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ALTERED STATES TRADE COOPERATION IN THE AGE OF INSECURITY

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(based on research projects with Bernard Hoekman and Robert Staiger)

Updating Trade Cooperation: An Economic View,
WTO, Geneva, 10-11 December, 2018.

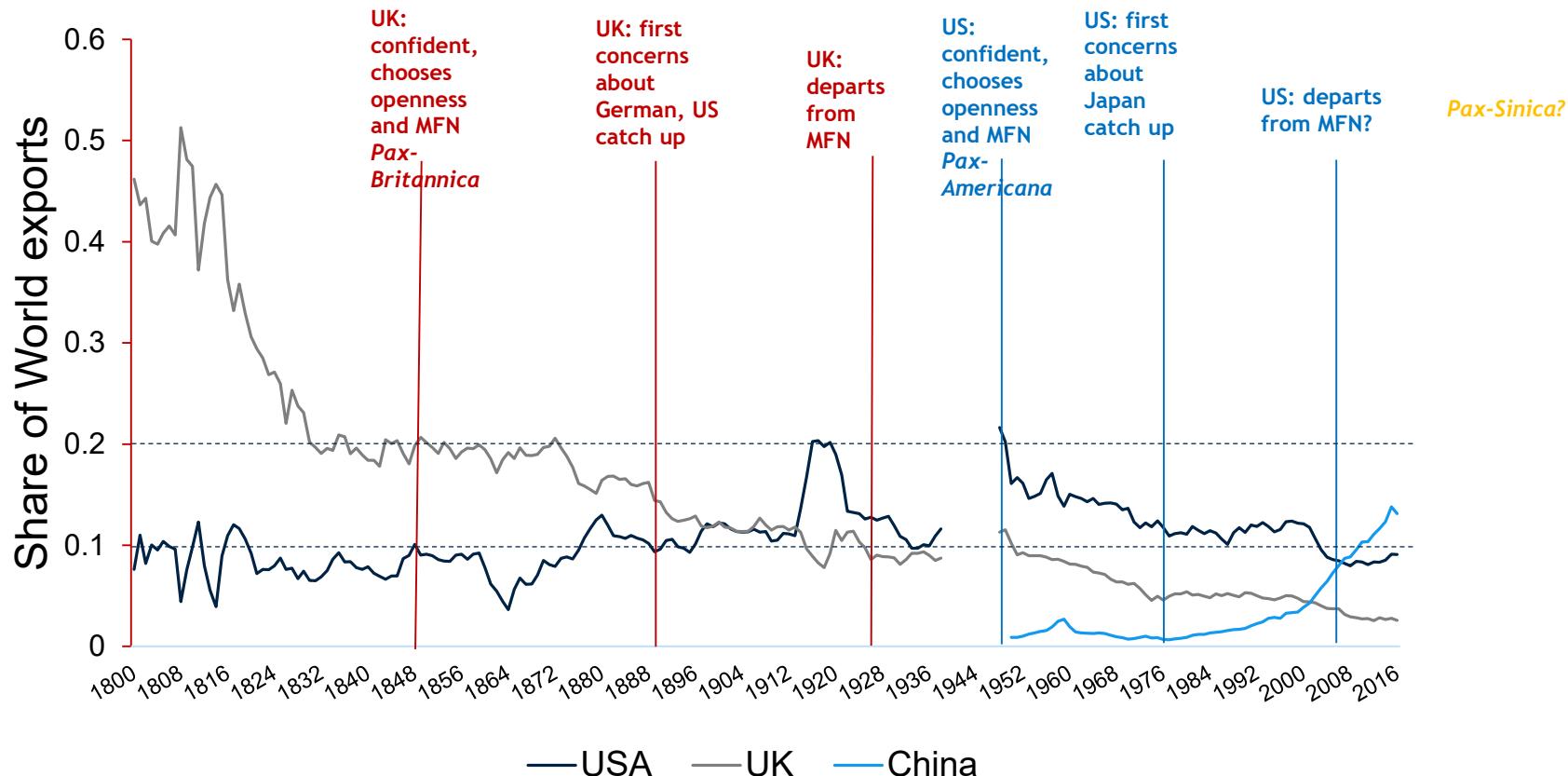
IMPLICATIONS OF THREE CHANGES

- Diminished dominance
- Empowered workers
- Empowered consumers

The threat to globalization may be a historical inevitability

Shifts in trade shares and changes in policy stance: why?

