Barriers to NZ-US Digital Trade

ARE THERE ANY?

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NZUS COUNCIL

Introduction

The New Zealand-United States trade relationship is significant, long-standing, and increasingly characterised by exciting and innovative exports of goods and services, technology and creative businesses, and leading-edge science and research.

The commitment of New Zealand's Prime Minister Jacinda Ardern to pursuing an enhanced trade relationship with the United States during this term is very positive. At the NZUS Council, we look forward to working with our government on shaping an agenda that reflects the modern and exciting nature of this relationship. It has been encouraging to see growing alignment across a range of issues, such as climate and the challenge of reaching net-zero carbon emissions by 2050.

The existing relationship provides an excellent foundation for accelerating New Zealand's export market diversification and post-Covid recovery. The US is already our 3rd largest individual market measured by two-way trade (NZ$16.2B), characterised increasingly by high value goods and services delivering high-paying jobs. Trade data shows that in many of our highest value sectors, the US is our number one or number two market after Australia.

While this report focuses on the experiences of our digital exporters, in many cases these are experiences shared by all exporters. We

also explore some of the reasons why New Zealand and the US, two innovative nations and leading thinkers on digital trade governance, might consider pursuing a digital services agreement. We believe both New Zealand and US businesses would benefit from setting the rules of the game and creating a more enabling environment for both New Zealand and the United States' digital exports.

However, over the medium-to-long-term, securing a high-quality, comprehensive free trade agreement (FTA) with the US would be the most effective way to deepen and strengthen the NZ-US trade and economic relationship. Pursuing a gold-standard digital trade agreement would be a first step toward a broader FTA and deepened trade ties that would more comprehensively cover New Zealand's strategic trade interests.

We hope that this report contributes to informed discussion on the future of digital trade in the NZ-US context and the broader trade and economic relationship.

Background

Today New Zealand's digital exports are some of our fastest growing and most exciting to the United States.

Over the last year (ending June 2021)

The US is our largest market for Information and Communication Technology (ICT) exports valued at over half a billion dollars

$500,000,000

Computer software exports to the US by value increased by 17% and computer software licences by 65%.

Since 2017

ICT exports, computer software and licences, have been among our fastest growing exports to the US

Computer software exports to the US grew more than 50% and computer software licences grew by 64%

The digital export sector is hard to define, with no single agreed definition of a "digital export". It ranges from software exports and interactive media such as videogames and entertainment, through to apps, and digitally-delivered services such as innovative financial technologies or cloud computing. It includes licensing for the use of digital products, high-tech exports and even digitally-enabled goods trade using e-commerce platforms, together with tools to help manage supply chains and facilitate trade in other ways.

However you define it, digital is big business when it comes to bilateral New Zealand-United States trade. The United States is New Zealand's most important export market for Information and Communication Technology (ICT), and one of our fastest-growing.

Based on Stats NZ export figures, the United States is our most important export market for ICT and this broad export category was valued at over half a billion dollars last year.[1]

If you look at some of the sub-category ICT exports, over the last year alone New Zealand's computer software exports to the US by value increased by 17.2% and computer software licences by 65.4%. Looking back over the last four years, these exports are also among some of our fastest growing with each having grown more than 50%, computer software licence exports by 63.8%.

Above all, the statistics tell a story of opportunity and potential.

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[1]   Getting accurate and comprehensive figures on "digital exports" is very difficult. How to measure "digital exports" is one of the live issues in the current global trade policy conversation about digital trade. For example, the Technology Innovation Network (TIN) in their annual report on New Zealand technology exports captures a much broader range of export revenue, including US branch revenue.

> For a small economy made up of mainly small and medium sized businesses, digital trade can be the equalizer, overcoming the challenges of scale and distance from global markets in a way that only our largest companies and exporters were previously able to do.

The purpose of this project was to better understand the experience of some of New Zealand's digital exporters to the United States, as well as the challenges or barriers that slow them down or result in additional expense, and which perhaps could be addressed in a future digital services agreement or free trade agreement with the US.

