Recent Research
on the WTO Moratorium on Customs Duties on Electronic Transmissions:
an Overview

The information that follows summarizes takeaways from recent studies on the WTO Moratorium on duties on electronic transmissions. A growing body of research has highlighted the value of traded digital services for greater inclusiveness in the global economy, including the significant advantages of the Moratorium for developing economies, for MSMEs, and for women, youth and remote communities.

Such research has also drawn attention to the benefits of continuing to avoid the imposition of customs duties and instead adopting alternative non-discriminatory types of taxes for governments seeking to boost fiscal revenue. In addition, the current tariff-free system facilitates trade in services and technologies used to promote environmental sustainability and mitigate climate change.

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***Digital services boost growth and diversification in developing economies*. Services are of value to all economies, including developing economies, whose relative share of global services exports is expanding.**

Developing economies' share of global commercial services exports jumped from 24 per cent to 34 per cent between 2005 and 2022, according to a 2023 joint report by the WTO and World Bank, *Trade in Services for Development*.

Export growth in ICT, finance and other services has offered a path to greater diversification for a number of developing economies. For example, computer services exports from Bangladesh grew an average of 31 percent from 2019 to 2022, while Pakistan has also seen double-digit growth in the sector. India and the Philippines have emerged as global leaders in computer services and business process outsourcing.

Beyond the economic realm, access to services in developing economies related to health, education, finance, transport and finance have also proven essential for making progress toward UN Sustainable Development Goals.

Digitally delivered services now account for 54 per cent of global services exports, according to a 2023 joint report issued by the IMF, OECD, UNCTAD and WTO, *Digital Trade for Development*. The report estimates that digitally delivered services have grown almost four times in value between 2005 and 2022, increasing an average of 8.1% percent a year. That's well above the 5.6 % growth in goods and 4.2% rise in other services exports over the same period.

The report includes a section examining how the e-commerce moratorium has benefited digital trade. "Customs duties on electronic transmissions would likely negatively affect those who can benefit the most from digital delivery or from the use of digital tools to trade, namely MSMEs and women owned traders," the report says.

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Digital services are of particular value to women. **Many women in developing economies rely on digitally delivered services to run small businesses**, according to an October 2023 report from the Trade Experettes, *The E-commerce Moratorium and Women: How the WTO E-commerce Moratorium Impacts Women Across the World*. The report is based on research and interviews with women leaders and business owners in Latin America, the Caribbean, Africa and Asia-Pacific.

The entrepreneurs interviewed for the report describe digitally delivered services as an equalizing force that allows women to participate economically on equal footing with men. For example, businesswomen from Africa point out that digital payment solutions offer a reliable way for women to close transactions without having to physically travel thorough areas that could be unsafe.

Digital services also provide a way for women to enter the formal economy, reducing barriers for small entrepreneurs to sell goods and services online. By keeping costs low and promoting greater access to digital services, the e-commerce Moratorium has expanded opportunities for women-owned businesses to export and join in global value chains.

Some interviewees note that in general, goods and services from MSMEs tend to be relatively more expensive than those offered by bigger companies that enjoy economies of scale. The imposition of duties on imports would likely force women small business owners to raise the cost of their products further, hurting profits.

The report calls for more research to be conducted to evaluate the potential social and economic impacts of eliminating the e-commerce Moratorium on women-led or -owned businesses and jobs, particularly in developing countries.

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Digital services imports can promote sustainability**. Trade in digital services plays a critical role in efforts to help WTO members transition to a low-carbon economy and to monitor and mitigate climate change.**

A 2023 WTO/World Bank report points out that services are less sensitive to the impacts of climate change than sectors that rely on land use and other natural resources, and therefore offer an important means of economic diversification.

It details a growing body of environmental services in use around the world, including the operation of renewable energy generation, advisory services on reducing vehicle emissions and improving the efficiency of agricultural practices, and the application of clean technologies in manufacturing.

The Moratorium enables customs duty-free access to such services, which are becoming critical components of sustainability initiatives around the world.

