministers develop a Buenos Aires memorandum for cooperation on digitally enabled trade, with support from the TIWG and the work stream of the digital task force. Such a memorandum can have several key elements:

- Ministers should commit to building dialogue focused on cooperation on digitally enabled trade at the trade ministerial level. Ministers can intentionally use the term “digitally enabled trade” to replace misused or misunderstood terms such as e-commerce and digital trade.
- Ministers should request the TIWG to strengthen work in the areas of building inventory of national experiences and good practice, carrying out studies on the special needs of low-income countries, micro, small, and medium-sized enterprises, and women’s empowerment in the areas related to digitally enabled trade in the wake of the New Industrial Revolution.
- Ministers should suggest that from 2018, and no later than 2019, ministries of trade should send deputised senior officials to attend digital ministers’ meetings, and ministries of digital affairs should send deputised senior officials to meetings of trade ministers, to keep the digital trade agenda well coordinated in the G20 and country capitals.
- Ministers should set up a G20 trade and investment package to enhance digital connectivity. This package can include three key elements: promoting the liberalisation of trade in goods that are essential for the digital economy, such as ICT equipment; promoting liberalisation of connectivity-enabling services, such as ICT, e-payments, logistics, and foreign investment; and developing public and private partnerships to provide targeted technical assistance to low-income countries, in particular least developed countries.
- Ministers should prepare guiding principles on policymakers in the digital economy. This can be a succinct document of non-binding principles in a format similar to the investment policymaking guiding principles agreed at the 2016 Hangzhou Summit. The principles can


be built on the basis of *A Roadmap for Digitalisation* (G20 2017) and *G20 Digital Economy Development and Cooperation Initiative* (G20 2016).

- Ministers should support a peer learning approach among the G20 economies, with a focus on best practice around infrastructure, regulations, implementation, technologies, and risk management. This could contribute to making digitally enabled trade more efficient, inclusive, and development-enhancing, while other legitimate policy objectives are achieved. For this purpose, the B20, L20, and T20 can continue to play a bigger role in doing research and communications.

Minister can pledge more resources to address the digital divide and other development challenges associated with the new industrial revolution, in particular for least developed countries, such as aid for trade in supporting digital connectivity, digital literacy, and regulatory capacity.

**PROPOSAL 2:** The G20 should reaffirm the facilitating role of the WTO in global governance on digitally-enabled trade and suggest a WTO facility on digitally-enabled trade as a focal point to enhance interagency cooperation and coordination in this regard.

It is imperative that the G20 reaffirms the WTO’s key role in building regulatory coherence on the issues related to digitally enabled trade through open and transparent processes. The G20 should ask international governmental or independent organisations to carry out deeper studies of measurement of such trade, best practices, and emerging disciplines from bilateral and regional trade agreements and from other initiatives, such as the CPTPP, Asia-Pacific Economic Cooperation, and Pacific Alliance, and bring them to the negotiations at the WTO.

Many issues related to digitally enabled trade may or may not be suitable for the WTO to handle directly, such as data protection, cybersecurity, and interoperability standards. Some of these issues can find an international governmental body as home. For example, digital communication standards are handled by the International Telecommunication Union and sister telecommunications and standards organisations. But many of these issues do not have a natural home for global policy cooperation, such as cyber security, data protection, and e-payments. In addition, there is no coordination between the various schemes that handle different aspects of digitally enabled trade.

This policy brief recommends that the WTO set up a facility not as a discussion or negotiation platform within the WTO, which already exists, but rather as a focal point for related agencies to come together to exchange views and proposals for policy development in this domain. With interagency exchange and understanding enhanced, this initiative can propose policy recommendations to the respective international governmental organisations, their members’ governments, the G20, and the public. Building trust in the digital economy should be a priority of this initiative in the WTO.

**PROPOSAL 3:** The G20 should set up an ad hoc intergovernmental panel on taxation in the digital economy to provide a series of technical reports allowing G20 political leaders to make holistic solutions to this cross-cutting issue.

The digital economy requires an update of the nexus of rules that goes beyond physical presence to ensure fair taxation and tame monopolies that may be reinforced by the networked economy and new business models.

The Organisation for Economic Co-operation and Development (OECD) Inclusive Framework on BEPS plans to work towards a consensus-based solution by 2020, with an update on progress in 2019. Recent G20 meetings in Buenos Aires have shown that much more work is needed to reach a consensus from both the political and the technical points of view.

In order to build consensus from a technical perspective on taxation in the digital economy era, this task force should reflect and draw lessons from the IPCC. The IPCC has expert groups from various backgrounds, such as climate scientists, economists, environmental policy experts, and political scientists, looking at the issue of climate change from different perspectives to help political leaders develop a clear view of the challenges and where the solutions lie. Such a body could gather data on economic activity to highlight changes and make policy recommendations in respect to economic changes taking place that are likely to exacerbate the already difficult challenge around taxation.

