American Association of the Indo-Pacific

aaip | IPEF Taskforce

DIGITAL TRADE:
THE IPEF KEYSTONE

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KEY POINTS

- **The Indo-Pacific Economic Framework (IPEF) agreement can play an important role in shaping rules that support economic growth, including strong digital trade provisions.**
- **The IPEF must adopt some flexibility and use phase-in periods for commitments to ensure broader participation.**
- **The IPEF should contemplate digital capacity-building initiatives for the private sector in countries that are digital trade newcomers, and the digital provisions in the agreement should not fall below the standards set by the USMCA and CPTPP.**
- **It should balance the interests of all stakeholders, facilitating fair competition between MSMEs and larger entities while promoting liberal trade policy without predetermining market outcomes.**

EXECUTIVE SUMMARY

The Indo-Pacific Economic Framework (IPEF) agreement can play an important role in supporting future economic growth in the U.S. and Indo-Pacific region. Given the digital economy's foundational role in global commerce, innovation, and future economic growth, strong IPEF digital rules are essential to achieving this goal. Digital trade tools are also critical for increasing access to global trade for micro-, small-, and medium-sized enterprises (MSMEs), women- and minority-owned businesses, leading to more inclusive access to the global economy.

The IPEF's digital provisions should reflect the strong standards set in the USMCA. Weakening these commitments will prevent U.S. economic interests from reaching their full potential. The language in the USMCA provides IPEF countries with the policy space needed to develop new digital regulations while supporting cross-border data flows. They create a balanced framework that promotes a thriving digital economy while enabling governments to regulate digital markets to protect important public policy interests, like consumer protection and privacy.

Weakening these rules would damage U.S. interests in an area critical to U.S. competitiveness, and that is helping to drive U.S. growth and innovation. Failure to reach agreement on the IPEF will leave the door open to the European Union and other governments that do not share the IPEF partners' vision of a competitive digital economy to write the rules that will shape the future of digital trade in the region.

At the same time, some IPEF members may need flexibility to meet these standards. While all IPEF countries should ultimately meet the same standards, it may be useful to consider phase-in periods, technical assistance, or other flexibilities to ensure broader participation. This will encourage a phased alignment of domestic regulations with the agreement's digital trade benchmarks.

The costs of a weak digital chapter will be significant. Digital trade and the free movement of data across borders underpin all aspects of the global trade environment. The IPEF is a clear and present opportunity for an open and liberal approach to be taken across the Indo-Pacific region. If negotiators lean to a more restrictive or even a 'lowest common denominator' approach, it will be a significant setback for U.S. companies in the region.

DIGITAL TRADE: THE IPEF KEYSTONE

Digital trade is an important catalyst for economic growth, innovation, and competitiveness. The role of digital trade and the free flow of data is critical to all commercial activity, not only the tech sector.

The **financial services** sector exemplifies how cross-border data flows have transformed traditional processes, facilitating real-time transactions, mobile banking, and tailored financial products. A comprehensive digital trade chapter in the IPEF will foster an environment conducive to continuous financial innovation and expansion across these diverse economies.

Similarly, **transport services** have undergone a shift owing to digital innovations. With the advent of AI-fueled logistics and supply chain management, autonomous vehicles, and ride-hailing applications, digital trade provisions—particularly those that prohibit data localization and advocate for unrestricted data flow—are integral to cultivating a more efficient, sustainable, and intelligent transportation sector within the IPEF region.

In **health services**, digital trade›s impact has been profound, underscored by its tremendous growth during the COVID-19 pandemic. Telemedicine, remote patient monitoring, and health data analysis are now vital components of modern healthcare. Incorporating digital trade provisions in the IPEF that facilitate the seamless cross-border flow of health data while ensuring robust privacy protections will promote enhanced patient outcomes and increase healthcare accessibility and healthcare innovation across the member nations.

The **movement of goods**—a cornerstone of global commerce—has been significantly enhanced by digital technologies. E-commerce platforms, online marketplaces, and digital payment systems have democratized access to global markets for businesses of all sizes. A digital trade chapter in the IPEF that prevents digital customs duties and encourages electronic transactions could further amplify the growth and competitiveness of e-commerce within the Indo-Pacific region.

Strong digital trade provisions are vital if the IPEF is to be meaningful and effective.

INTEROPERABILITY AND INDO-PACIFIC TRADE

Digital trade policy, regulation, and free trade agreements (FTAs) are critical in defining the operational landscape for businesses engaged in digital commerce. Interoperability within these regulatory frameworks facilitates seamless data exchange, compatibility between digital platforms, and uniformity in regulations and digital standards across jurisdictions.

Interoperability enables businesses to streamline their operations across different markets, maximizing efficiency. The inclusion of digital trade provisions in the CPTPP or the USMCA creates a more harmonized regulatory environment within those agreements, thereby reducing legal and compliance barriers to trade.

