Prepared Testimony of

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On

"International Data Flows: Promoting Digital Trade in the 21st Century

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Mr. Chairman and Ranking Member, I am Mark MacCarthy, Senior Vice President for Public Policy for the Software & Information Industry Association (SIIA). Thank you for the opportunity to share our views on International Data Flows.

The Software & Information Industry Association (SIIA) is the principal trade association for the software and digital information industries. The more than 700 software companies, data and analytics firms, information service companies, and digital publishers that make up our membership serve nearly every segment of society including business, education, government, healthcare and consumers. As leaders in the global market for software and information products and services, they are drivers of innovation and economic strength—software alone contributes $425 billion to the U.S. economy and directly employs 2.5 million workers and supports millions of other jobs. For more visit the SIIA Policy Home Page.

I want to make three points in my testimony. The first is that cross border data flows fuel 21st Century trade and investment across all sectors of economic activity, affecting not just Internet companies but all enterprises and organizations that have come to rely on modern information and communications technology. Second, one goal of U.S. trade policy is to reduce unwarranted barriers to digital flows. We have achieved substantial success in the recently concluded Trans-Pacific Partnership Agreement, and can look forward to similar achievements in other trade negotiations such as the Trade in Services Agreement and the Transatlantic Trade and Investment Partnership. Third, the recent decision by the European Court of Justice to invalidate the U.S.-EU safe harbor arrangement for transatlantic data sharing is in tension with our trade objectives for reducing unnecessary barriers to digital trade. If a workable new safe harbor framework is not put in place soon, the transatlantic data flows that fuel the world's largest trading and investment relationship could be at risk.

Many of SIIA's 700 member companies use the now-invalidated safe harbor arrangement for their transatlantic data transfers. The loss of the Safe Harbor Framework as a legal basis for the transfer of personal information from Europe creates substantial legal uncertainty and has required them to begin a process of seeking alternative mechanisms for these transfers that is likely to be extended and expensive. Our immediate goals include the provision of a reasonable transition period and interim guidance by European regulators. Longer term, we need the legal certainty that can be provided by a modernized Safe Harbor Framework.

We are supportive of the Committee's inquiry into these matters and grateful for their support of our efforts and those by U.S. Administration officials to accomplish these goals.

Economic Benefits of Cross-Border Data Flows

Open digital trade is critical to U.S. tech industries, which are major contributors to job creation and economic growth. According to a recent report from the Software & Information Industry Association, about 12 percent of American software production is exported, totaling up to $57 billion in 2012. Moreover, exports of software and related services have grown by at least 9 percent each year since 2006—nearly 50 percent faster than all other U.S. exports. These exports helped fuel a steady increase in software employment, from 778,000 jobs in 1990 to 2.5 million in 2014.

And software jobs are good jobs. In fact, through the recent recession the average computer system design worker made $86,457 per year—three times as much as the average wage offered by the other four industries that also created large numbers of jobs during the downturn.

But digital trade is important for the broader economy as well. In 2011, the Global McKinsey Institute published a ground breaking study on the impact of the new information and communications technologies on growth and jobs.[1] Key findings were that the Internet contributes 34 percent to gross domestic product in the 13 countries studied. In the developed countries studied, it accounted for 21 percent of GDP growth over the most recent five-year period. It also found that most of the economic value created by the Internet falls outside of the technology sector, with 75 percent of the benefits captured by companies in more traditional industries, and it created 2.6 jobs for each lost to technology-related efficiencies.

This study was followed by a Commerce Department assessment of international trade in the business services, communications services, royalty and licensing flows, and financial services, where digital technologies are thought to play an important role in facilitating trade.[2] The study found that trade in these "digitally-enabled services" grew from 45 percent of all trade in services in 1998 to 61 percent in 2010, rising at a rate of 9 percent per year, while all other services grew at only 3 percent a year.

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[1] McKinsey Global Institute. Internet Matters: The Net's Sweeping Impact on Growth, Jobs, and Prosperity, May 2011.