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***Digital services imports benefit MSMEs and enhance job growth*. Indian and Indonesian small companies that use imported digital services enjoy significant economic benefits, including a bigger work force, productivity gains, and enhanced production output**.

Such are the findings of research by Badri Narayanan Gopalakrishnan, an Indian economist and former head of trade and commerce at NITI Aayog. His study on India, titled *The Impact of Cross-border Digital Transmissions on the MSME Sector in India and the Benefits of the WTO E-commerce Moratorium*, is based on the most recent available MSME data from Indian government sources.

It highlights the value to small Indian firms of imported digital services, such as e-commerce platforms, social media for marketing and communication, and digital payment applications.

Among its findings:

- Digital services imports have a positive and significant impact on employment by MSMEs. Every 1% rise in imported digital services production inputs by MSMEs is associated with a 0.4-0.8% rise in MSME employment.
- Digital services imports have a positive and significant impact on gross value-added output of MSMEs in India. Every 1% rise in imported digital services inputs by MSMEs is associated with a 0.1-0.2% rise in MSME output.

Narayanan concludes that ending the Moratorium on the imposition of customs duties on electronic transmissions would undermine Indian economic growth by raising the price of key digital services inputs.

Another study conducted by Narayanan finds that small businesses in Indonesia that use digital services stand to deliver greater output, enhanced labor productivity and better growth. In *The Value of Cross-border Digital Transmissions to MSMEs in Indonesia: Implications for Participation in the WTO E-commerce Moratorium*, he estimates that every 1% increase in imported digital inputs by Indonesian MSMEs generates the following positive impacts:

- GDP (production output) increases by 0.96%
- Labor productivity (defined as MSME output or GDP per employee) rises by 0.95%
- Employment grows by 0.42%

Small businesses are especially dependent on seamless flows of electronic transmissions to bolster their competitiveness, Narayanan concludes. The study’s findings suggest that any measures to curtail digital imports would be expected to have a significant negative impact on Indonesia’s MSMEs.

In addition to the research on India and Indonesia, soon-to-be-published research on Thailand finds similar links between MSMEs’ use of digital service imports and enhanced productivity and output.

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***Digital services imports and adoption of digital tools facilitate exports by small business*. A survey of Indonesian MSMES using digital services found that small firms not only saw increased sales and profits and were able to expand their payrolls, but were also much more likely to export.**

A study by the Indonesia Services Dialogue in cooperation with the Indonesia Ministry of Cooperatives and MSMEs highlights the value of digitally enabled services to Indonesian small business. The study, *Digital Adoption and Dependency on Digital Goods and Services in MSME: A Survey of MSME in Java and Bali*, is based on a survey of 764 MSMEs in the period from February to August 2021. It finds that:

- After MSMEs started using digital services, they saw revenues and profits increase by an average of over 20% on a monthly basis, with the typical consumer base increasing by 31% and the average work force expanding by 3 employees.
- More than 90% of MSMEs surveyed used digital services (such as social media tools) for marketing. More than half of those surveyed use digital services for business operations (61%) and delivery of goods or services offered (59%).
- The survey also showed that adoption of digital tools meant that MSMEs were 4.6 times more likely to export abroad. This finding suggests that policies that make it more expensive for MSMEs to adopt digital tools would be highly likely to hurt MSME exports.

The MSME respondents surveyed represent a broad cross-section of the economy, with 60% engaged in manufacturing, 32% in retail/hotels/restaurants and smaller numbers in the agriculture, forestry and fishery sectors, as well as transportation.

As many as 61% of the MSMEs surveyed were run by women entrepreneurs. The ISD research suggests that raising the cost of service imports, which would make it harder for small business to use key service inputs, would be especially detrimental to women entrepreneurs.