The fragmentation of digital trade policy presents significant challenges for businesses, primarily through increased operational and compliance costs. A European Centre for International Political Economy (ECIPE) study found that restrictive data policies could potentially reduce GDP by up to 1.7 percent in the European Union, 1.1 percent in the United States, and 0.8 percent in China. This reduction reflects the added costs businesses incur due to policy fragmentation, including expenses associated with navigating complex regulatory landscapes, complying with different rules across jurisdictions, and adapting digital services and platforms to varying standards.

Divergent data protection and privacy standards across countries could compel businesses to maintain separate databases or modify data handling practices in each jurisdiction, leading to higher compliance and operational costs. Inconsistent e-commerce regulations require businesses to adjust platforms and processes for different markets, increasing expenditure on product adaptation and local compliance.

The fragmentation of digital trade policy can also lead to digital protectionism. Countries may implement restrictions on cross-border data flows or favor local digital services, creating an uneven playing field and further increasing costs for businesses that operate internationally.

Negotiators of future trade agreements must prioritize the principle of interoperability rather than succumbing to the urge to 'reinvent the wheel' or push for novel standards. This requires building on existing digital trade provisions in FTAs, such as those found in the USMCA and, to a lesser extent, the CPTPP, and striving for coherence across multiple agreements. The process should seek to establish common regulatory and legal frameworks that address key areas of digital trade, such as data protection, consumer rights, cybersecurity, and digital transactions.

THE BASELINE: USMCA AND CPTPP

The United States-Mexico-Canada Agreement (USMCA) stands out as the leading benchmark in digital trade agreements. These landmark agreements are characterized by their comprehensive and progressive digital trade provisions, encompassing key aspects such as cross-border data transfers, non-discriminatory treatment of digital products, and the protection of online consumer rights and privacy.

These agreements have created operational frameworks conducive to businesses and protective of consumer interests. By adopting the principles embedded in the USMCA, future agreements can capitalize on established standards, promote interoperability, and encourage harmonious digital trade practices in an increasingly interconnected global economy.

It is also worth noting that the CPTPP agreement represents a digital baseline for many countries in the region. The value of the CPTPP should not be discounted when it comes to digital. Both include progressive digital trade chapters, but there are key differences between the two.

1. **Data Localization:** Both the USMCA and CPTPP prohibit data localization—the requirement that data must be stored within a country›s borders. However, the CPTPP allows for exceptions to this rule for legitimate public policy objectives, provided that the measure is not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on trade. In addition, the CPTPP localization prohibition does not cover financial services data.
2. **Cross-Border Data Transfers:** Both agreements prohibit restrictions on cross-border data transfers. However, the language in the CPTPP is slightly less absolute, acknowledging that countries can have legitimate policy reasons to restrict data flows, provided these are not disguised restrictions on trade.
3. **Personal Information Protection:** Both agreements require the protection of personal information. However, the USMCA includes a more detailed provision on this, specifically referring to the principles and guidelines of relevant international bodies. In contrast, the CPTPP simply requires each party to adopt or maintain a legal framework that provides for the protection of personal information.
4. **E-commerce Duties:** Both agreements prohibit the imposition of customs duties on digital products distributed electronically.
5. **Net Neutrality:** The USMCA includes provisions promoting net neutrality—the principle that all Internet traffic should be treated equally—which is not explicitly mentioned in the CPTPP.

A potential barrier for IPEF negotiators is that several IPEF countries are not members of the CPTPP or USMCA agreements or parties to other trade agreements with strong digital provisions, such as the Korea-Singapore Digital Partnership Agreement. These countries include Thailand, Indonesia, the Philippines, Fiji, and India.

OTHER DIGITAL STANDARDS

Throughout the IPEF negotiations, some parties have made references to so-called 'global standards' for digital. There are no 'global standards' for digital trade, but there are competing approaches to digital that diverge from those under the USMCA and CPTPP.

The most prominent of these is the approach of the General Data Protection Regulation (GDPR) enacted by the European Union (EU). The digital approach of the EU via the GDPR has become a de facto model for some countries with regard to their domestic regulations; this includes IPEF members.

The GDPR places a greater emphasis on placing barriers on the movement of data rather than allowing free trade in data with appropriate safeguards.

Other global standards include the principles outlined in the Organisation for Economic Cooperation and Development's Guidelines on the Protection of Privacy and Transborder Flows of Personal Data and the Asia-Pacific Economic Cooperation Privacy Framework, and APEC Cross Boarder Privacy Rules (CBPR) system, which gives effect to the APEC framework. These principles form a broad consensus but do not represent a regulatory model for trade agreements. In this regard, the CPTPP and USMCA are the clear benchmarks.

The Association of Southeast Asian Nations (ASEAN) and China seek to upgrade the ASEAN-China Free Trade Agreement (ACFTA). This will likely include commitments on digital commerce that extend beyond the minimal commitments in the Regional Comprehensive Economic Partnership (RCEP) Agreement. The ACFTA upgrade's digital working group has already met several times in 2023, with work underway.