We held structured discussions with a sample of New Zealand's digital exporters to uncover potential barriers and focus on some of the common problem areas, to inform our thinking about the next steps in the New Zealand-United States digital trade relationship. We spoke to 15 companies during the first quarter of 2021.

This is particularly timely given continued public speculation about the potential for the United States and New Zealand to deepen their trading relationship on digital issues. This is already an increasingly crowded space with multilateral efforts on digital trade through the WTO, a number of bilateral agreements, and of course New Zealand's efforts on agreements such as the innovative Digital Economy Partnership Agreement (DEPA).

Both New Zealand and the United States have been at the forefront of cutting-edge thinking on digital trade, developing a range of approaches to digital trade governance. In the final section, the report makes the case for New Zealand and the US to develop a deeper partnership on digital trade, including through leveraging an innovative approach like that taken in the DEPA.

Key discussion themes

Two key themes emerged from the discussions. The first is that there are very few barriers experienced (or perceived) by New Zealand's digital exporters going into the US. The second is that digital exporters need help with more basic ease-of-doing business challenges like company set up, tax arrangements, banking and currency issues.

1. Very few trade barriers are experienced by our digital exporters going into the US.

This is the key takeaway. There are a range of commercial and set up challenges, which are discussed below, but exporters really struggled to identify any barriers that would typically be addressed in a digital trade agreement or via an e-commerce chapter in an FTA. The US operating environment was viewed positively as stable and low-risk.

When we asked about measures that are typically identified as "barriers" in research on digital trade, such as data localization[2], privacy restrictions[3], and cybersecurity requirements, these were seen as non-issues in the US market context.

Specific conditions may apply. Some situations were identified where US contracting parties may require, for example, data to be stored on a local server. This was generally the case where service was being provided in sensitive sectors like defence, finance and healthcare. While these requirements may add cost or complexity for the companies involved,

commercial contractual obligations are not typically able to be addressed in digital trade agreements or FTA e-commerce chapters.

Privacy, data and security. Privacy constraints were recognised as imposing some compliance costs, but seemed to be easily handled and were seen as generally justified in the public interest.

The EU's General Data Protection Regulation ("GDPR") has effectively become the global privacy standard for New Zealand digital exporters. One exporter referred to GDPR as the "gold standard". They tended to apply the higher GDPR standards across all markets to lower the complexity and compliance costs of having to meet different standards from market to market.

There were no concerns with cybersecurity standards acting as an effective barrier. Exporters tended to follow industry best practice.

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[2] That is, a requirement to store data or a copy of data in a "local" (in-market) server.

[3] For example, restrictions on the storage or cross-border transmission of personal data or information for reasons of privacy protection.

Potential for efficiency. The paper-heavy nature of trade documentation and the sheer number of parties involved in moving physical goods across borders was also discussed.

Exporters identified the potential for achieving large efficiency gains through a greater push towards "paperless trading" (for example, using machine-readable, electronic documentation including Customs declarations, Bills of Lading and certification of origin and other elements,

processed through digital "Single Windows" as a one-stop-shop for the submission of trade documents).

This was identified as a concern with a number of exporters who use digital platforms, such as Amazon, to export physical goods. We expect this would likewise reflect the interests of our traditional goods exporters who may be exporting directly to markets rather than via an e-commerce platform.

2. Digital exporters need assistance navigating US set-up requirements, tax complexity and visas.

The 50 US states operate as separate markets with sometimes very different legal and tax requirements, creating complexity for exporters. We heard concerns about a lack of easily accessible information about the laws and regulations, where to find them and how they are likely to be interpreted.

Digital exporters want guidance on where to start establishing these commercial set up arrangements. Government agency support in this area would be helpful, for example through standardized guidance that would give newer exporters an overview of some of the common company law and tax set up requirements, and service providers that may be of assistance.

A web portal with links to relevant requirements could also be a potential channel for providing exporters with the trade information they need; this approach has been used in recent trade

agreements including the Comprehensive and Progressive Agreement for Trans Pacific Partnership ("CPTPP") as well the DEPA.