[2] Maria Borga and Jennifer Koncz-Bruner Trends in Digitally-Enabled Services, Bureau of Economic Analysis US. Department of Commerce

The Commerce Department updated this study for 2011, finding that:[3]

- The United States exported $357.4 billion in digitally-deliverable services. This represented over 60 percent of U.S. services exports and about 17 percent of total U.S. goods and services exports.
- The United States imported $221.9 billion in digitally-deliverable services. This represented 56 percent of U.S. services imports and about 8 percent of total U.S. goods and services imports.
- The United States had a digitally-deliverable services trade surplus of $135.5 billion.
- The total value of digitally-deliverable services in the supply chain of total U.S. goods and services exports was $627.8 billion, or about 34 percent of total export value.
- The majority of U.S. digitally-deliverable services exports went to Europe and to the Asia and Pacific region.
- Specifically, the United States exported the highest value of digitally-deliverable services to the United Kingdom, Canada, Ireland, and Japan. The highest values of digitally-deliverable imports came from the United Kingdom, Bermuda, Switzerland, and Canada.

In response to a Congressional request, the International Trade Commission conducted two studies on digital trade, documenting the size and economic importance of cross border data flows for the global economy. The first study[4] confirmed the growth of "digitally-enabled services" from from $282.1 billion in 2007 to $356.1 billion in 2011, with exports exceeding imports every year. In the second study[5], the ITC found that digital trade contributes to economic output by improving productivity and reducing trade costs. These efficiencies meant that digital trade increased U.S. GDP by up to $710.7 billion or 4.8 percent and increased employment by up to 2.4 million full time workers. The Commission also estimated that removing global digital trade barriers could raise U.S. GDP by up to $41.4 billion, or 0.3 percent.

[3] Jessica R. Nicholson and Ryan Noonan, "Digital Economy and Cross-Border Trade: The Value of Digitally deliverable Services", US Department of Commerce, Economics and Statistics Division Issue Brief # 01-14, January 27, 2014

[4] United States International Trade Commission, "Digital Trade in the U.S. and Global Economies, Part 1", Pub.4415, Investigation No.332-531, July 2013

[5] United States International Trade Commission, "Digital Trade in the U.S. and Global Economies, Part 2", Pub.4485, Investigation No.332-540, August 2014

A recent Brookings report found that cross-border data flows between the U.S. and Europe are the highest in the world.[6] They are 50 percent higher than data flows between the U.S. and Asia and almost double the data flows between the U.S. and Latin America. These data flows underpin many aspects of the transatlantic economic relationship.

- In 2012, the United States exported $140.6 billion in digitally-deliverable services to the European Union. That same year, the EU exported to the U.S. $106.7 billion worth of digitally-deliverable services.
- The U.S. and the EU are globally competitive exporters of digitally-deliverable services. In 2012, the EU trade surplus with the world in this category was 168 billion. The U.S. trade surplus was $150 billion.
- Today, almost 40% of data flows between the U.S. and EU are generated by commercial and research needs and these uses account for a majority of the growth in transatlantic traffic.
- The potential for data flow growth is strong as the Internet of Things increasingly grows. Given the EU's $125 billion trade surplus with the U.S. in goods, data flows originating from Europe will likely increase.

According to the Brookings Report, digital flows are important for investment as well as trade. Since 2000, Europe has attracted 56 percent of U.S. global investment and the United States receives 56.2 percent of global European investment. Much of this investment consists of U.S. subsidiaries and affiliates doing business in Europe and European subsidiaries operating in the United States. In 2011, U.S. foreign affiliates in Europe delivered $312 billion worth of digitally deliverable services and European businesses in the U.S. provided $215 billion worth of digitally deliverable services. Continued uninterrupted data flows are essential to maintaining economic integration of this size.

Recent studies from the European Centre for International Political Economy show that a loss of open data flows would not be a minor, sector-specific irritant. One study estimates that data localization mandates in Russia would reduce their GDP by 0.27 percent, even taking into account possible positive economic benefits of local data storage.

Another study from ECIPE estimates that recently proposed or enacted data localization measures would reduced GDP by 0.2% in Brazil, 1.1% in China, 0.4% in the EU, 0.1% in India, 0.5% in Indonesia, 0.4% in Korea and 1.7% in Vietnam.

