The Committee on Energy and Commerce

Memorandum

September 15, 2014

To: Members of the Subcommittee on Commerce, Manufacturing, and Trade

From: Majority Committee Staff

Re: Hearing on "Cross Border Data Flows: Could Foreign Protectionism Hurt U.S. Jobs"

On Wednesday, September 17, 2013, the Subcommittee on Commerce, Manufacturing, and Trade will convene a hearing at 1:30 p.m. in 2322 Rayburn House Office Building entitled "Cross Border Data Flows: Could Foreign Protectionism Hurt U.S. Jobs".

I. <u>Witnesses</u>

Witnesses are by invitation only and include the following:.

- Linda Dempsey, Vice President, International Economic Affairs, National Association of Manufacturers;
- Brian Bieron, Senior Director, eBay, Inc. Public Policy Lab;
- Sean Heather, Vice President, Center for Global Regulatory Cooperation, Executive Director, International Policy & Antitrust Policy, U.S. Chamber of Commerce; and,
- Laura K. Donohue, Professor of Law, Georgetown University Law Center, Director, Center on National Security and the Law.

II. <u>Summary</u>

In today's global economy, cross border data flows support businesses in every sector from traditional technology companies to manufacturers, agribusinesses, healthcare, energy, financial services, insurers, retailers, and advertisers. The transfer of data across international borders allows for the free flow of information, goods, and services—benefiting consumers around the world and creating jobs. However, restrictions on data flows are emerging as a primary non-tariff trade barrier in the international marketplace and could threaten U.S. job growth.

The U.S. is in the midst of trade negotiations that will set the baseline for international data transfer policy. As the Trans-Pacific Partnership (TPP), Trade in Services Agreement (TiSA), Transatlantic Trade and Investment Partnership (TTIP), and Safe Harbor Framework negotiations progress, it is critical to understand how important cross border data flows are for economic growth and jobs. It is just as important to understand the negative effects of some possibly protectionist policies, whether under the pretext of privacy concerns or hopes of supporting local businesses. This hearing will give Members of the Subcommittee an opportunity to hear from experts on the frontlines of these issues about the potential impact on U.S. companies, both big and small, and the jobs they support. It also will establish a base of information from which Members can be certain that the Department of Commerce and the Office of the United State Trade Representative do everything necessary to prevent cross-border data flow restrictions from harming the U.S. economy.

III. Background

A. The value of cross-border data flows

Global cross-border data flows have become an essential component of all international companies' daily operations. The infrastructure supporting these data flows also support local businesses. Businesses are able to harness economies of scale to provide goods and services to their clients and customers in the most efficient manner because of the free flow of data. U.S. exports of goods and services were estimated at $2.3 trillion in 2013. When looking at the entire supply chain for each industry represented by that figure, it is not difficult to see how important data flows are to the American economy. Data is at the core of business processes across industries from traditional technology firms to manufacturing, energy, agribusinesses, health care, financial institutions, retailers, advertisers, and insurers.

U.S. exports of digitally enabled services were $357.4 billion in 2011—representing over 60%of U.S. services exported and 17%of total U.S. exports.[1] However, this number only represents data flows that are "traded between a seller and buyer at market price." Two important categories of data flows are excluded from these figures: commercial data and services flowing between businesses (e.g. supply chain information, design information, personnel data), and digital services provided to customers at no cost (e.g. search engine services, map services, social media, email). The economic impact of cross border data flows will increase only as usage of and reliance on the Internet increases across the world. Attempts to restrict the free flow of data between countries based on jurisdictional borders create a barrier to the efficient operation of global commerce.

According to the U.S. International Trade Commission, digitally enabled service exports from OECD countries neared $1.6 trillion in 2011.[2] A recent International Trade Commission report estimated that U.S. GDP could increase by an estimated $16.7 to $41.4 billion if barriers to digital trade were removed.[3]

Companies face a host of barriers to trade in the international marketplace, including forced localization requirements, market access limitations, data privacy and protection requirements, intellectual property rights infringement, censorship, legal liability rules, and customs measures. The Subcommittee's focus will be on non-tariff cross-border data flow issues in order to highlight the importance of all data flows in international trade.