ASEAN member states also seek to develop and implement the ASEAN Digital Economy Framework Agreement. It is positioned to be ASEAN›s premier framework for facilitating a harmonized digital trade ecosystem throughout Southeast Asia. Nevertheless, its capability to bring about a truly integrated digital economy remains a subject of discussion.

ASEAN member states have been vocal in their commitments to achieve an integrated digital economy. However, these states have independently reinforced their data regulation frameworks. States with more open data regimes have progressed towards further liberating data flows, while others have adopted stricter measures on cross-border data flows.

In 2022, Singapore embarked on comprehensive digital partnerships, including establishing agreements with Australia, South Korea, and the United Kingdom. In Indonesia, the proposed personal data protection bill maintains data localization stipulations applicable to all operators of public electronic systems. Vietnam introduced the cybersecurity-focused Decree 53/2022 on August 15, 2022, mandating data localization requirements on private service providers.

FLEXIBILITY AND INDUCEMENTS

The United States is late to the game in terms of its push for a digital framework across the region. This presents a significant risk to the approach taken by the USMCA and CPTPP. This approach risks being subsumed by the EU's approach to digital trade, which some countries have incorporated into their domestic regulations, as well as the approach that some ASEAN member states are taking.

There are two risks. First is that the approach is watered down to accommodate a broad range of IPEF parties. Second is that the digital trade newcomers do not agree with the ambition of the provisions in agreements such as the USMCA and CPTPP. Third is that a lack of support for MSMEs in the agreement engenders broader opposition.

This will require three things: flexibility on implementation, digital infrastructure inducements from the agreement's developing nations, and striking a balance on competition.

FLEXIBILITY

Phase-in periods should be considered for the commitments under the digital chapter. Although it may seem desirable to follow the CPTPP and provide exceptions for non-conforming measures, this will likely create an agreement with simply too many loopholes and not enough consistency across all members.

If members are not in a position to immediately implement digital commitments, it is possible to use a phasing in of commitments. This would have specific advantages in that it would give greater levels of certainty within the agreement going forward and ultimately encourage investment in digital as commitment deadlines approach.

INDUCEMENTS – DIGITAL CAPACITY BUILDING

The digital trade newcomer countries for the IPEF's digital agreement will—as is the case with many other agreements—require inducements in the form of capacity building for their digital economies. This will require a shift in thinking on digital capacity building away from simply government capacity building, but to capacity for the private sector itself, with a focus on SMEs. This could take the form of:

- **Internet Access:** Collaboration with local and international telecommunications firms to enhance broadband access and improve connectivity quality, particularly in rural and underserved areas.
- **E-commerce Platform Assistance:** Guidance for businesses in offsetting user-friendly e-commerce websites and digital payment systems. This includes both on-site and remote support for software and hardware setup.

- **Cybersecurity and Data Protection:** Implementing robust cybersecurity measures and providing training on data protection protocols.
- **Infrastructure Maintenance and Upgrade:** Ongoing technical support for system upgrades and troubleshooting, ensuring that the IT infrastructure remains efficient and up-to-date.
- **Financial Assistance for Infrastructure Building:** Financial support through subsidized loans for qualifying institutions and businesses. This could be facilitated through partnerships with multilateral funds. This financial assistance mechanism will play a crucial role in accelerating e-commerce infrastructure development in participating countries.

MSME INCLUSION

A critical concern for many IPEF economies is ensuring that the agreement serves the interests of consumers, workers, and small enterprises. This is not mutually exclusive with a liberal approach to digital trade and good competition policy. Striking a balance in competition for digital trade needs a clear and depoliticized understanding of the dynamics between MSMEs and larger players.

MSMEs depend on the digital infrastructures established by larger entities to access international markets. Small businesses cannot easily sell their goods and services on the other side of the world without robust digital platforms.

At the same time, larger entities must be given an open and non-discriminatory environment if they are to enter new markets. The balance hinges on fostering a landscape that is not monopolistic, which could lead to reduced accessibility or unfair advantages.

Theoretically, MSMEs should leverage the digital platforms of the larger players, while larger players benefit from increased usage and a diverse customer base. A digital trade agreement should foster a good competition policy and aspire to establish a level playing field rather than predetermining the outcome.

KEY RECOMMENDATIONS

AAIP makes the following recommendations:

1. IPEF negotiators must not compromise on the digital provisions of the agreement and should not fall below the benchmarks set by the USMCA and CPTPP
2. IPEF negotiators should have some flexibility in the implementation of the agreement with regard to phase-in periods where necessary;
3. IPEF parties should utilize digital capacity building aimed at the private sector, particularly MSMEs, to provide additional 'carrots' for digital trader newcomer IPEF parties with regard to digital industries;
4. The IPEF should seek to create a level playing field for MSMEs, but any approach to digital competition must seek to level that field rather than predetermining an outcome.