May 10, 2017

ITI Comments Regarding Causes of Significant Trade Deficits for 2016

Introduction

The Information Technology Industry Council (ITI) appreciates the opportunity to submit its comments for the "Omnibus Report on Significant Trade Deficits." We support the Administration's efforts to grow the U.S. economy, and we share its goals of opening markets and increasing U.S. manufacturing and services exports, creating jobs and raising wages in the United States, and improving the U.S. climate for investment and innovation. ITI has participated in recent opportunities to share views on trade barriers impacting U.S. Information and Communications Technology (ICT) companies, including through our most recent National Trade Estimates submission.

Our goals for this submission are to: 1) describe why the standard official measurement of goods trade surpluses and deficits does not capture the significant U.S. economic activity related to the production of services (including manufacturing-related services) and the participation in Global Value Chains (GVC), and how such a focus is likely to distort policy making, and; 2) outline the specific barriers to trade (those that violate existing commitments and those that limit the ability of U.S. technology companies to trade) in the markets identified in Executive Order 13786.

The Complexity of Modern Trade

Focus on trade barriers, not trade deficits.

While economists may use trade surpluses or deficits as indicators of international trade trends, there is a consensus among economists that trade balances themselves are driven by macroeconomic factors – such as household savings, foreign exchange rates, and investments – much more than particular barriers to trade in individual markets. A number of recent reports have underscored this consensus.[1] Thus, ITI believes that the focus of the Administration's trade policy should not be to impact trade balances, but rather to identify and address the trade barriers themselves.

[1] Think tanks, government research institutions, and industry groups have all supported this point. Please see the Peterson Institute for International Economics' (PIIE) papers Free Trade Agreements and Trade Deficits and Macroeconomic Forces Underlying Trade Deficits; the Congressional Research Service's (CRS) papers Financing the U.S. Trade Deficit and Should the U.S. Trade Deficit be Redefined?, and; the U.S. Chamber of Commerce's article The Big Lie: The Trade Balance with Agreements.

Focus on the full view of U.S. economic activity not just the balance of trade in goods.

While ITI appreciates the Administration's attention to trade in goods, a narrow focus on the traditional official measurement of bilateral goods trade does not reveal much about the health of the economy and U.S. competitiveness, given the complexity of trade in the 21st Century – certainly in the ICT sector. First, this approach does not factor in trade in services, in which the United States is a global leader. In fact, the United States runs a surplus on services trade with all but one of the markets upon which this report focuses (more on this below). Second, the data used to calculate trade in goods does not capture much of the value added to those products in the U.S. in the form of Research and Development (R&D), Intellectual Property (IP), and other services, nor does it capture much U.S. economic activity related to global data flows and trade in digital products.[2] Third, trade patterns are global – not bilateral – and as such the bilateral lens necessarily misses much of the economic dynamism created by these trade networks (see below).

In this regard, ITI is not convinced that a bilateral deficit between two countries, or even an aggregate trade deficit that one country has with the rest of the world, is an effective metric for assessing and setting U.S. trade policy and the role of trade agreements.

Global Value Chains

ITI urges the Administration to pay particular attention to the economic benefits that the U.S. derives from GVCs. The production of ICT goods and services (like most modern goods and services) are the result of complex, global business networks that companies develop in multiple locations around the world to tap innovation, maximize cost efficiencies, and be responsive to supply and demand. In the process of creating a finished product, components of that product are potentially imported and exported multiple times with multiple countries before a final product is created – 70% of global trade is intermediate goods and services and in capital goods.[3] Within GVCs, companies specialize in different "tasks," which add value to a good or service as it moves from concept to market.

Almost every sector of the U.S. economy relies on GVCs (e.g. agricultural products, industrial goods, and energy production), which require imports of raw materials, intermediate inputs, and a wide array of services to operate efficiently. U.S. manufacturers depend on the ability to acquire and use such inputs.[4] In addition, U.S. companies are world leaders in producing the R&D and IP value added to manufactured goods, as well as many of the services that support goods production – for example

[2] See the Department of Commerce's report Measuring the Value of cross-Border Data Flows.
[3] OECD, WTO, and World Bank Group: Global Value Chains: Challenges, Opportunities, and Implications for Policy.
[4] Ibid.

cloud computing services, finance, logistics and transportation, marketing. Both of these sets of activities create jobs and generate economic growth in the United States.

