<u>Understanding the Moratorium on Customs Duties on Electronic Transmissions:</u>
<u>Fact checking "Digital Trade for Development"</u>[1]

The World Trade Organization (WTO) along with the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), the United Nations Conference on Trade and Development (UNCTAD), and the World Bank (WB) published a report titled "Digital Trade for Development" in December 2023 that attempts to demonstrate the numerous benefits of electronic commerce. One of the issues the report deals with concerns the WTO's moratorium on customs duties on electronic transmissions, which is up for renewal at the WTO's Thirteenth Ministerial Conference in Abu Dhabi in February 2024 (MC13). Unfortunately, the report provides a number of flawed findings in this respect. This note provides a quick overview of some of these flaws.

Claim: The extent of the potential loss of customs revenue resulting from the WTO moratorium has been estimated to be below 0.33 per cent of overall government revenue on average. These estimates do not take into account administrative and technical costs related to the collection of this revenue, which would reduce the net revenue collected.

Claim: Uncertainties exist about the scope and the definition of electronic transmissions in the WTO moratorium, but existing estimates of the potential revenue that could be collected using tariffs on electronic transmissions vary between 0.01 per cent and 0.33 per cent of overall government revenue on average for developing economies, with higher losses for a handful of economies.

Response:

- The 0.33% figure is calculated based on total government revenues: both tax and non-tax. A clearer picture may emerge when one compares the potential tariff revenue on e-transmissions to total tariff revenues. It is also worth noting that the absence of a clear definition of "electronic transmissions," as noted by the report, makes the moratorium unnecessarily broad and vague. This also means the impact of the moratorium is harder to capture. By the report's own admission, the stated potential loss is an estimate alone.
- Studies demonstrate the imbalanced impact of the Moratorium on developed and developing countries, with developing countries standing to lose significantly more than developed countries. Notably, UNCTAD studies from 2019 and 2022 find that developing countries can generate significantly more tariff revenue than developed countries by imposing customs duties

[1] This note is authored by Rishab Bailey, with inputs from Melinda St. Louis and Melanie Foley, all from Public Citizen, USA. The authors would like to thank Richard Hill, Association for Progressive Communications, Sanya Reid-Smith, Third World Network, Deborah James, Centre for Economic and Policy Research, Rashmi Banga, UNCTAD, Zorka Milin, FACT Coalition, and Shrija Sen, IT for Change, for their valuable comments and suggestions.

on electronic transmissions. The 2019 UNCTAD study estimates that 95% of world's total tariff revenue loss due to Moratorium will be borne by the developing countries.[2] The 2022 UNCTAD study estimates that "in the period 2017-2020, developing countries and LDCs lost $56 billion of tariff revenue, of which $48 billion were lost by the developing countries and $8 billion by the least developed countries".[3]

- Developing countries rely far more on tariff revenues than developed countries. For example, countries such as Andorra, Bermuda, Togo, Guinea, Liberia, Maldives, and Vanuatu rely on tariffs for 20-30% of their tax revenue (with a number of other developing countries in the 10-20% range).[4]
- The methodology used by many studies that aim to show the purported limited revenue impact of the Moratorium have been questioned, notably on grounds of relying on unrealistic assumptions. These include (1) assumptions about the nature of competition in the digital economy when it is clear that the digital economy does not have perfect competition as evidenced by the number of digital monopolies (all largely based in the developed world), and (2) assumptions concerning the absence of domestic substitutes for a foreign digital good/service, which are contested.[5]
- If the revenue gained from imposing tariffs on electronic transmissions is low (as claimed), countries will not impose tariffs even if the Moratorium is ended (in the absence of any other reasons to impose tariffs on electronic transmissions). Thus, there is no reason to impose a Moratorium through WTO agreements.
- If "services" are included within the scope of the Moratorium, developing countries will lose the flexibilities under the General Agreement on Trade in Services (under which they can, amongst other things, progressively liberalize different sectors of the economy).

Claim: Existing commitments under regional trade agreements (RTAs) outside the WTO framework prohibit the imposition of customs duties. Thirty-three developing economies have signed such RTAs.

Response:

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[2] Rashmi Banga, *Growing trade in electronic transmissions: Implications for the South*, UNCTAD Research Paper No. 29, February 2019, https://unctad.org/system/files/official-document/ser-rp-2019d1_en.pdf and https://www.wto.org/english/tratop_e/ecom_e/wkmoratorium29419_e/rashmi_banga.pdf

[3] This figure is calculated based on the import of just 49 products. Given the lack of clarity on the scope of "electronic transmissions," the figure could be much greater. Rashmi Banga, *WTO Moratorium on Customs Duties on Electronic Transmissions: How much tariff revenue have developing countries lost?*, South Centre, June 2022, https://www.southcentre.int/wp-content/uploads/2022/06/RP157_WTO-Moratorium-on-Customs-Duties-on-Electronic-Transmissions_EN.pdf

