The perils of unilateralism

Simon Evenett and Johannes Fritz consider the latest research and find that commercial policies and regulations now fragment the digital economy

The last inventory of digital economy policies was published in 2018. Since then, officials have gone into overdrive, acting unilaterally to regulate and to promote digital activities. Drawing upon an up-to-date inventory of over 15,000 state acts, a new report assesses whether unilaterally determined policy is fragmenting the digital economy along national and regional lines.

As ever-more-pervasive digital technologies rewire our societies, governments are adopting different approaches to regulate and, in some cases, to promote the digital domain (Global Commission on Internet Governance 2016, O'Hara and Hall 2018, UNCTAD 2021). While governments have taken some joint approaches (Nemoto and Lopez Gonzalez 2021, TAPED 2022), most policy intervention has been unilateral, has not been aligned with trading partners, and often has not been aligned internally either (that is, policy was developed in regulatory silos).

While useful lists of policy interventions in specific regulatory domains have been assembled recently (Cory and Driscoll 2021, Ferracane and van der Marel 2021), the last comprehensive inventory of state action in the digital domain was published four years ago (ECIPE 2018). The upshot: policymakers are flying blind as they both regulate and nurture the digital domain.

This is a recipe for poor public decision-making. Policy incoherence at home can coexist with international regulatory divergence. A fragmented internet and global digital economy denies users choice, diminishes the incentives for innovation, exacerbates trade tensions between governments, and increases the risk of numerous crises.

Still, as a factual matter, where do matters stand? Using novel evidence from the Digital Policy Alert and the Global Trade Alert independent policy monitoring initiatives, a new report assesses whether policy choices are fragmenting the global digital economy (Evenett and Fritz 2022).

The notion of digital fragmentation and the role of policy and regulation

The negative connotation attached to the term 'fragmentation' may be unfamiliar to some trade economists. For them, fragmentation refers to the slicing up of production processes into multiple stages located in different economies, thus resulting in international or global value chains.

In the digital domain, fragmentation refers to the form and consequences of policies that decouple national markets from global markets or that prevent the crossborder deployment of data or digital technologies. Motivated by statements from experts and businesspeople, Drake *et al* (2016) describe digital fragmentation of the digital economy as *"the internet [being] in some danger of splintering or breaking up into loosely coupled islands of connectivity."*

Since this is a global challenge, ways must be found to engage expertise and officials from developing countries in deliberation and norm formation

Our report focuses on fragmentation risk for the digital economy stemming from commercial policy and regulation choice. Besides outright discriminatory policy choice, fragmentation may occur because of national differences in regulatory approaches to the same digital activity.

Such regulatory heterogeneity arises when (a) when some countries do not have a law widely regarded as necessary to regulate the digital domain, or (b) when there is a material difference across jurisdictions between the legal provisions associated with a particular class of law governing the digital domain.

Filling the evidence gap

We adopt a comprehensive view of the policies affecting the digital domain and their crossborder repercussions. A whole-of-supply-chain approach is taken, considering those policy decisions affecting upstream activities that support the digital economy (eg. the mining of Rare Earths), midstream activities (eg. developments in the critical semiconductor sector and in hardware and software), and downstream activities (eg. platform businesses and digital delivery to customers).

Drawing upon two extensive inventories of public policy intervention – the Digital Policy Alert and the Global Trade Alert – we delineate the global policy landscape towards the digital domain with a focus on the G20 nations and members of the EU.

Evidence on legal and regulatory developments – such as those relating to the governance of data, content moderation, and differential taxation – is presented along with information on resort to trade and investment policy changes and subsidy policies so as to provide a comprehensive perspective. Information on over 15,000 policy and regulatory developments was used to compile this report.

