Much has been made of the digital trade provisions of the new NAFTA. Because the parties already largely enjoy duty-free trade in goods and services, the digital trade provisions are touted as a principal source of economic gains under the agreement.

But this chapter raises many broader questions about trade agreements. What subjects really are "trade"? How prescriptive should the rules be? If those rules are included in an agreement, what happens when one of the parties changes its mind?

Let's take a look at the provisions and the thinking behind them, and then examine the good and bad of having them in the agreement. For good measure, we'll also talk about the controversy over a French proposal to tax digital revenue.

What Do These Provisions Do?

Some of the digital provisions reflect standard trade liberalization principles. These include:

- ***non-discriminatory treatment*** of digital products (that is, the United States can't favor its own digital products at the expense of those of Mexico or Canada). (Article 19.4)

- ***no taxes on imported or exported digital products***. Trade agreements are designed to eliminate duties. Eliminated taxes on imported or exported digital products is not an inherently unreasonable provision in that context. We'll discuss the proposed French tax later. (Article 19.3)

- ***free cross-border data flows****.* The provision precludes the Parties from prohibiting or restricting cross-border information flows, unless there's a valid public policy reason for doing so. (Article 19.11)

Others are not necessarily trade provisions. The rules around "intermediary liability" are an example. As the U.S. International Trade Commission (ITC) explained in its report on the economic effects of the new NAFTA, these provisions "would protect suppliers of interactive computer services from liability for harm related to information stored, processed, transmitted, or made available by interactive computer services providers, as long as the provider is not responsible for creating the information." (179) "Interactive computer services" are the tech platforms. Thus, the ITC states that major "U.S. online platforms such as Google, Facebook, and Amazon are likely to benefit from this provision . . . ." (179-180)

It's catching some heat because it tracks a U.S. law that is itself catching some heat.

To make sense of the debate around this provision, it's useful to go back, briefly, to the 90s.

The "Palo Alto Consensus"

A recent op-ed by Professor Kevin Munger of Penn State provides context for the current discussion around tech and trade. At the dawn of the tech boom, there was a "Palo Alto Consensus" holding that

> American-made internet communication technologies . . . should be distributed globally and that governments should be discouraged from restricting speech online. Its proponents believed that states in which public discourse was governed by 'everyone' – via social media and the internet – would become more democratic.

But Munger goes on to explain that the consensus has broken down, and "{e}ven Mark Zuckerberg admitted" that these companies shouldn't be the arbiters of speech.

Munger points out that the deregulatory (or, private regulatory) regime embodied in the Palo Alto Consensus "was adopted with little public discussion or oversight about how these new technologies were being used or how to regulate them." The result, he notes, hasn't been "more democracy, stronger communities, or a world that's closer together."

It is in this context that a debate has emerged over how to regulate tech companies.

What Does This Have to do with NAFTA?

Good question. As noted above, some of the provisions are plainly related to the importation and exportation of goods, and some plainly are not. How did the ones that plainly are not find their way into a trade agreement?

The U.S. International Trade Commission gives an explanation that says the quiet parts out loud. The report explains, over and over again, that the benefit of these provisions is that they preclude any change in *domestic and foreign* regulation:

- "Many of the provisions in USMCA represent commitments to maintaining current regulatory conditions." (52)

- "The commitments in USMCA address this regulatory uncertainty by providing assurance to firms that current conditions will be maintained into the future." (53)

- "The Commission's quantitative analysis in this report expands its previous modeling of provisions intended to reduce policy uncertainty for trade and investment. Many of the provisions in USMCA represent commitments to maintaining current regulatory conditions, rather than policies that increase or decrease restrictions. These commitments reassure firms that they will continue to face the same regulations going

> forward and alleviate concerns that any of the USMCA member countries could formulate more restrictive policies in the future." (42).

The intermediate liability provision is a prime example. These online platforms are coming under increasing criticism for the way they have been used, for example to radicalize racists and xenophobes. That is part of the reason the Palo Alto consensus is breaking down.