This policy briefing suggests that the G20 set up an IPCC-like intergovernmental panel on taxation in the digital economy composed of experts from taxation, technology, industry, law, economics, and political science. A key role of the panel would be to provide a series of technical reports for the G20 in the next few years and build up momentum and knowledge, with a view to reaching political agreements on key issues by 2020, and agreeing on the implementation plan by 2022, two years after the OECD BEPS plan is due.
The intergovernmental panel on taxation in the digital economy can also provide analysis of existing measures. For example, in March 2018, the European Commission proposed new rules to ensure digital business activities are taxed in a fair and growth-friendly way in the EU. The European Commission has made two legislative proposals. The first proposal responds to calls from several member states for an interim tax on revenues that covers the main digital activities that currently escape tax altogether in the EU (European Commission 2018a). The second initiative aims to reform corporate tax rules so that profits are registered and taxed where businesses have significant interaction with users through digital channels (European Commission 2018b). By reviewing these kinds of initiatives, the panel could help to foster consensus.

Concluding Remarks

The G20 has raised the level of knowledge accumulation and made impressive policy progress in the field of digital economy and trade since 2015.

For the next step, in particular in a time of uncertainty of major economies' trade and related strategies, G20 countries are faced with some critical challenges with respect to maintaining and strengthening their cooperation to advance a robust and inclusive digital economy and trade in 2018 so as to contribute to achieving Agenda 2030. The first challenge is that the WTO has not been able to deliver any significant multilateral mandate for market access and rule-making in the area of digitally enabled trade, nor has the development dimension been fully explored and addressed. The second challenge is that new developments happening at both trade and internet governance fronts are still fragmented, which creates uncertainty and potential trade wars in this field. The third challenge is that digitalisation of the economy exacerbates misallocation of taxable profits of both traditional businesses enabled by the internet and new digital businesses.

Against this backdrop, this task force makes three proposals:

1. The G20 should convene a meeting of trade ministers as soon as possible, which can put forward a Buenos Aires memorandum for cooperation on digitally enabled trade, including a G20 package to enhance digital connectivity, and guiding principles on policymaking of digital economy.

2. G20 members should reaffirm the facilitation role of the WTO in global governance on digitally enabled trade, and propose that the WTO sets up a new facility as a focal point to enhance interagency cooperation and coordination on a variety of aspects of digitally enabled trade, including standards, data protection, cyber security, and consumer protection.

3. The G20 should set up an ad hoc intergovernmental panel on taxation in the digital economy, similar to the IPCC, to provide a series of technical reports for G20 political leaders to make holistic solutions to this cross-cutting issue by 2020.

Appendix

Brief Review of G20 Decisions Related to the Digital Economy, Digital Trade, and Tax Cooperation in the Digital Age

Digitally enabled trade is a defining feature of the new economy that is transforming domestic and international markets with an unprecedented pace and magnitude. The G20, as a high-level forum for international economic policy coordination, has recognised this reality. At the Antalya Summit in 2015, G20 leaders first introduced the digital economy to the G20 policy agenda devoting a whole paragraph to the “internet economy.” At the same summit, the G20 and the Organisation for Economic Co-operation and Development (OECD) adopted the Base Erosion and Profit Shifting (BEPS) Action Plan, the first action of which deals with the tax challenges of the digital economy.

Following these forays, topics linked to the digital economy have quickly gained traction among G20 members. Under the Chinese presidency in 2016, the G20 members endorsed the G20 Digital Economy Development and Cooperation Initiative, and the G20 Leaders’ Communique featured the first ever reference to “digital trade.” In particular, G20 members agreed in Hangzhou to promote cross-border trade facilitation for e-commerce, eliminate barriers to trade, advance international efforts to measure e-commerce and its macroeconomic effects, protect consumers’ rights, and develop dispute resolution mechanisms. The Trade and Investment Working Group (TIWG) was
effects, protect consumers' rights, and develop dispute resolution mechanisms. The Trade and Investment Working Group (TIWG) was established in the same year to provide G20 economies with a dedicated cooperation platform for these areas of work.

2017 saw a range of digital economy-related G20 activities. For the first time, G20 ministers responsible for digital matters convened in a pre-summit meeting to set out the G20 roadmap for digitalisation. Their ministerial declaration identified the measurement of digital trade, its development potential, and international digital trade frameworks as G20 digital trade key priorities. To advance these topics, G20 members set up a G20 Digital Economy Task Force.

At the Hamburg summit, G20 leaders highlighted how the digital transformation can contribute to the successful implementation of the 2030 Agenda for Sustainable Development and called for constructive discussions on e-commerce at the WTO. It is worth noting that, for the first time in G20 history, G20 leaders referred in Hamburg to tax challenges that arise from the digitalisation of the economy and pointed to joint efforts with the OECD to tackle these taxation challenges. Responding to a request from the G20, the OECD released in March 2018 its interim report on the digital economy.

### Argentina's G20 Priorities and Work streams on the Digital Economy and Digital Trade

Argentina's G20 presidency follows the theme “Building consensus for fair and sustainable development.” Based on the theme's three pillars of consensual decision-making, fair treatment, and sustainable development, Argentina identified education and employment, infrastructure, and sustainable food as key priorities that will steer the country's efforts throughout its G20 presidency. In addition to these priorities, Argentina is also committed to building on work streams that emerged from previous G20 summits.

With regard to trade and investment, Argentina seeks to advance international cooperation to promote an inclusive “rules-based system that is strong and WTO-consistent at multilateral, regional, bilateral and national levels.” In 2018 the TIWG will focus on global value chains in the agricultural sector, the Fourth Industrial Revolution, and Industry 4.0. Argentina's priorities for the Digital Economy Task Force focus on the provision of inclusive development and put a particular emphasis on gender.

### References


Existing Initiatives & Analysis