The UK and US Share of World Trade, 1800-2016



RETHINKING RECIPROCITY?

- Problem: Perceived asymmetry in protection, from a positive-sum to zero-sum game
- Incumbent power's goal: from first difference reciprocity to level reciprocity
- Transitional mechanism: change in the nature of reciprocity:
from increased market access (carrot) for increased market access (carrot)
to increased market access (carrot) for not denying market access (stick)
- How is success measured? Short-term gains in terms of trade vs longer-term debasement in the currency of legal commitments
- Will the incumbent refrain or the rising power accommodate?

The political economy of trade is being turned on its head

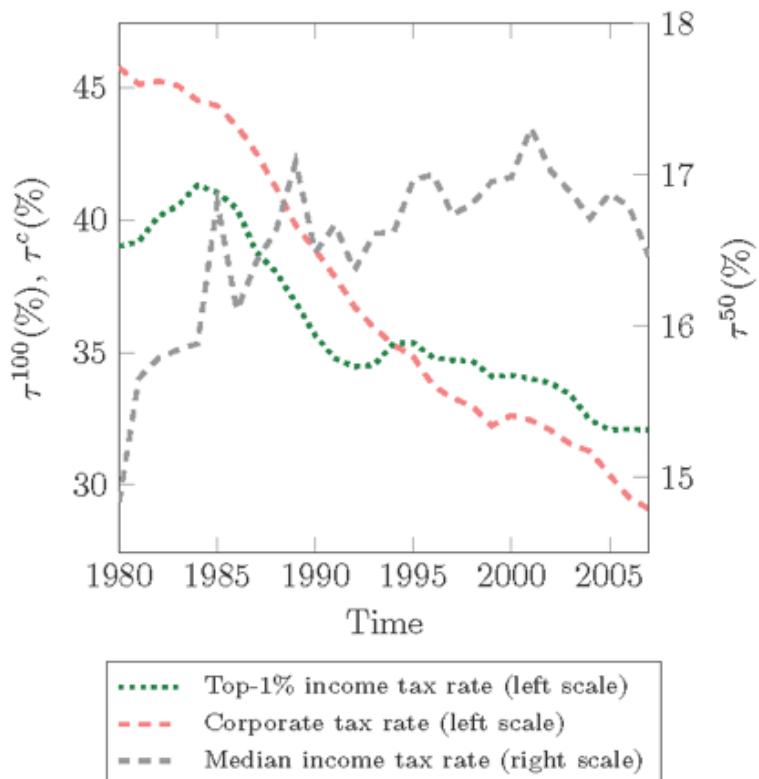
- Classical view of national trade policy and trade negotiations: driven by concentrated producer interests
- But globalized production and ownership, weaken link between producer interests and national trade policy.
- The result: democratization of trade policy to favor diffuse and less-mobile labor and consumer interests.
- What does that mean for international trade cooperation?

EMPOWERED WORKERS

- In industrial countries, trade is hard on blue-collar workers, so their increased political influence would only lead to greater openness if they shared in the gains from trade.
- However, globalization itself makes it difficult to tax the winners – who have mobile capital and skills – and the failure of domestic redistribution leads to the use of trade barriers as a means of social protection.

IMPACT OF GLOBALIZATION ON TAX STRUCTURES MAKES IT HARDER TO TAX WINNERS AND COMPENSATE LOSERS

Corporate tax rates and personal labor income tax rates for top 1% and median workers in 65 economies over 1980-2007



In 1994-2007, middle-income workers experienced a globalization-induced rise in their personal income tax rate of around 1.5, whereas the top 1% of workers faced a reduction of approximately 1.5 percentage points.