Yet even as the Palo Alto Consensus is being challenged as a matter of domestic policy, it is being embedded into our trade agreements, with even *less* public discussion or oversight than in the 90s. The "consensus" was based on the view that liberalization as an end in and of itself is good, and thus a deregulatory environment was appropriate. But whether liberalization for liberalization's sake is always a good idea is questioned here, in the context of Huawei.

Maybe these rules are the right rules – maybe they aren't. But Congress seems to have woken up to the problem that putting these rules in trade agreements may come at its expense.

What about that Theory that Regulatory Certainty is Good for Trade?

It is also important to take a closer look at the ITC's argument for the link between regulatory certainty and gains from trade. This is increasingly relevant because U.S. tariffs are so low that demonstrable gains from trade must be scrounged up elsewhere. Nothing proves that point like the new NAFTA because there is already duty-free trade among the parties. The ITC admits as much:

> USMCA is unlike many previous trade agreements for which the primary impacts were assessed by analyzing the reduction or removal of tariffs and easily quantified nontariff measures like quotas. Because these changes were by and large already accomplished under NAFTA, the analysis of USMCA's effects *had to focus more intensively on provisions applicable to nontariff issues.* (37, emphasis added)

Actually, the ITC didn't have to do that at all. But imagine doing a whole report on a new trade agreement, and the conclusion is: "it's a wash, because the trade is already duty-free."

Nevertheless, the ITC did focus on the non-tariff provisions. The most important thing to note is that the report refers in some places to "regulatory certainty" and in other places to "trade policy certainty." They are not the same thing. Regulatory certainty is much broader than trade policy certainty and may have nothing to do with any cross-border transaction. There is a fundamental question about whether trade agreements are increasingly becoming vehicles to export domestic regulatory regimes that have little or no relationship to actual trade. Intellectual property is the poster child for these concerns.

When it comes to actually *calculating* the GDP gains from the agreement, the ITC does seem to limit itself to provisions that involve some sort of cross-border nexus. (53) But the casual use of the phrase "regulatory certainty" in other parts of the report – and in the emerging discussion of the merits of the agreement – feeds into the idea that regulatory certainty is a good in and of itself, and an appropriate goal of trade agreements. As we have previous discussed, however, sometimes certainty is certainly wrong.

Second, the basis for the ITC's calculation of the benefits of trade policy certainty rests on a dubious analogy, Portugal's accession to the European Community. (53) When Portugal joined the European Community, it joined a political organization that itself had regulatory authority. It is a bit silly to refer to Portugal's "exports" to rest of the Europe when the one of the raisons d'être of the European Community was the existence of a single trading block.

The NAFTA parties have not formed a political union. They haven't even formed a customs union. They are not in any sense a "single" trading entity with common regulatory authority. When trade agreements that are not part of a broader political union strip signatory governments of the ability to regulate, there is no superseding regulation in its place. The parties can of course collectively decide to change the terms of the agreement at any time. But all three have to agree. And as we have seen, there is a deep reluctance to revisit these agreements in the absence of a threat to pull out.

This is yet another justification for the Sunset Clause. And it explains why there's opposition to it from the business community: having locked in rules favorable to them, they're reluctant to risk having them come out when the zeitgeist changes.

The ITC's real point seems to be that *trade policy* certainty is an inducement itself to trade. That's fine. But it's certainly not a justification for allowing trade agreements to encroach into domestic regulatory territory.

Who Benefits?

This leads us to the question of who benefits from this handcuffing of government flexibility. With respect to the liability provision, the ITC tells us it's Facebook, Google, and Amazon. That means, as with pharmaceutical companies, it's their shareholders. Trade agreements, increasingly, are vehicles for maximizing returns to capital. Even the Economist has noted that labor's share of GDP is shrinking relative to capital's, and draws a connection to trade.

So what about returns to labor here? Do these provisions also benefit these companies' employees? Presumably. And many of these employees are, in fact, in the United States.

But are we sure it will always be that way?

At one point, we assumed that our manufacturing superiority was essentially untouchable. On that basis, we were advocates of liberalization as an end in and of itself. The result? Manufacturing offshored. And it's the offshoring that *the Economist* blames for contributing to labor's declining relative share of GDP.