[4] World Customs Organisation, *WCO Annual Report 2019-2020*, https://www.wcoomd.org/-/media/wco/public/global/pdf/about-us/annual-reports/annual-report-2019_2020.pdf

[5] Rashmi Banga, *Modelling impact of moratorium on electronic transmissions using CGE: A critique*, Advances in Social Sciences Research Journal, Vol 6 No 8, August 25, 2019, https://journals.scholarpublishing.org/index.php/ASSRJ/article/view/6966/4434; Governments of India and South Africa, *Moratorium on customs duties on electronic transmissions: Need for clarity on its scope and impact*, Communication to the WTO Work Programme on Electronic Commerce, November 2021, https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/GC/W833.pdf&Open=True

- If some countries have signed up to RTAs that prohibit the imposition of customs duties, it does not mean that others should be forced to do so at the WTO.
- The report recognises that only 33 developing economies have signed such RTAs. However, about two thirds of the WTO membership (i.e. close to 100) are developing countries, including 35 least developed countries. Thus, a large majority of developing countries have not signed up for such provisions.
- Relevant provisions in some regional RTAs, such as the Regional Comprehensive Economic Partnership Agreement (RCEP), are directory in nature. Additionally, relevant provisions in some RTAs (for instance in the RCEP) are linked to the continuation of the Moratorium.

Claim: Domestic taxes such as value-added tax (VAT) and goods and services tax (GST) represent another way to collect revenue from digital trade that does not discriminate between domestically supplied and imported products. These taxes are also more uniform across different products and do not impose a tax burden on the intermediate inputs used by domestic producers

Claim: While tariffs and VATs are not mutually exclusive, recent evidence shows that for most economies, VAT could generate higher revenue from taxing electronic transmissions with appropriate investment in the capacity of tax administrations.

Response:

- Tariffs on electronic transmissions do not only serve a revenue need. They can, for instance, be used to regulate imports, promote domestic industries, and overcome the digital divide.
- The biggest exporters of digitizable products are developed countries (approximately 76% per a 2019 UNCTAD study).[6] Developed countries impose relatively high tariffs on certain products from developing countries (such as agricultural or textile products) for a variety of reasons, including to protect domestic industry and to avoid adverse balance of payments situations.[7] It appears hypocritical to disallow developing countries from imposing tariffs on digital goods when they may have similar concerns.
- VAT is applied uniformly and therefore does not serve the policy purpose of many developing countries which is to ensure development of their nascent digital sectors. Tariffs provide a tool to encourage domestic industry that could not compete with imports otherwise, thereby enabling the creation of a level playing field between big technology companies based in developed countries and smaller ones based in developing countries.

[6] Rashmi Banga, *Growing trade in electronic transmissions: Implications for the South*, UNCTAD Research Paper No. 29, February 2019, https://unctad.org/system/files/official-document/ser-rp-2019d1_en.pdf

[7] Note, for example, high tariffs applied by the United State to clothing (particularly baby clothing), shoes, and steel imports. Refer to the Harmonised Tariff Schedule, https://hts.usitc.gov/, and Dre Desilver, *US Tariffs tend to vary a lot, but the highest duties tend to be on imported clothing*, Pew Research Centre, March 2018, https://www.pewresearch.org/short-reads/2018/03/28/u-s-tariffs-vary-a-lot-but-the-highest-duties-tend-to-be-on-imported-clothing/

- In taxation, there is no "one size fits all." The optimal mix between income tax, sales tax, VAT, excise tax, and customs duties will differ across countries and economies. Even within a country, taxation may differ across economic areas, which is why VAT rates differ for different products.
- Similarly, there is no agreement that taxation uniformity (or tariffs) across different products is necessarily a good or desirable practice. For instance, luxury products are often taxed at higher rates.
- It is universally agreed that the digital economy, which will eventually encompass most of the economy, must be taxed. Each country and economy should be free to find the optimal way to tax the digital economy, and this may include customs duties in some cases.
- It is unclear why digital products should be exempted from customs duties (with or without an additional VAT regime) when physical products are subject to both.
- The growth in internet traffic over the last decade has largely been on account of growth of a limited number of consumer-facing, bandwidth-heavy services (such as streaming services, social media, online gaming, etc.).[8] None of these are intermediate inputs for industries in developing countries, and taxing such products will have no impact on domestic producers (it may in fact encourage domestic production of similar content).
- The WTO's Doha Development Round of negotiations agreed to exempt Least-Developed Countries (LDCs) from tariff reductions.[9] The Moratorium violates this requirement by disallowing any tariffs on digital products.
- Various studies contest whether developing countries can adequately apply internal non-customs-based tariffs in a uniform or consistent manner, not least due to the size of the informal economy in these countries.[10]

Claim: Contrary to tariffs on goods, there is less understanding on how to apply customs duties on electronic transmissions.