[6] Joshua Meltzer, The Importance of the Internet and Transatlantic Data Flows for U.S. and E.U Trade and Investment, Brookings Global Economy and Development Working Paper 79, October 2014

Actual economic losses by the citizens amount to up to $63 billion for China and $193 billion for the EU. For India, the loss per worker is equivalent to 11% of the average month salary, and almost 13 percent in China and around 20% in Korea and Brazil

It is sometimes thought that digital flows and trade benefit the exporting country more than the importing country. In this view, a strategy of digital protectionism can be seen as economically rational. But digital flows and trade improve economic performance in importing countries in a number of ways:

- Domestic productivity increases when firms are able to import the best computing and information services at the lowest prices.
- Online information services, Internet-based services, and computer services supply strategically important inputs for all sectors, goods, and services.
- A country that wants to excel in the provision of banking and financial services, education, tourism, construction, and healthcare services needs to allow its businesses and citizens to obtain the best possible inputs from information and computer service providers regardless of location.
- Worldwide suppliers of online and computer services provide the spur of competition to ensure that all service sectors excel. These suppliers help domestic exporting and manufacturing companies.
- Having a seamless flow of information and a flexible location of servers leads to increased price competition, better quality, and wider choice for consumers.
- Lower prices and a wider availability of information services and computer services lead to greater product and process innovation throughout a domestic economy.
- Lowering digital barriers would provide producers, investors, workers, and users with a clear idea of the rules of the game, thereby encouraging long-term investment and commitment to local markets.

U.S. Trade Policy on Cross-Border Data Flows

In principle, trade in digitally-enabled services is addressed in the General Agreement on Trade in Services (GATS). This multilateral trade agreement, signed in 1994 at the same time as the establishment of the World Trade Organization, commits signatory nations to reduce barriers to trade in service and to treat international service suppliers in the same way it treats its domestic service providers.

However, GATS is limited in several respects as a tool for enforcing open digital flows. Signatory nations are committed to open a particular service only if they have specifically agreed to do so. This creates a nightmarish complexity in determining which services are really open, a difficulty that is even greater since many of the key digital services did not exist in 1994 when the treaty was signed.

Moreover, under the general exceptions provided for in Article 14, even countries who have committed to a market opening measure in a particular service are permitted to adopt or enforce measures necessary to secure compliance with consumer protection laws and laws or regulations related to "the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts."[7]

These privacy and consumer protection measures cannot be applied in a discriminatory manner or as "a disguised restriction on trade in services." But still this general exception can serve as a way for countries to step back from full commitment to open data policies, if they want to do so.

As a result, U.S. trade policy has sought to establish more explicit principles of openness in digital trade. A good start was made in the U.S. Korea Free Trade Agreement, but the text in the electronic commerce chapter was hortatory, requiring the signatories merely to "endeavor to refrain from imposing or maintaining unnecessary barriers to electronic information flows across borders."

In the Trans-Pacific Partnership negotiations, the U.S. sought binding commitments for cross-border data flows. In particular, USTR sought "requirements that support a single, global Internet, including ensuring cross-border data flows, consistent with governments' legitimate interest in regulating for purposes of privacy protection…(and)…rules against localization requirements that force businesses to place computer infrastructure in each market in which they seek to operate, rather than allowing them to offer services from network centers that make business sense."[8]

In 2011, USTR succeeded in negotiating an agreement with Europe that contained prohibitions on data and server location.[9] One provision provided that

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[7] Article XIV, General Agreement on Trade in Services at https://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm

[8] USTR, Trans-Pacific Partnership: Summary of U.S. Objectives https://ustr.gov/tpp/Summary-of-US-objectives

[9] USTR, United States-European Union Trade Principles For Information and Communication Technology Services, April 2011 at http://trade.ec.europa.eu/doclib/docs/2011/april/tradoc_147780.pdf

"governments should not prevent service suppliers of other countries, or customers of those suppliers, from electronically transferring information internally or across borders, accessing publicly available information, or accessing their own information stored in other countries." Another provision said, "Governments should not require ICT service suppliers to use local infrastructure, or establish a local presence, as a condition of supplying services."