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***If the Moratorium lapses, MSMEs expect slower sales growth*. Nearly two thirds of MSMEs surveyed in Kenya and South Africa project they would see a significant or moderate impact on potential growth if the Moratorium expired and they were forced to comply with any new customs duty requirements. With added costs and additional customs requirements to navigate, most say they would also expect to become less internationally competitive.**

According to a forthcoming study from New Markets Lab, which conducted surveys with 292 MSMEs in multiple industries in Kenya and South Africa, MSMEs indicated their business could suffer if the Moratorium expires. Over 65% of MSMEs surveyed were not aware of the moratorium's existence or the potential for WTO members to let it expire in February 2024.

Three fifths (60%) said they have little or no capacity to comply with additional customs administrative requirements.

The majority of MSMEs surveyed by NML, 55%, said they would need customers to help shoulder the burden of added costs, which could have the effect of hurting their business. For example, an animation studio in South Africa that depends on digital e-commerce said if it is required to pay duties on those transactions, it would need to pass on the new costs to its clients. A Kenyan firm that provides micro-financing to 10 million women-owned MSMEs via mobile phone said new duties could force up its lending costs, potentially rendering credit unaffordable for many clients.

According to NML, the study results indicate an urgent need for greater empirical assessment of the potential impact of lifting the Moratorium on MSMEs in the developing world.

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***Cost-benefit analysis underscores the net benefits of the Moratorium*. Customs duties levied on electronic transmissions would cost more in the form of lost economic growth and a shrunken tax base than they would generate in additional tariff revenues.**

A study from the European Centre for International Political Economy (ECIPE) titled *The Economic Losses from Ending the WTO Moratorium on Electronic Transmissions* determines that developing economies reap significant economic benefits from maintaining the WTO Moratorium. The study finds that:

- Customs duties would depress consumption, resulting in lower economic growth and a smaller tax base.
- ECIPE also considers the scenario that if a given WTO member opts out of the Moratorium – in other words, begins imposing duties on electronic transmissions – others are likely to follow suit. Assuming a scenario of widespread reciprocal duties on international e-commerce transactions, a number of developing economies stand to lose many times in economic growth what they would generate in customs revenues.

Domestic employment and GDP would also suffer in the short run, according to a 2020 Indonesian report titled *Economic Assessment of Import Duty on Electronically- Transmitted Products: Key Findings*.

Other conclusions noted in the paper related specifically to Indonesia:

- Indonesian MSMEs that make greater use of digital technologies were found to be more internationally competitive, according to the Indonesian Ministry of MSMEs and Ministry of ICT.
- The World Bank projects that boosting digital engagement by Indonesia's MSMEs would increase annual economic growth by 2%.
- In a worst-case scenario in which tariffs imposed by Indonesia were matched by retaliatory tariffs from key trading partners, Indonesia would suffer a net fiscal deficit.

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***Tax revenue increases associated with eliminating the Moratorium are likely to be marginal*. Potential foregone government revenues due to the Moratorium on e-transmissions are estimated to be low for developing economies, and absent the Moratorium, any enhanced tax revenues would be offset by new burdens for SMEs and consumers.**

A 2019 OECD study, Electronic Transmissions and International Trade - Shedding New Light on the Moratorium Debate, estimates that even when taking the highest estimates, the foregone customs revenue due to the Moratorium amount to a relatively small sum, only about 0.08% to 0.23% of overall government revenue on aggregate for developing economies.

The report notes that the burden of tariffs would fall mainly on domestic consumers who would face higher prices rather than on foreign services suppliers. Meanwhile greater digitalization, including the ability to deliver and to source digital services, is paving the way for new export opportunities, including for SMEs, and some of these opportunities would be foregone.

The report also points out that some academic studies that project the costs of the Moratorium to governments in terms of lost tariff revenue have likely overestimated the potential benefits of ending it.

Those studies have been based on debatable assumptions, including that any good that could be digitized would be digitized, and the use of estimates based on bound, not applied, tariffs. But in any case, the OECD study concludes that the opportunity cost of foregone government revenue is low.