Companies and countries participating in GVCs increase wages, create jobs, innovate, and increase skills and knowledge levels of employees to greater degrees than countries that those that do not participate in GVCs.[5]

A key factor in facilitating these gains is the duty-free, barrier-free trade in ICT hardware, which is vital for manufacturers and services providers alike. ICT inputs make U.S. manufacturers as well as U.S. service providers across every industry competitive in the United States and globally. And U.S. manufacturers can produce and export more goods when both they and the U.S. services providers, upon which they rely, can transfer data seamlessly across borders. This is true for large and small enterprises, including the many micro-enterprises that now participate in GVCs and access global sales markets via global e-commerce and other Internet-based platforms.

Technology Sector Contributions to the U.S. Economy

For the technology sector, we view this intertwining of hardware, software, and services as core to our priorities and outlook on the global economy. According to a recent study by the Information Technology and Innovation Foundation (ITIF), technology products and services play a critical role in all U.S. states and Congressional districts. In addition, CompTIA's 2017 Cyberstates report indicates that the tech sector is critical for creating high-quality jobs for American workers in manufacturing and other sectors. Technology companies employ over 6.9 million Americans – 5% of private sector employment – and account for 7.5% of U.S. GDP. Technology products and services drive growth and job creation in virtually every sector of the economy, allowing our manufacturers, automakers, energy firms, construction firms, financial firms, healthcare providers, and other U.S. industries to be more competitive, at home and abroad. U.S. competitiveness, jobs in all sectors, and businesses of all types now depend on companies being able to move digital information rapidly and freely, including across borders, to support their businesses and reach customers in foreign markets. In addition, the technology sector makes significant contributions in the United States to innovation, education programs, skills and knowledge development, and products that improve the lives of citizens at all social and economic levels.

Barriers to Trade

The U.S. technology sector, and all U.S. sectors relying on technology, face numerous barriers to trade around the world, many of which are not yet addressed by existing

[5] Ibid.

trade agreements. As U.S. companies are increasingly competitive and successful, foreign governments respond by imposing discriminatory measures in attempts to protect and develop their own technology sectors. These barriers range from burdensome conformity assessment procedures for technology products to restrictions on the location of data and ability of companies to transfer data across borders. ITI members were encouraged by the positive statements made by Secretary Ross and USTR-designate Lighthizer on the importance of digital trade and the chapters of the Trans-Pacific Partnership Agreement that advanced disciplines in this important area.

ITI would welcome greater U.S. Government engagement to address both barriers to trade in goods and services and restrictions on cross-border data flows. However, as we stated earlier, ITI is not convinced that such engagement would have a significant impact on U.S. trade balances. We therefore urge that the Administration not use changes in the trade balance as the metric for trade policy success. We also caution that unilateral U.S. enforcement actions to address these barriers, particularly in the form of higher import duties, may undermine U.S. competitiveness at home and abroad. If either U.S. or foreign retaliatory actions increase the uncertainty or costs within these trade networks, it will have an adverse impact on U.S. export performance, job creation, and deficit reduction.

The WTO Information Technology Agreement (ITA) has eliminated a significant number of duties on technology products across the world since its entry into force in 1997. ITI has long supported zeroing out the duties on ICT products and was a major supporter of the Information Technology Agreement and its update. This agreement requires that countries that account for 90% of world trade in the products covered participate in the ITA before it can enter into force – this has gone a long way to address concerns about free riders. Enforcement of the ITA remains a high priority and we support efforts to reduce or eliminate tariffs on goods traded through e-commerce technologies.

We would also like to see that the moratorium on customs duties on electronic transmissions be made permanent in the WTO, consistent with U.S. Free Trade Agreements (FTA). Digital products (e.g., software, video, music, books) are increasingly traded, and we should guarantee that tariffs on these products remain zero.

The reduction or elimination of non-tariff barriers to trade in goods and services is a high priority for our sector, in particular addressing discriminatory regulatory measures.[6] The variance in regulations across the world forces companies to make products for specific markets at higher costs. The resulting market segmentation continues to undermine the competitiveness of U.S. technology companies.

[6] See the WTO's World Trade Report 2012 which focused on non-tariff measures. A detailed discussion on the effects of these measures begins on page 136.

Our industry is also now focused on new challenges to the sector involving data, an area where there are few trade rules in effect. At the firm level, a report from the Leviathan Security Group shows that data localization measures raise the cost of hosting data by 30-60%. This is because the internet enables centralized data storage and processing, taking advantage of economies of scale in cloud computing and a seamless, global internet. When governments break apart these efficiencies they exponentially raise the cost of doing business.