Ongoing visa challenges, non-Covid related, prevented some exporters from being able to send people to the US market even for short stays to undertake work. Compared with the equivalent in Australia, there are some gaps in coverage, and it is considerably more expensive in New Zealand. It would be valuable to better understand these gaps, and to increase awareness of the availability and requirements to access the E1/E2 visa category.

Many of these issues will not be unique to digital exporters, and New Zealand exporters across the board are likely to face similar challenges when operating in the US market.
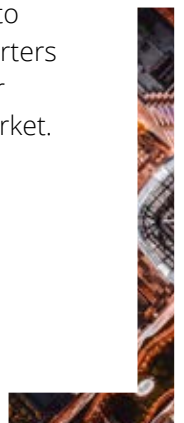
Where is the value for New Zealand in a digital services agreement with the US?

While our research suggests that there are no immediate significant trade barriers to digital exports to the US, there are strong commercial and strategic reasons for a digital trade agreement. A gold-standard digital trade agreement would have multiple benefits.

1. **Pathway toward a broader, comprehensive agreement:** Securing a high-quality, comprehensive trade agreement with the US remains the most effective way to deepen and strengthen the NZ-US trade and economic relationship. A gold-standard digital trade agreement could serve as a first step or pathfinder in the short term, toward a broader FTA and deepened trade ties that would more comprehensively cover New Zealand's strategic trade interests.

2. **Lock in current export-friendly settings:** On the commercial side, locking in the current export-friendly settings would give New Zealand exporters certainty and predictability, and encourage greater investment and innovation. The bilateral trade and economic relationship would benefit from some agreed rules for digital trade, both to support our goods exports and to create a solid foundation for the growth of the dynamic digital services export sector.

3. **Benefits from paperless trading:** Given the volume of goods trade between the two markets, establishing an agreed framework for paperless trading would produce significant gains. Paperless trade and digital Single Windows help to reduce border processing time for shipments, lessen the risks of fraud, and reduce inefficiencies and disruptions in supply chains. According to one recent estimate, a shift to paperless trade in global markets could reduce trade costs by up to 20 percent of the costs of physical transportation.[4] At a practical level, too, the value of greater automation in border processing has been vividly highlighted by the border disruptions arising from the COVID pandemic, and the potential for greater digitalisation to keep trade flowing.

4. **Establish interoperability:** A digital trade agreement could help to establish ground rules for interoperability between digital systems in the two countries. Digital trade works best when digital systems can 'talk' to each other easily, at the technical, regulatory and policy levels. Modern digital trade agreements such as the DEPA set out frameworks and processes to develop interoperability across areas such as electronic signatures (to facilitate business-to-business transactions), e-invoicing (which helps reduce costs and increase cashflow, especially for small businesses), and digital identities (a building block in the financial services sector and more broadly in trade).

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[4]   IBM research for Maersk-IBM TradeLens blockchain platform https://www.ibm.com/blogs/blockchain/2018/01/digitizing-global-trade-maersk-ibm/

5. **Platform for ongoing discussions on frontier digital and advanced technology issues:** US policy and regulatory settings will evolve over time. There are good reasons to establish a platform for ongoing conversations on these issues. For example, while New Zealand exporters did not identify any significant challenges from current privacy settings, it is also possible that new privacy regulations may be developed in the US that impose new compliance costs on New Zealand exporters. Equally there is value for businesses in both markets to operate in an environment that fosters greater trust among consumers. A DEPA-style agreement could help to support that, not only through agreed or cooperative approaches on data protection or

cybersecurity, but also by putting in place agreed frameworks for measures such as online consumer protection rules and ways to address spam or online harms.

Digital and advanced technologies continue to evolve rapidly, and areas such as artificial intelligence and innovative new data models may call for new regulatory responses. If each country develops these in isolation, new trade barriers may unwittingly be created; equally there are potentially large synergies – including from the demonstration effect for others – in New Zealand and the United States seeking to collaborate, deepen knowledge on shared challenges and develop model approaches in regulating the cross-border use of such technologies.