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[1] http://www.esa.doc.gov/sites/default/files/reports/documents/digitaleconomyandtrade2014-1-27final.pdf
[2] U.S. International Trade Commission, "Digital Trade in the U.S. and Global Economies," Figure 4/16, Investigation No. 32-531, USITC Publication 4415, July 2013.
[3] "Digital Trade in the U.S. and Global Economies, Part 2." United States International Trade Commission, Publication No. 4485, August 2014. http://www.usitc.gov/publications/332/pub4485.pdf.

Even with the economic development associated with the free flow of data, countries including Argentina, Australia, Brazil, Canada, Chile, China, Colombia, Costa Rica, Greece, Hong Kong, India, Indonesia, Korea, Mexico, Peru, Russia, Turkey, Switzerland, and Vietnam have proposed or adopted data flow restrictions on commercial enterprises. The European Union (E.U.) and its Member States are considering a host of proposals that would have a direct and significant impact on trade between the U.S. and E.U. A study from the European Centre for International Political Economy examined the consequences for GDP of these protectionist policies for several countries and found a negative impact in all cases: Brazil (-0.2%), China (-1.1%), E.U. (-0.4%), India (-0.1%), Indonesia (-0.5%), Korea (-0.4%), and Vietnam (-1.7%).[4] These data demonstrate how important access to foreign markets is for countries of all sizes and political regimes.

In Brazil, the proposed forced localization requirement would have mandated that companies doing business in Brazil hold a copy of all data relating to Brazilian operations and Brazilian citizens on servers inside the country. While industry was successful in explaining to the Brazilian government the myriad of problems with the proposal, including the potential harm to Brazilian companies, unresolved issues stemming from the protectionist mindset remain that could create barriers to commercial investment in Brazil.

The National Security Agency revelations have given greater momentum to international interest in protectionist policies. Unfortunately, the protectionist policies rarely reflect a good understanding of how the Internet works and do not account for various ambiguities in international law. However, these proposals will have a significant negative impact on commercial businesses and their customers. In the case of forced localization, there is no evidence that these mandates will increase data security. A persuasive argument can be made that increasing the number of servers worldwide, in each country with such a requirement, could decrease data security by increasing the number of attack vectors for cyber criminals. Further, small and medium sized enterprises that benefit from cross-border data flows will not have the resources of larger companies to comply with country-by-country regulations.

B. Current trade negotiations: TPP, TiSA, and TTIP

In light of the technological developments of the last several decades, there are multiple ongoing trade negotiations that have the opportunity to set the stage for digital trade policy moving forward. As the world's largest economy and trading nation, there is a significant interest in supporting trade policies that have allowed the U.S. economy to develop and mature. According to the Department of Commerce, current and proposed trade agreements account for more than 60% of global trade.[5] The ongoing negotiations in TPP, TiSA, and TTIP present an opportunity to recognize the value of cross-border data flows and support U.S. companies doing business overseas.

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[4] Matthias Bauer, Hosuk Lee-Makiyama, Erik van der Marel, and Bert Verschelde, "The Costs of Data Localisation: Friendly Fire on Economic Recovery." European Centre for International Political Economy. ECIPE Occasional Paper No. 3/2014.

[5] "Trade Agreement Benefit U.S. Exports" International Trade Administration, U.S. Department of Commerce, 2014. http://www.trade.gov/mas/ian/build/groups/public/@tg_ian/documents/webcontent/tg_ian_005310.pdf

The Trans-Pacific Partnership (TPP) is a group of twelve countries throughout the Asia-Pacific region that account for nearly 40% of global GDP and one-third of all trade. A successful agreement will open new market access for Made-in-America goods and services. The prevailing view is that as negotiations continue (the U.S. engaged in negotiations in March 2010), the language agreed to in the TPP rounds (there have already been 20) will lay the ground work for future trade negotiations regarding cross-border data flows.