Compounding this, increased costs raise barriers to market entry for would-be startups, suppressing innovation and reducing an economy's competitiveness in the long term. The global nature of the internet enables small and medium sized enterprises (SME) to have an instant sales presence in foreign markets, allowing them to quickly scale popular products and expand their customer base.

Key Barriers to Trade in Target Markets

We have included a number of examples of concerning barriers to trade in the markets referenced in EO 13786 in annexes below our submission. These barriers are a snapshot of our broader priorities in these markets. The 2017 National Trade Estimate Report, and the accompanying fact sheet on barriers to digital trade, reflect many of these priorities and contain more detailed information. We look forward to working with the Administration on addressing these barriers and are happy to share our views on the best possible enforcement or policy tools to address them.

Conclusion

In summary, ITI recommends that the Administration take the following steps as it drafts and completes its "Omnibus Report on Significant Trade Deficits of Concern for 2016":

1. Evaluate the benefits of trading relationships on the basis of a more complete economic picture of the United States' participation in global trading networks.
2. Delink addressing barriers to trade from reducing U.S. trade deficits.
3. Closely examine the role of services and cross-border data flows in enhancing the competitiveness of U.S. manufacturers and other industries.

Though U.S. government engagement on the barriers in these annexes may help U.S. companies compete in foreign markets, we remain unconvinced that such engagement will have a material impact on U.S. bilateral trade balances with these markets.

Annex 1: China

- Cybersecurity Law: This measure discriminates against foreign technology and companies through multiple and overlapping security review regimes that potentially require disclosure of source code or other sensitive information, requirements to store personal and important business data within the territory of China, and poorly defined requirements that ICT products and equipment be designated as "secure & controllable" by the Chinese Government.

- Notice on Regulating Business Behaviors in the Cloud Service Market: This draft regulation when combined with existing Chinese laws would force U.S. Cloud Service Providers (CSP) to transfer valuable U.S. intellectual property, surrender use of their brand names, and hand over operation and control of their business to a Chinese company in order to operate in China.

- Restrictions of Electronic Payments Services (EPS): Despite commitments made when joining the WTO, China has created several barriers to market entry for companies for EPS providers. Primarily, the People's Bank of China (PBOC) has limited foreign companies to only processing transactions made in foreign currency, closing off large sections of the domestic economy. In addition, PBOC has created increasingly onerous technical regulations for licensing of foreign EPS providers that include potential disclosure of source code, intellectual property, and encryption keys.

- A Broad Effort to Localize Data: A high priority of the technology industry – and other industries that depend on ICT platforms for global operations – are requirements to store, process, or manage data locally within China and restrictions on flows of data in and out of China. In particular, there are a raft of laws and regulations that restrict the flow of data relating to the medical (Population and Healthcare Information Management Measures), financial (Notice to Urge Banking Financial Institutions to Protect Personal Information), credit (Administrative Regulation on the Credit Information Industry and Credit Reference Agencies), and online publishing (Online Publishing Service Management Rules) sectors. In addition to these, there are broader restrictions requiring explicit permission to transfer data overseas (Guidelines for Personal Information Protection within Public and Commercial Information Systems).

Annex 2: Mexico

- Energy Efficiency Standards: Mexico is regulating the energy efficiency of products through a variety of often duplicative and conflicting regulations, including the secondary regulation of the Law on Sustainable Energy and the new Law on Energy Transition, and official standards for specific products (such as NOM-032 for standby energy usage and draft NOM 029 for external power supplies), as well as country specific tests and labels that impose additional costs and burdens on manufacturers. Concerns with Mexico's proposed NOM-029 regulation for external supplies include unique and excessive test requirements. As currently written, up to 36 families of certificates (compared to 2 in the United States) could be required, plus annual re-testing, which is not done anywhere else in the world. Globally, industry tests and registers products once; only re-testing when a product is modified. Mexico's proposed NOM-029 deviates from regionally and internationally accepted practices, imposing significant burdens on industry.

- WEEE Standards: The Mexican federal government has delegated WEEE standards to the states. The result is that companies operating across the country encounter differing and often inconsistent rules for labeling products, requiring them to change labels and markers as those products move from one state to the next. This is unnecessarily burdensome for importers and should be addressed at the federal level.

- Customs Rules for Express Carriers: Mexico is considering a change to its customs procedures (specifically rule 3.7.3) for express shipments. Currently, Mexico provides simplified and consolidated import procedures for express shipments, which will be eliminated under the rule change, adding to the time, cost, and complexity U.S. companies will face in sending express shipments into Mexico.