Conclusion

There is broader value in two innovative, cutting-edge thinkers on digital trade governance developing smart shared ways to regulate the digital economy. Global economic governance has struggled to keep pace with both the technology and business models in this area. A number of DEPA-style agreements have recently been agreed or are under development, while a patchwork of different digital trade rules applies elsewhere. Work on the WTO on e-commerce is slow at best.

Deepening collaboration with the US in this area – either through the expansion of a DEPA - style agreement, or a separate bilateral deal – could help shape developments in global markets by serving as a building block to broader outcomes. Ultimately this would create a more enabling environment for both New Zealand and the United States' digital exports into other markets too.

For today's trade, but even more for tomorrow's, there are strong reasons to put a digital trade deal firmly on the NZ-US agenda.

Very few barriers to digital exports

The consistent, and reassuring, picture is that New Zealand's digital exporters to the United States generally see little in the way of barriers to exporting to the US and typically view the US operating environment as relatively stable.

In discussions, we focused on uncovering the kind of barriers that could potentially be addressed in a digital services agreement or e-commerce chapter. We provided exporters with a list of common examples as a basis of discussions.

Before starting the discussions, we heard feedback that digital exporters may experience obstacles that they work around, but those obstacles are not necessarily seen as trade barriers that could be addressed though an agreement. We made a significant effort to identify potential trade barriers, via providing common examples, prompting, and follow up questioning, but the digital exporters we spoke to struggled to identify many.

For those using digital means to enable goods trade, paperless trading was commonly referred to as something that would facilitate trade. This could potentially be addressed in an agreement.

> "I don't know that there's any barriers to digital trade going into the US from NZ is there?"
>
> CEO/Founder, SasS Firm

> "There's not any barriers that particularly stand out to me around doing business with the US and with suppliers."
>
> Director, Innovation Incubator

Common problem areas that digital services agreements typically address, based on New Zealand's Ministry of Foreign Affairs and Trade:

Existing regulations/laws not keeping pace with technological change

- E.g. small, low value packages at high volumes. Border procedures not equipped to handle this.
- Border costs/fees
- Are digital and analogue products treated "like" (non-discrimination)?
- Interoperability of rules
- Tariffs applied

Technology/digital trade giving rise to new issues that governments must legitimately respond to

- Privacy and personal data protection
- Cybersecurity
- Data storage and access issues
- Policies that impede access to communications infrastructure and movement of information across networks

Business and consumer confidence and trust in the online environment

- Consumer protection laws applied – protection from fraudulent and deceptive online activities, SPAM
- Electronic authentication, contracts and signatures – verifying overseas parties, digital certificates, e-signatures, online invoices
- Paperless trading – documents submitted by importers and exporters, international standards, legal equivalence, e-government initiatives, customs administration
- Transparency issues – rules are known and easily discoverable, differences in rules between states

The operating environment is positive and stability and certainty were emphasized. One executive talked about US political rhetoric towards working with other countries but distinguished this from on the ground regulatory issues that would impact New Zealand digital exporters.

"We're really happy with the environment we're operating in. No shocks is what we want."

CEO/Founder, SasS Firm

"I don't think there's regulatory issues. There are political issues, not regulatory right? So it's just whatever the mood of the current regime is around doing business with other countries."

Director, Innovation Incubator

Focus on: data localization, privacy, cybersecurity and paperless trading

Data localization

Data localization restraints would be hugely problematic for New Zealand's digital exporters, but this was generally not a problem in the US. Ensuring that data flows with few restrictions is a large part of the value from a digital trade agreement providing that certainty.

There are examples of commercial requirements where the US party may contractually outline their expectation that, for instance, data be stored locally. This is common for a subset of companies operating in more sensitive sectors such as security, finance and healthcare.

While clearly a burden for these companies, the requirement is typically not a federal requirement and so could not be resolved through typical FTA data localization provisions.

One software exporter talked about 'contracting out' of data localization requirements where a client may have an initial preference to have their data stored in the US on their own server but it ends up being financially impractical.