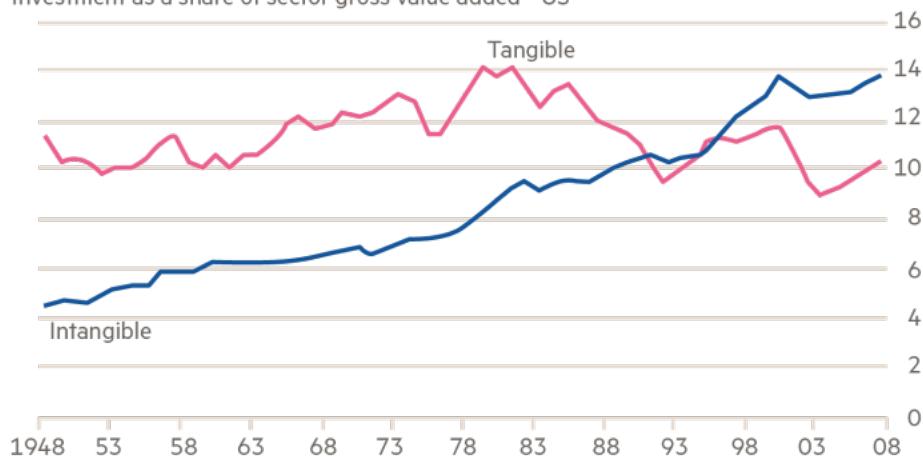
Source: Peter Egger, Sergey Nigai, Nora Strecker (2016).

Is the current US tax proposal driven by ideology, influence or the imperative of globalization?

IN PARALLEL, THE GROWTH OF FOOTLOOSE “INTANGIBLES” - HARD TO MEASURE AND HARD TO TAX

Intangible assets have soared in the US ...

Investment as a share of sector gross value added - US



Source: 'Capitalism Without Capital - the Rise of the Intangible Economy'

Haskel & Westlake (Princeton University Press, 2017)

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... and in the UK

Investment as a share of sector value added - UK



Source: 'Capitalism Without Capital - the Rise of the Intangible Economy'

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REGULATORY EXTERNALITIES IN TAXATION

- Tax competition between jurisdictions is leading to base erosion in jurisdictions with higher tax rates, and lower tax rates through tax competition
- Profit shifting through transfer pricing implies low revealed profits in high tax jurisdictions – a particularly acute problem in new platform services
- Routes to international tax cooperation
 - OECD initiatives to deal with base-erosion and profit shifting
 - But strong resistance to the idea of fiscal harmonization
 - Destination-based taxation?

DESTINATION BASED TAXATION? FAVORED BY SOME TO DEAL WITH DIGITAL SERVICES

Destination based taxation

In March 2018, the **European Commission** proposed a 3 percent tax on the gross revenues from digital activities in which users play a major role in value creation.

In October 2018, **UK** proposed a 2 per cent tax on the UK-generated revenues of search engines, social media platforms and online marketplaces. Similar initiatives in Hungary, Italy, Spain and Slovakia.

India announced in early 2018 a potential digital tax on gross revenues of tech companies.

In 2016, **Israel** included a definition of “significant digital presence” for purposes of taxing foreign companies that derive income from online transactions with Israeli residents.

The Global Intangible Low-taxed Income (GILTI), a new provision in the **US** Tax Code enacted as part of the 2017 reform.

VAT extensions

Several countries have extended or are in the process of extending their VAT or GST regimes to cover non-resident digital services suppliers to domestic consumers (including services such as apps, games, software downloads, ebooks, music, video streaming). These include: Australia (GST), Chile, Egypt, European Union, India (equalization levy), Japan, Kenya, New Zealand (GST), Russian Federation, South Africa, South Korea, Switzerland, Turkey.

The **European Union's** intracommunity VAT rules have been in place since January 2015

EMPOWERED CONSUMERS

- Politically empowered consumers should support greater openness because they are the biggest beneficiaries from trade.
- But concerns about market failure in globalized markets – from finance to information-based services – are leading to the **use of protection as a means of regulatory precaution**.