- Product Safety: Mexico has made some recent efforts to streamline its product testing and certification requirements. ITI hopes that it will make further progress toward fully implementing its mutual recognition agreement for telecom approvals with the U.S. At the same time, there is industry concern with Mexico's proposal to revise its product safety regulations for ICT equipment. Currently, there is an agreement in place by which Mexico agrees to accept products tested in the U.S. to meet a North American safety standard. The latest draft of these safety regulations (NOM019) does not provide reference this agreement. US manufacturers would like to ensure that they do not have to retest and recertify their products to meet a unique set of product safety requirements in Mexico.

Annex 3: Canada

- *De Minimis* Threshold: Canada's *de minimis* threshold remains at CAD $20 (approximately USD $15), the lowest of any industrialized country and among the lowest in the entire world. For comparison, the *de minimis* threshold for items imported into the United States is $800 USD – over 40 times higher than Canada's. This low threshold, which has not been adjusted since the 1980s, unfairly impact internet-enables businesses – especially small businesses – in the United States who regularly ship low-value items to Canada.

Annex 4: European Union

- Restrictions on Data Flows: While the U.S.-EU Privacy Shield arrangement, which took effect on August 1, 2016, represents a strong commitment by both the U.S. and EU to enable transfers of data across the Atlantic and safeguard consumer privacy, threats to transatlantic data flows remain. These threats are due to: 1) the judicial review in Ireland – and perhaps later in 2017 at the European Court of Justice – of standard contractual clauses, which give U.S. companies an alternative option to ensure that they can transfer data from the EU to the U.S., and; 2) increasing preference for data localization policies in EU member states, including France and Germany.

- EU Copyright Reform: The current reform of the EU copyright rules is proving increasingly problematic for U.S. technology companies seeking to do business in Europe. First, the European Commission is considering significantly changing existing principles of "intermediary liability" by requiring online services to create content filtering technology. Second, the European Commission has also proposed the creation of a new "neighboring right", which would give publishers the right to charge online services a fee when they show even a small amount of news content, such as headlines, on their platforms. Both measures would raise considerable market access barriers for major technology companies, startups, and other entrepreneurs and deviate fundamentally from U.S. principles underlying a free and open internet.

- Radio Equipment Directive (RED): With a June 2017 deadline rapidly approaching, the EU has not yet figured out how it will implement its transition to a new set of telecom and other technical requirements that will impact a wide range of ICT products. Harmonized EU standards for the Radio Equipment Directive will not be published before the transition date. As a result, U.S. companies have been left scrambling to figure how to demonstrate compliance with requirements that are not yet available. The Commission has refused to extend the transition deadline, forcing companies to pursue an alternative approval process for their products that relies upon third parties and will create delays and additional costs in getting products to market. The alternative process also leaves much uncertainty about how this issue will be resolved in the longer term.

Annex 5: India

- Compulsory Registration Order for ICT products: Ostensibly a product safety regulation, the Compulsory Registration Order (CRO), requires manufacturers to undertake redundant testing and certification in India as a condition of market entry. This system ignores an existing international mutual recognition agreement of which India is a member. If adhered to, this agreement would eliminate the need for these unnecessary in country requirements. Instead, American companies face an unpredictable and ever-changing list of requirements that make India's product safety requirements by far the costliest in the world, especially for companies seeking to sell highly specialized products (e.g. industrial and commercial goods) in the Indian market. Despite repeated engagement by the U.S. Government and ITI members, the Government of India has expanded the product scope of the CRO and has refused to make fundamental changes that would provide significant regulatory relief for ITI member companies. There is growing industry concern that the CRO model of product registration will become the norm for other areas of regulation.

- Tariffs on ICT products inconsistent with India's WTO ITA commitments: India continues to raise tariffs on an increasingly wide range of ICT products, including products on which India has committed to maintaining a zero tariff under its WTO ITA commitments.

- Restrictions on Foreign Direct Investment: India restricts foreign ownership on business to consumer retail, making it difficult for U.S. companies to offer these services in India.

- Preferential Market Access for Government Procurement (PMA-G): The PMA-G is a program that defines certain performance requirements – such as local content requirements – required goods to qualify for government procurement. The program currently applies to a wide array of ICT products, and is expanding to include higher margin, highly complex products, such as servers.