Contours of a highly active, increasingly heterogenous policy landscape

The principal findings are:

1. Governments have gone into regulatory overdrive in digital sectors since the start of 2020.

- Together, European and G20 governments took 1,731 legal and regulatory steps since the start of 2020. Fifty-five percent of those steps have already translated into state action; 41% are in the pipeline.
- The three most active regulatory areas are data governance, online content moderation, and competition law enforcement.
- Resort to regulation is accelerating. The first quarter of 2020 saw 71 regulatory developments; the first quarter of 2022 saw 217.

2. Regulatory heterogeneity is growing, posing an ever-greater risk of digital fragmentation.

- Particular concerns arise concerning rules on the storage, use, and transfer of data, with China, the EU, India, Russia, and the US going off in different directions.
- Divergent regulatory approaches to online content moderation – including demands to takedown material posted on the internet – are emerging.

3. Commercial policy developments over the past decade have erected more and more barriers between national digital sectors.

- A third of global trade in digital economy goods currently faces market access barriers.

- During the last decade, digital economy sectors saw twice as much discrimination against foreign firms than world goods trade overall, as measured by the ratio of discriminatory to reforms measures implemented.

4. Subsidy races are breaking out in the digital economy, most notably in the semiconductor sector.

- Looking across sectors, states tend to substitute digital trade barriers for subsidies. Consolidation of public finances after COVID-19 is likely to result in more digital fragmentation as governments resort more to trade and investment barriers.

5. With no global playbook to guide policymakers and regulators, burgeoning unilateral state action in the digital domain remains uncoordinated, stokes trade tensions on topics from corporate taxation through to competition law enforcement, and chills crossborder corporate deployment of digital technologies.

Fragmentation is not inevitable: the way forward

Digital fragmentation is already happening – that much is clear from the resort to trade and investment barriers documented in our report.

Strictly speaking, the thousands of subsidies lavished on firms in sectors associated with the digital economy do not fragment markets. However, the tendency of governments to substitute between subsidies and digital trade barriers implies that fiscal retrenchment after the COVID-19 pandemic adds to the risk of further digital fragmentation.

The potential for digital fragmentation is all the greater because of the extensive pipeline of regulatory policy announcements recorded by the Digital Policy Alert. At the very minimum, careful monitoring of associated legal and regulatory developments is needed.

As rivalry between these behemoths intensifies, governments would benefit from developing some rules for the road. One risk is that divergent policy becomes a source of tensions between nations.

Another is that the benefits arising from crossborder commercial ties are thrown to the wolves in the name of geopolitics. Those crossborder ties are part of the reality facing officials as they devise approaches to shaping and promoting the digital domain.

The right to regulate the digital domain is not being questioned – rather, the concern is that, without some degree of alignment on how to design regulations and enforcement, emergent digital fragmentation will become entrenched and a heavy price will be paid. The perils of unilateral governance action are becoming clearer.

Some governments have recognised the need for greater alignment in policies towards the digital domain. When compared to the first decade of this century, the electronic commerce chapters of regional trade agreements now include more wide-ranging provisions.

Yet, those provisions do not address all of the forms of crossborder harm done by poorly conceived unilateral state action. Progress at the WTO has been patchy too – a worthwhile attempt to negotiate a plurilateral deal on electronic commerce is still in the works.

Recently, much energy had to be devoted to stopping a step backwards – namely, to counter calls to end the WTO's Moratorium on Customs Duties on Electronic Transmissions.

Going forward, while there is a strong case for developing new multilateral understandings concerning the digital economy, progress can be made in a number of alternative groupings. For example, aligning digital policies is an important part of the work programme of the recently announced Indo-Pacific Economic Framework. It is central to the activities of the EU-US Trade and Technology Council.

Since this is a global challenge, ways must be found to engage expertise and officials from developing countries in deliberation and norm formation.

Inevitably, this will involve addressing the incentives of firms to deploy digital technologies to close the digital divide, among other pressing digital imperatives. Such deliberations should be informed by evidence on the choices and consequences of unilateral policy as well as collaborative alternatives, where much research remains to be done. ■

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