"It's super important that governments agree not to restrict the movement of data… if there were some kind of restrictions on the movement of data it would stop New Zealand companies being able to play at a global level."

CEO/Founder, SasS Firm

"So data sovereignty is a consideration, but generally we try and contract out of that when we can. We just say, look, you're using a cloud service. What you're asking for is technically possible, but fiscally impractical. And then you just talk about the costs associated with it. And they then very quickly relinquish their grasp on this concept of domiciling data in certain territories or jurisdictions."

CEO, Software Exporter

Privacy laws

Discussions on privacy law requirements reflected a reasonably unanimous position: the European GDPR standards now effectively operate as the international privacy standard for New Zealand's digital exporters to the US. New Zealand digital exporters choose to apply the higher European standards across most markets they operate in to avoid the additional compliance costs that would result from trying to meet each market's individual privacy requirements.

"The things that have caught us out are things like privacy laws. They've not caught us out, but they've become compliance related issues. GDPR, of course, is the gold standard. So if you try and comply with GDPR you're pretty much OK, with the exception of things like the California privacy law that's come in. And ironically, you know, even with New Zealand's new Privacy Act, which is pretty useless to be honest, but if you're doing GDPR compliance it's kind of moot."

CEO, Software Exporter

"[the] complexity is the standards for what you need to disclose… vary by geography. So there's an administrative cost for a business to engage in database hygiene where you manage these different streams of prospective client data. You can conform with the relatively stringent EU requirements, you can either comply with the strictest requirements everywhere or you can selectively choose and comply with the laxer rules in more lax countries but that also creates complexity. So, we've generally erred to a more conservative approach. Generally applied a GDPR standard across most of our work. That's particularly important for us as we have a lot of partners."

CEO/Founder, Education SasS Firm
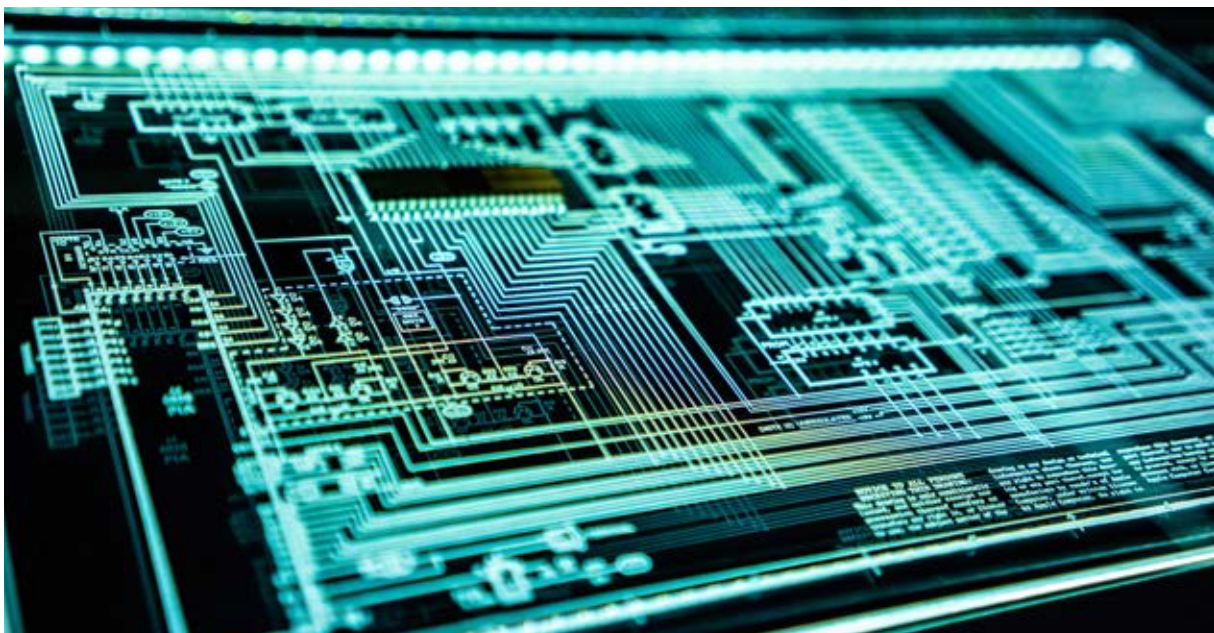
Paperless trading