- Security Testing Requirements: The Indian Government is set to implement new and potentially problematic security testing requirements for ICT products next year. Despite repeated requests by ITI member companies, the government has yet to provide any detail about the scope or coverage of these requirements. However, there are indicates that the government could require ICT companies to hand over source code, IP and other sensitive design elements.

Annex 6: Indonesia

- Kominfo/MICT Regulation No. 82/2012 on Data Localization: This law contains data center and disaster recovery center localization requirements and source code surrender for software developers, along with other onerous requirements that would impose large costs on all U.S. industry sectors that wish to do business in Indonesia. Though it appears that an amendment to this law is being considered, there are no details forthcoming on the nature and extent of the amendment. We expect Indonesia to begin enforcing this law in October 2017.

- Data Localization of Financial Services: The Bank of Indonesia has released Circular 17/52 and Regulation 18/40 which mandate local processing of ATM, debit card and credit card transactions and impose a foreign equity cap of 20% on EPS providers. This is in addition to the Financial Services Authority (OJK) *Regulation on Information Technology Risk Management* which requires foreign banks to locate data centers and process payments in country.

- Local Content Requirement for 4G LTE Mobile Phones and Modems: Regulation 27/2015, *Technical Requirements of Equipment and Telecommunication Devices Standards-based of Long Term Evolution (LTE) Technology* — in addition to a more recent regulation, Regulation 65/2016 — impose strict local content rules on 4G LTE smartphones, laptops, tablet computers, and all related equipment. The Government of Indonesia is phasing in these requirements over several years, progressively raising costs and pushing out U.S. industry.

- Draft Regulation on Over-the-Top (OTT) Services: The *Draft Regulation Regarding the Provision of Application and/or Content Services Through the Internet,* first opened for comments in May of 2016, places vague requirements on providers of OTT services. The most onerous requirement is that an OTT service provider must "place a part of its servers at data centers within the territory of the Republic of Indonesia." It is not clear what "part of its servers" means precisely, nor is it clear why this requirement is in the draft regulation — there seems to be a line of rationality drawn between this draft regulation needing to mirror Regulation 82/2012.

Annex 7: The Republic of Korea

- Data Protection Standards for Cloud Computing Services: These cloud computing standards require cloud service providers serving public institutions to locate all cloud systems and data in country.

- Act on the Establishment and Management of Spatial Information: Korea has strict rules governing the exportation of mapping data. Though this restriction was originally from the Korean War era, it has been updated to include the exportation of digital maps. The original measure which imposed this restriction was called the Measurement Act but was replaced by the current law in 2014 in which Article 16 prohibits taking any maps or "fundamental surveys" without permission from the authorities.

- Software Industry Promotion Act (SIPA): Korea's SIPA is designed to promote government procurement from domestic SMEs by barring large corporations from bidding on contracts for software. Whereas this in itself is concerning for many ITI members, the definition of "software business" has been extended to include data analytics, information, and insights; effectively barring large companies from bidding on a wide range of government contracts beyond what was originally considered to be covered by the law.

Annex 8: Vietnam

- Law on Network Information Security**:** Vietnam's Law on Network Information Security (LONIS) contains multiple troubling provision in regards to commercial cyber security products. In general, the language in the law is vague, but it could be interpreted to require source code disclosure of encryption software, encryption key surrender, and the surrender of proprietary trade secrets or cyber security products. In addition, the broad requirement to cooperate with the government and obtain licenses in order to sell products within Vietnam could be implemented in a discriminatory manner. The first implementing regulation, "The Decree Guiding Law on Cyber Security" contains broad licensing and certification requirements in addition to strict local presence requirements for providing cyber security services.

- State Bank of Vietnam (SBV) Circular 19/2016/TT-NHNN: This circular requires the construction of a "national payments gateway" in a way that would dramatically disrupt and inhibit the ability of U.S. EPS suppliers to continue exporting to Vietnam. Circular 19, set to take effect in January 2018, would require U.S. electronic payment service suppliers to route all domestic and overseas payment transactions through the National Payments Corporation of Vietnam (NAPAS) – a commercial entity that SBV helped create and in which SBV is the majority shareholder. NAPAS is a direct competitor to U.S. EPS providers.

- Draft Decree on Information Technology Services: This measure, which we understand may be implemented soon without public input, would require every U.S. digital service or website to locate at least one server within Vietnam.

- Draft Regulation on OTT Services: This draft measure includes additional data localization requirements as well as restrictions on cross-border data flows, which would prevent U.S. companies (including OTT service providers) from providing or supplying Internet services in Vietnam unless they enter into a commercial agreement with local telecommunications companies.