Congress approved these policy initiatives on cross-border data flows in trade promotion authority legislation. One provision of the law is a directive to U.S. trade negotiators "to ensure that governments refrain from implementing trade-related measures that impede digital trade in goods and services, restrict cross-border data flows, or require local storage or processing of data."

The trade promotion authority law also address the concern that domestic policy objectives might sometimes affect digital trade, specifying that U.S. policy on this point is that such exceptions needed to be narrow: "where legitimate policy objectives require domestic regulations that affect digital trade in goods and services or cross-border data flows, to obtain commitments that any such regulations are the least restrictive on trade, nondiscriminatory, and transparent, and promote an open market environment."

The United States has largely achieved these negotiating goals in the recently concluded Trans-Pacific Partnership (TPP) Agreement. According to the USTR:

"In the Electronic Commerce chapter, TPP Parties commit to ensuring free flow of the global information and data that drive the Internet and the digital economy, subject to legitimate public policy objectives such as personal information protection. The 12 Parties also agree not to require that TPP companies build data centers to store data as a condition for operating in a TPP market…"[10]

SIIA is strongly supportive of this development. Clearly, given the importance of data flows for modern economies, the United States must seek similar outcomes in the Transatlantic Trade and Investment Partnership (T-TIP) negotiations.

For the TTIP negotiations, USTR has already set out cross border data flow objectives, seeking to "include provisions that facilitate the movement of cross-border data flows" on the grounds that "free flows of data are a critical component

[10] USTR, Summary of the Trans-Pacific Partnership Agreement at https://ustr.gov/about-us/policy-offices/press-office/press-releases/2015/october/summary-trans-pacific-partnership

of the business model for service and manufacturing enterprises in the U.S. and the EU and key to their competitiveness."[11]

The Trade in Service Agreement (TISA) will also consider cross border trade in services and data flows. Recently, SIIA held a discussion for the TISA negotiators and others in Geneva focused on the data flows and discussing ways in which countries could have both strong privacy rules and modern data flows.[12]

The European Court of Justice Invalidation of the Current Safe Harbor Data Sharing Arrangement

The European Data Protection Directive of 1995 prohibits commercial data transfers abroad unless the country to which the data is being sent has an "adequate" level of data protection.[13] In 2000, the European Commission ruled that company adherence to a set of negotiated privacy practices would be adequate for data transfers to the United States.[14] These privacy practices include notice, choice, onward transfer, access, security, data integrity and enforcement. Companies self-certify that they follow these practices and their name is published at a Department of Commerce website.[15] Their promise to follow these practices is enforceable by the Federal Trade Commission, which has taken 10 enforcement actions from 2009 to 2013 and has stepped up enforcement substantially since then.[16]

This Safe Harbor Framework has provided a convenient and effective legal basis for U.S companies and subsidiaries of European companies to comply with European regulations on commercial data transfers, which typically include data

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[11] USTR, T-TIP Issue by Issue Information Center at https://ustr.gov/trade-agreements/free-trade-agreements/transatlantic-trade-and-investment-partnership-t-tip/t-tip-15

[12] Software & Information Industry Association, The Cross-Border Data Flow Discussion Comes to Geneva, at http://blog.siia.net/index.php/2015/10/the-cross-border-data-flow-discussion-comes-to-geneva/

[13] European Data Protection Directive 1995 at http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012PC0010

[14] European Commission, Commission Decision of 26 July 2000 pursuant to Directive 95/46/EC of the European Parliament and of the Council on the adequacy of the protection provided by the safe harbour privacy principles and related frequently asked questions issued by the US Department of Commerce at http://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX:32000D0520

[15] U.S. Department of Commerce, Welcome to the EU – US Safe Harbor Framework at http://www.export.gov/safeharbor/

[16] Future of Privacy Forum, The US EU Safe Harbor, December 2013 at http://www.futureofprivacy.org/wp-content/uploads/FPF-Safe-Harbor-Report.pdf

from employees, such as payroll information, and information about a company's European customers, suppliers, vendors, and partners.

Two years ago, to help restore public trust in the aftermath of revelations about U.S. surveillance activities, the European Union and the United States began negotiations for a modernized commercial data sharing arrangement.