HOW EXPORTING COUNTRY DESTINATION-BASED REGULATORY COMMITMENTS WORK: DATA FLOWS

The problem



The necessary bargain

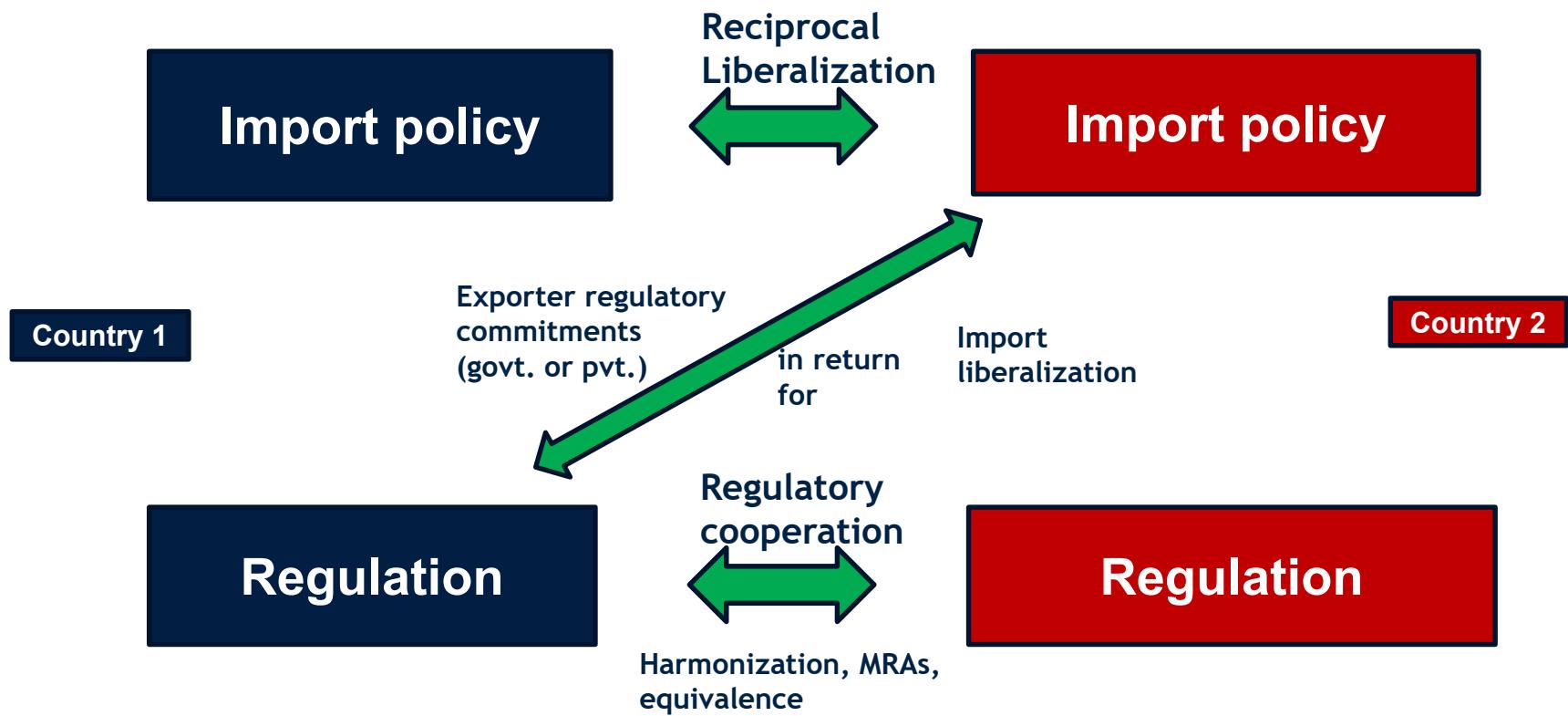
Exporting country (data destination) commits to adhere to importer (data source) standards of privacy in return for free data flows

Example

- Standalone agreement:* EU-US Safe Harbor Agreement; renegotiated as EU-US privacy shield;



HOW THE PROPOSED APPROACH IS DIFFERENT



ENSHRINING REGULATORY COMMITMENTS IN A TRADE AGREEMENT – THE TPP INNOVATION

MARKET ACCESS

Article 14.11: Cross-Border Transfer of Information by Electronic Means

2. Each Party shall allow the cross-border transfer of information by electronic means, including personal information, when this activity is for the conduct of the business of a covered person.

IN RETURN FOR

Article 14.7: Online Consumer Protection

2. Each Party shall adopt or maintain consumer protection laws to proscribe fraudulent and deceptive commercial activities that cause harm or potential harm to consumers engaged in online commercial activities.

Article 14.8: Personal Information Protection

2. To this end, each Party shall adopt or maintain a legal framework that provides for the protection of the personal information of the users of electronic commerce.
3. Each Party shall endeavour to adopt non-discriminatory practices in protecting users of electronic commerce from personal information protection violations occurring within its jurisdiction.

THE EXPORTER REGULATORY COMMITMENT APPROACH CAN HELP ADDRESS A RANGE OF CONCERNS:

- Production subsidies
- State-related enterprises and sovereign wealth funds
- Labor mobility
- Financial services
- Competition policy

SUMMING UP

- Why now? Historical inevitability
- What is to be done? New forms of reciprocity
 - For firms: first difference to level?
 - For workers: destination-based taxation
 - For domestic consumers: precaution for protection