Discussions focused on the obstacles to and huge benefits of paperless trading. This is something that could feasibly be encouraged through an FTA. The DEPA has gold-standard provisions in this area. In other areas of trade facilitation, such as the use of blockchain platforms to manage supply chains, this element has not been included in trade agreements to date, and clearly there is work to be done in achieving seamless interoperability between blockchain providers and border processes, for end-to-end digital connectivity in supply chains.   Interviewees had little hope for dedicated blockchain solutions in the short-to-medium term.

"Customs process is still so convoluted and time consuming. A power of attorney is required to export into the US. Streamlining of this process would be beneficial. Singapore is an example of an ideal trading partner."

Director, Innovation Incubator

"Any export transaction is very, very document heavy. Probably the last bastion of paper-based transactions. All banks have teams that do document flow, checking, ticking, verifying, sending on to the next party, getting it back, checking it again, sending it on to another party and getting it back. Honestly, it's ridiculous. In an average trade transaction, there can be 20 to 30 different parties involved. To get something from here to the US, for example, could be 30-odd different trade documents that are handled. All sorts of different documentation. Shipping companies, logistics providers, paper bills of lading, handlers and all that sort of stuff. And there's probably 300 different data points. So it's very, very ridiculously duplicated and paper heavy. It's quite mind boggling what can happen. There are the obvious ways to improve that and digitizing that transaction is obviously the way to go."

Trade Manager, Bank

Cybersecurity

Restrictive cybersecurity requirements were not a commonly cited concern. Comments tended to refer to following industry best practice because often the regulatory standards lag behind what is needed to be secure.

Elementary challenges

Exporters frequently mentioned a bigger set of challenges that were more elementary than would typically be addressed in a digital trade agreement or FTA. They involved information or knowledge gaps (perceived or real) on setting up in the US, organizing tax affairs, hiring staff in the US, and visa complexities. There is clearly a need and demand for this information.

Setting up

The challenge of setting up in the US was the most cited difficulty during discussions. A major shared concern was the perceived lack of easily accessible information about the laws and regulations that would apply to set up and operation of a US entity. While this information is publicly available, it's hard to know where to find information and how to interpret it. This was often further complicated when working across multiple US states. It was clear from discussions that exporters must be prepared to spend significant sums, by New Zealand standards, to obtain advice and have in place legal agreements to ensure compliance across the different states they plan to operate in.

A common thought was that New Zealand government agencies could provide greater assistance in this space (although they are not of course in a position to speak authoritatively on US requirements). There is clearly a demand for this type of practical advice on setting up and operating a legally compliant business in the US. However, it would be problematic for government agencies to provide this type of advice. There may be other more appropriate sources of guidance and educational resources than New Zealand government agencies such as consulting and legal firms and chambers of commerce.

Other set up issues concerned banking and setting up accounts, currency conversion fees, and liability and insurance issues.

> "I hear from customers that they don't know where to start in setting up a company in the US."

> "Ideally in a really good trade agreement for ecommerce it would be awesome to have it really spelt out; this is the best way to do it, this is the cost. Some proper channels to go through. Because realistically if you're a multimillion-dollar business you'll hire top lawyers and they'll sort it out for you. They'll go to all the individual departments and that's why it costs so much money. But let's say you're doing 30-40K a month and you want to break in to the States, you just can't do it. You just go off word of mouth and figure it out as you go. But you lose money figuring it out as you go."
>
> Senior Manager, Digital Consultancy

Tax complexity

Navigating the complexity of the US tax system was another frequently cited concern. Some cautioned that this can easily upend New Zealand exporters if they don't obtain the right advice. Discussions highlighted a range of potential hazards with US tax complexity clearly acting as a barrier to growing their businesses and some cases limiting their US in market growth ambitions.