On October 6, however, just as these discussions were coming to a conclusion, the European Court of Justice issued a ruling that invalidated the existing Safe Harbor on the grounds that U.S. privacy protections relating to mass surveillance of European citizens were not adequate.

Suddenly, the roughly 4,400 European and U.S. companies that have been using the Safe Harbor were thrown into a kind of legal limbo. After a meeting on October 16, the European data protection regulators said that other legal bases for transfers are still available including model contractual clauses and binding corporate rules. But moving to these alternatives cannot be done quickly or easily. In some cases, thousands of existing contracts have to be renegotiated.

The European regulators as a group urged EU negotiators to reach a new modernized safe harbor agreement with the United States by the end of January 2016. After which, they felt obliged to consider enforcement actions.

Some individual regulatory authorities, however, announced that they are considering enforcement proceedings even earlier than January. One data protection officer authority suggested to a magazine that companies might want to "consider storing personal data only on servers within the European Union."

European Commissioners in charge of negotiations have publicly said that they are close to a final agreement in principle on the new framework, a message echoed by U.S. Commerce Department officials. Passage of the Judicial Redress Act, they say, will facilitate the negotiation of a new safe harbor that will pass European court review.

On October 20, the House of Representatives passed the Judicial Redress Act by a voice vote. The House leadership, House Judiciary Chairman Bob Goodlatte, Ranking Member John Conyers, and Representative Jim Sensenbrenner all joined forces in a show of bi-partisan support for this vital legislation.

The legislation, which is supported by U.S. law enforcement and a broad industry coalition, is narrowly targeted to allow citizens of European nations and other designated allies the ability to request corrections of inaccuracies in data held by a number of U.S. agencies, verify their data has not been improperly disclosed, and

seek civil judicial recourse in certain circumstances. It is a modest step toward giving citizens in other countries procedural privacy protections similar to – but not exceeding - those available to U.S. citizens.

In passing the Judicial Redress Act, the House acted to advance U.S. international interests in globally effective law enforcement and the free flow of data across borders. The leadership of the Senate and the Senate Judiciary Committee should act quickly to pass the Senate version the legislation co-sponsored by Senators Chris Murray and Orrin Hatch.

The perception that the Safe Harbor is of use only or primarily for technology companies is false. Many of the online publishing and information service companies in SIIA use the Safe Harbor as well. The list of Safe Harbor companies reads like a who's who of American brand name corporations including Ford Motor Company, Starbucks and the Walt Disney Company.

The perception that the Safe Harbor is important only for U.S. companies is also false. Over 150 subsidiaries of European companies use the Safe Harbor, including well-known brands like Adidas, BMW, Bayer, Ericsson, Nokia, Bertelsmann, and Vodafone.[17] The demise of the Safe Harbor is bad news for these European companies.

Conclusion

Cross-border data flows are an intrinsic feature of the 21st century global information economy, as essential to today's economic, social, and political activity as air travel and electricity. Studies assessing the economic importance of data flows all agree that their benefits for growth, jobs and inclusive prosperity are large and growing. Conversely, attempts to turn back the technological tide through server or data localization requirements will impose tangible economic costs on the lives and economic activity throughout society.

The Congress has endorsed U.S. objectives to negotiate reasonable cross-border data provisions in trade agreements, including the successful outcome in the Trans-Pacific Partnership Agreement and the upcoming efforts in the Trans-Atlantic Trade and Investment Partnership and the Trade in Service Agreement. We urge this Committee to work with the Administration to stay the course.

[17] Future of Privacy Forum, EU-US Safe Harbor Essential To Leading European Companies at http://www.futureofprivacy.org/2014/04/30/eu-us-safe-harbor-essential-to-leading-european-companies/

The invalidation of the safe harbor transatlantic data sharing agreement is a set back. A failure to establish a modernized transatlantic data sharing agreement would be in some tension with the digital trade principles that the U.S. is seeking to implement in international trade agreements. It would greatly complicate negotiations on the upcoming TISA and TTIP trade agreements. It would be a step back from the openness of the past which allowed U.S. companies a convenient, effective and enforceable method to engage in cross border data flows while demonstrating compliance with data protection rules. A new data sharing arrangement is urgently needed to ensure that the transatlantic digital trade market stays as open and free as it has in the past.