The TiSA involves the United States and over 50 other countries engaging in negotiations for a "high-standard trade agreement."[6] The countries participating in TiSA represent 75%of the world's $44 trillion services market.[7] Service industries support approximately three out of every four American workers, and every $1 billion in U.S. services exports supports almost 6,000 American jobs.[8] TISA was launched in April 2013 and has the specific goal of dealing with new issues facing the services driven global economy, particularly cross-border data flow restrictions.

Shortly after the first round of negotiations concluded, the Subcommittee held a hearing discussing the TTIP negotiations on July 24, 2013, entitled "The U.S. – E.U. Free Trade Agreement: Tipping Over the Regulatory Barriers?"[9] Negotiations continue and the sixth round was completed in Brussels on July 18, 2014.[10] The U.S. and E.U. are the largest trading markets in the world, and the bilateral trade relationship between the U.S. and the 27-member E.U is the world's largest, with the two economies combined accounting for 40% of world output and over $1 trillion in trade.[11]

C. Status of the Safe Harbor Framework

The Safe Harbor Framework was negotiated between the U.S. Department of Commerce and the European Commission (E.C.) so that U.S. organizations could comply with the E.U.'s "adequacy" standard for privacy protection after the Directive on Data Protection went into effect in 1998.[12] Companies that meet the Safe Harbor requirements submit to enforcement by the Federal Trade Commission (FTC) and complete a certification process.[13] The most recent FTC enforcement action was announced on June 25, 2014, against 14 companies for falsely claiming to participate in the Safe Harbor program.[14]

Over 3,000 U.S. businesses are certified through the Safe Harbor program with the Department of Commerce. While it is possible to comply with the Directive on Data Protection

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6 https://www.uschamber.com/issue-brief/trade-services-agreement

7 http://www.ustr.gov/TiSA

8 "Benefits of Trade" Office of the U.S. Trade Representative, http://www.ustr.gov/about-us/benefits-trade. *See also* "Readout of Trade in Services Agreement (TISA) negotiations." November 2013. http://www.ustr.gov/about-us/press-office/press-releases/2013/November/readout-Trade-In-Services-Agreement-Negotiations

9 http://energycommerce.house.gov/press-release/subcommittee-examines-obstacles-surrounding-negotiation-transatlantic-trade-and

10 http://www.ustr.gov/ttip

11 http://www.ustr.gov/countries-regions/europe-middle-east/europe/european-union

12 http://www.export.gov/safeharbor/eu/eg_main_018365.asp

13 http://www.business.ftc.gov/documents/0494-federal-trade-commission-enforcement-us-eu-and-us-swiss-safe-harbor-frameworks

14 http://www.ftc.gov/news-events/press-releases/2014/06/ftc-approves-final-orders-settling-charges-us-eu-safe-harbor

through E.U.-approve standard contractual clauses or binding corporate rules, these mechanisms are not available to every business, impose a significant cost, and involve a lengthy approval process.

In November 2013, the EC released a series of 13 recommendations to update the Safe Harbor framework as a response to "deep concerns about revelations of large-scale U.S. intelligence collection programmes."[15] The Department of Commerce and the E.U. continue negotiating to address the concerns raised in the recommendations.

IV. Questions for Consideration

- What challenges are companies facing in the current international regulatory environment that could be addressed by on-going trade negotiations?
- How severe a competitive impact can cross-border data flow restriction have, and what does that mean for U.S. jobs?
- What outcomes related to cross-border data flows should we aim for in the Safe Harbor, TiSA, TPP, and TTIP negotiations?
- What are the major concerns for small and medium enterprises that do not have the resources to comply with a patchwork of international regulations on cross-border data flows?
- How do restrictions on cross-border data flows impact industries outside of the traditional technology sector, such as manufacturers or health care?

Please contact Paul Nagle or Melissa Froelich of the Committee staff at (202) 225-2927 with questions.

[15] "Restoring Trust in EU-US data flows – Frequently Asked Questions," European Commission – Memo/13/1059. November 27, 2013. http://europa.eu/rapid/press-release_MEMO-13-1059_en.htm