On a related front, in *Setting the Record Straight: Correcting Misleading Empirical Evidence and Other Errors About the Moratorium on Customs Duties on Electronic Transmissions*, Simon Evenett and Johannes Fritz raise questions about research that claims developing countries are highly dependent on tariff revenue, and therefore stand to forego substantial revenue by adhering to the Moratorium.

As Evenett and Fritz point out, only about half a dozen developing countries rely on import tariffs for at least 20% of their budgets. Half of the countries that are most dependent on tariffs are not even members of the WTO and so not obliged to uphold the Moratorium. Yet they have nonetheless opted not to implement duties on electronic transmissions.

And of those developing countries that do belong to the WTO, the majority have set tariff rates at least 10 percentage points below the maximum permitted under their WTO commitments. In short, it appears that developing countries choose to refrain from maximizing tariff collection even when it would be allowed, presumably because of the well-documented economic costs associated with high tariffs. Such an approach suggests developing countries "willingly forego" fiscal space, suggest Evenett and Fritz.

Indeed, one 2020 study focused on Egypt and Vietnam points out that both countries already have trade commitments both through regional trade agreements and in their WTO GATS schedules that substantially limit the scope of duties that either government would be able to collect.

That study, *New Evidence on the Impact of Customs Duties for Digitizable Products and Electronic Transmissions: the Cases of Egypt and Vietnam*, finds the value of potential duties on remaining cross-border services to be relatively insignificant. In the case of Egypt and Vietnam, researchers conclude: "The administrative and economic costs that would be associated with customs duties on electronic transmissions would thereby far outweigh the little additional fiscal revenue that could be gained."

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***There are non-discriminatory taxation alternatives for enhancing government revenue*. In most cases, any potential loss of fiscal revenue due to the Moratorium on customs duties on e-transmissions can be compensated for by the use of non-discriminatory taxes, such as value-added tax (VAT) and goods and services tax (GST).** (VATs and GSTs are non-discriminatory because they apply to both domestic and imported services).

In 77 out of 106 countries economies evaluated, the use of VATs or GSTs would completely offset any potential foregone revenues resulting from the Moratorium, according to a report from the OECD, *Understanding the Potential Scope, Definition and Impact of the WTO E-commerce Moratorium*. On average, the amount of potential foregone customs revenue that could be attributed to the Moratorium is 0.68% of potential total customs revenue or around 0.1% of overall government revenue.

Allowing the Moratorium to lapse would generate greater policy uncertainty and reduce trade, with low-income countries and smaller firms likely to suffer most, according to the OECD. New tariffs on digital services and digitizable goods would increase input costs, making companies less internationally competitive. The OECD also notes that raising the price of digital inputs would hurt SMEs and women-owned businesses, which tend to rely on digital tools to tap export markets.

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For governments that want to tax electronic transmissions, value-added taxes are more efficient and generate more revenue than tariffs. A study from the International Monetary Fund estimates that at the global level, a VAT on electronic transmissions would yield about 150 percent more potential revenue than tariffs.

The 2023 report by the IMF, *Fiscal Revenue Mobilization and Digitally Traded Products: Taxing at the Border or Behind It?*, concludes that non-discriminatory VATs are the preferred way to tax electronic transmissions.

Because VATs are broad-based and exclude intermediate inputs, the study finds they are not likely to distort consumption and production decisions. As a result, VATs have minimal impact on economic output and welfare.

VATs are also easier to implement and administer. Tax administrators can build on existing infrastructure that can be adapted to handle digital trade, while drawing on extensive international experience with VAT implementation. In contrast, little is known about implementing tariffs on electronic transmissions.

The greater revenue generation associated with VATs compared to tariffs was highest for high-income countries, due to their large share of global imports combined with low tariffs relative to VAT rates. Results were mixed for middle-income countries, while low-income countries had relatively lower revenue potential for both VATS and tariffs, due to lower levels of digital imports.

The study recommends that governments invest in updating and enhancing domestic VAT infrastructure rather than creating a new system to implement customs duties on electronic transmissions. It suggests further investment by the global community would be helpful in modernizing the tax and customs infrastructure of developing countries amid rapid digitization.

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