There is clearly a need for a better understanding of the US tax system and that getting the tax piece right for exporters can become very expensive. It was suggested that working through platforms such as Amazon helped to minimize tax issues because the platform manages the collection of sales tax and submits in all but five or six states. However, this narrows down the available options for exporters and creates a raft of other issues including the business not owning customer information and being locked into Amazon fee increases.

"New companies could be stepping into problems without realizing it, due to lack of clarity around storage in the United States, which creates a nexus for US tax purposes."

CEO/Founder, E-Commerce Consultancy

"Tax and the different duties across state lines is an issue... so that's probably the biggest pain point from exporting into the States from New Zealand and Australia, is jumping through all the red tape of America's laws and taxes. And it's crazy because it goes down to states. There are State taxes."

Senior Manager, Digital Consultancy

Visas

Exporters frequently raised the limitations on visas and the impact this has on staff mobility and the ability to fulfil contract work while in the US. There was some awareness of the KIWI Act E1/E2 visa category, but further work is needed to raise the profile of the availability of this category.

One company mentioned that the E1/E2 visas are still really expensive, saying it costs on average $5K an application in New Zealand versus $1K in Australia under the equivalent category, and that there were gaps in the New Zealand provisions that means Australia is more competitive. Further information is required to better understand this.

It was also clear that these kinds of limitations or restrictions are not just an obstacle to growing businesses and job opportunities in New Zealand, but also have implications for the growth of US operations and jobs.

"It does materially affect us. We work with partners in the States. Recently they wanted one of our staff to go over for three months. Everything was progressing. And then the partner said "hang on, with the visa regulations we absolutely cannot do this". And it's on the back of millions of dollars of work. Which is problematic for us as a country because it would have been a lot of funds for New Zealand… [A]nd they just said to us '[X], have you got any Australian staff?"

Co-Founder, Software Exporter

"We would send someone from New Zealand to the US to actually grow that relationship locally, which means potentially we could then hire people in the US and that organisation. That said, though, we've got ways around that now because we've hired people in the US who are Americans to build that team out. However, it's taken three years rather than just doing it three years ago."

Co-Founder, Software Exporter

Other concerns

Digital capability

Digital capability and the availability of digital skills was not often raised, although we know from other sources that this is a challenge for New Zealand's digital sector along with most other sectors in New Zealand right now. The few comments made on this point focused on the availability of suitably qualified talent for specific needs and the general digital capability of New Zealand companies.

There was a concern that New Zealand firms needed to up their game and a suggestion that this is a fundamental challenge or barrier that needs to be addressed urgently. On this point it is reassuring to note the significant government resource going into improving the digital capability of New Zealand firms.

"This is a little bit harder, actually, to find people that know digital e-commerce in the fruit category."

CEO, Horticultural Exporter

"I think a major factor in this is how digital is each business base? [US and NZ]. There is still a number of New Zealand companies that still don't have a website. So you go, okay, well, their challenge with doing business digitally with the US is actually pretty bloody fundamental."

Director, Innovation Incubator

Big Tech concerns

While not frequently raised, that there were some concerns that could broadly be categorized as "Big Tech" related. These included antitrust and global taxation issues.

"There is the attraction and frustration of a single ecommerce platform – Amazon... The challenge is, Amazon owns the customer... It competes too much with the retailers on its site which is an antitrust issue. [And] Amazon's continual fee increases are concerning."

CEO, E-Commerce Platform

"Tax comes into it mainly when the services are digital. We get the GST debates on the Microsofts and the Apples and all of those. So that's definitely a tension that will not be able to be avoided as you consider these. Clearly, they want to pay tax nowhere. Clearly, we want them to pay tax in New Zealand on the earnings in New Zealand."

Director, Innovation Incubator

About the NZUS Council

Established in 2001, we are a non-partisan, non-government organisation focused on advancing New Zealand's interests in a strong bilateral relationship.

www.nzuscouncil.org