What's to stop unfettered liberalization from doing the same from in the digital trade space? This will be an even greater risk if the United States replicates these provisions in an e-commerce agreement at the WTO. As discussed in the context of the Information Technology Agreement, when a subset of WTO Members negotiates a sectoral deal, the terms of that deal have to be made available to all WTO Members, whether they sign onto the deal themselves or not.

If data is indeed the new oil, then are we sure provisions like mandatory cross-border information flows and data localization provisions serve our long-term interests? They certainly sound like good provisions *today*, but what happens if China emerges as the digital trade superpower, the way it has in so many other areas? Are we sure we won't want to require servers to be located in the United States as a condition of doing business here? Yes, there are exceptions that a party can invoke. But invoking an exception doesn't mean you won't be found in breach.

The U.S. government recently blocked a Chinese company's acquisition of Grindr due to concerns that the data would be used to blackmail government officials. We're just now starting to recognize the risks associated with totally liberalized cross-border data flows.

The Ultimate Justification: Efficiency

The ITC report does a great job of explaining the justification for this kind of relentless liberalization: efficiency.

> Maintaining free international data transfers is important for firms in all parts of the economy because industries increasingly rely on data to **efficiently** produce and supply their products and services. (175)
>
> [O]pen data transfer between countries is crucial for maintaining **efficient** global supply chains . . . . (176)
>
> [P]rotection from localization laws is essential for U.S. carriers . . . [s]uch centralization offers these carriers major cost and network **efficiencies**. (181)

Is efficiency the only good? Our outsized dependence on single-sources for certain materials necessary for our national security is the product of this obsession with efficiency to the exclusion of all other public goods. Now that these single sources are found in hostile, authoritarian regimes, the Pentagon is rethinking its 70+ year obsession with relentless liberalization. Redundancy also has value.

These same provisions, born of the same default to efficiency, also raise questions about global concentration. As it is, there are calls to break up Facebook, Google, and Amazon, and the issue has become a feature of the Democratic Presidential primaries. The ITC discusses this issue generally, and perhaps unwittingly: "USMCA provisions that help to establish a benign investment climate are likely to make it easier for U.S. carriers to operate in Canada and Mexico." (180). In its discussion of telecom, the ITC goes on to discuss whether the number of carriers in Mexico is likely to increase, concluding no because of the "lack of attractive merger/acquisition" opportunities." (181). In the meantime, the competition provisions in modern U.S. agreements, including USMCA, are principally devoted to making sure that merger candidates get a fair shake, while doing little to nothing to promote real competition.

About Those Taxes

The U.S. Trade Representative has launched an investigation into the French government's efforts to tax digital trade revenues. It's not clear that this falls under the type of anti-tax provision in the USMCA (it's a tax on revenues, not products), but even if it did, the United States has no agreement with the EU that would bar European countries from imposing them.

The claim underpinning USTR's action is that France's tax disproportionately affects U.S. platforms, and thus deserves to be criticized on that basis alone. But let's recall the intermediary liability provision, which disproportionately *benefits* U.S. platforms. If the United States is going to treat these platforms as national champions, and include non-trade provisions in trade agreements to benefit them, is the United States really in a position to criticize France for *also* treating them as American national champions?

Moreover, the French have identified a serious problem: these companies seem to be very good at not paying much in the way of taxes. Why is the U.S. government trying to foreclose alternative mechanisms of collecting revenues? As the French finance minister asked, "'How will we finance our environmental needs, our schools, day care centers, hospitals and colleges if we don't tax them at the same level' as other goods or services?"

And lastly, what does it mean for a publicly-traded multinational company to be a "national" champion? When the Trump Administration threatened sanctions against Huawei, American companies, including Google, lobbied to keep their sales alive – shortly after having been threatened by the Chinese government.

Milton Friedman essentially said that companies only owe allegiance to their shareholders. Companies have adopted that framework to maximize returns without regard to the national welfare. That's fine. But they aren't national champions, and shouldn't be treat as if they are.

The Bigger Picture

This particular blog is about the digital trade provisions. But they are the poster child for the broader questions about what our trade agreements do in the modern era. The notion of what's trade-related is more and more elastic, and the efforts to identify gains more and more acrobatic, in a self-justifying loop that only values the upside of trade.

What area will be left untouched by these agreements, if we continue along this path?