Response:

- Any regulatory change will require some element of capacity building and administrative learning. Countries will develop appropriate practices to apply customs duties on electronic

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[8] Mark Sweney, *Squid Game's success reopens who pays debate over rising internet traffic*, The Guardian, October 2021, https://www.theguardian.com/business/2021/oct/10/squid-games-success-reopens-debate-over-who-should-pay-for-rising-internet-traffic-netflix

[9] See for example, Para 14, 4th Revision of draft modalities for non agricultural market access (NAMA), WTO, December 6, 2008, https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=Q:/TN/MA/W103R3A1.pdf&Open=True.

[10] Devika Dutt, Kevin P. Gallagher and Rachel D. Thrasher, "*Trade Liberalization And Fiscal Stability In Developing Countries: What Does The Evidence Tell Us?*", Global Policy Insights, 2020, https://onlinelibrary.wiley.com/doi/abs/10.1111/1758-5899.12803; Emram and Stiglitz, *On selective indirect tax reform in developing Countries*, Journal of Public Economics, vol. 89, no. 4,2005, pp. 599-623, https://www.sciencedirect.com/science/article/abs/pii/S0047272704000933, cf. Governments of India and South Africa, *Moratorium on customs duties on electronic transmissions: Need for clarity on its scope and impact*, Communication to the WTO Work Programme on Electronic Commerce, November 2021, https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/GC/W833.pdf&Open=True

transmissions in due course. The fact that the moratorium has been in place for the last 20+ years means that there has been no real need for countries to invest in developing alternate practices.

- It is also notable that the report recognises the need for improved administrative and other capacities in order to realize the purported benefits of moving towards a VAT-based tax regime. However, the possibility of capacity building to tax electronic transmissions is not considered.
- All taxes have collection costs. Tariffs on electronic transmissions could be collected the same way that countries like Australia, New Zealand, India, Norway, South Africa (amongst others) collect VAT or GST from digital entities (eg: by requiring platforms to collect it and remit it from time to time). Keep in mind that the imposition of such taxes has not had the effect of fragmenting the internet or reducing access to services.
- In any event, if countries find it too difficult to impose customs duties on electronic transmissions, they will not do so regardless of whether or not a moratorium exists.

Claim: Imposing customs duties on electronic transmissions would reduce relevant digital trade and thereby lower its benefits.

Response:

- This ignores the unequal distribution of benefits from enhanced digital trade. Given that developing countries are net importers of digital goods and services, they may not gain as much from increased digital trade.[11] In any event, they will lose a greater proportion of revenue on this count.
- Even assuming that increased digital trade leads to increased economic growth, this does not imply such growth is productive, just, or equitable. Countries may have normative reasons that go beyond "increasing economic growth" (such as protection of domestic livelihoods, encouraging the development of domestic industry, or restricting certain types of luxury imports) to impose tariffs on the imports of digitized goods and services.
- As noted above, the digital economy has to be taxed in one way or another, given its growing share of the economy. According to the argument made in the report, any form of taxation would negatively affect economic growth. Such a position should be a non-starter.

Claim: Tariffs on electronic transmissions might also impact competitiveness and participation of firms in trade, especially micro-, small, and medium-sized enterprises (MSMEs) and women-owned businesses.

Response:

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[11] Rashmi Banga, *Growing trade in electronic transmissions: Implications for the South*, UNCTAD Research Paper No. 29, February 2019, https://unctad.org/system/files/official-document/ser-rp-2019d1_en.pdf and https://www.wto.org/english/tratop_e/ecom_e/wkmoratorium29419_e/rashmi_banga.pdf; Rashmi Banga, *WTO Moratorium on Customs Duties on Electronic Transmissions: How much tariff revenue have developing countries lost?*, South Centre, June 2022, https://www.southcentre.int/wp-content/uploads/2022/06/RP157_WTO-Moratorium-on-Customs-Duties-on-Electronic-Transmissions_EN.pdf

- While increased costs of certain inputs may enhance prices for domestic MSMEs, tariffs can also be used to promote and protect sectors in the domestic economy including MSMEs and women-owned businesses. In fact, smaller domestic enterprises tend to be most at risk from cheap imports.
- As highlighted by India and South Africa in their submissions to the WTO, the development of 3-D printing could also have significant effects on domestic industries, "particularly in sectors such as textiles and clothing, footwear, auto-components, toys, mechanical appliances, and hand tools, etc. which generate large scale employment for low skilled workers and are sectors in which most MSMEs operate."[12]
- While it is important to focus on the needs of MSMEs, the Moratorium often also helps the largest technology companies gain more by reducing their tax burden.
- As mentioned previously, a large proportion of electronic transmissions are in fact consumer products such as streaming services, games, e-books, etc. Tariffs on such imports would not affect domestic MSME or women-owned enterprises.

[12] Governments of India and South Africa, *Moratorium on customs duties on electronic transmissions: Need for clarity on its scope and impact*, Communication to the WTO Work Programme on Electronic Commerce, November 2021, https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/GC/W833.pdf&Open=True