Fundamental Rules in E-Commerce Chapter for SMEs to Expand Their Business

Submitted by: Japan
Fundamental Rules in E-Commerce Chapter for SMEs to Expand Their Business

SMEs: Small and Medium Enterprises

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Data flows and e-Commerce are expanding

• Cross border data flows and e-commerce transactions have been expanding and will continue to expand.

Global B2C e-commerce transaction volume

- Cross-border % of total

Recent expansion of data flows

- commerce
- information
- searches
- music / video
- communication
- intracompany traffic and etc.

Reference: McKinsey Global Institute
Benefit of e-commerce for SMEs

• More than 90% SMEs realize that e-commerce is beneficial for their business activities.
• Both B2B and B2C e-commerce affect SMEs business activities in many aspects.

**Questionnaire for SMEs about benefit of E-commerce**

<table>
<thead>
<tr>
<th>Benefit</th>
<th>B2C</th>
<th>B2B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cutting cost</td>
<td>23.2</td>
<td>30.7</td>
</tr>
<tr>
<td>Efficiency of operating process</td>
<td>16.9</td>
<td>27.6</td>
</tr>
<tr>
<td>Promotion of cooperation between companies</td>
<td>10.5</td>
<td>27.3</td>
</tr>
<tr>
<td>Enhancement of sales capabilities</td>
<td>10.5</td>
<td>31.5</td>
</tr>
<tr>
<td>Expansion of sales</td>
<td>23.8</td>
<td></td>
</tr>
<tr>
<td>Improvement of client satisfaction</td>
<td>19.9</td>
<td>40.4</td>
</tr>
<tr>
<td>Rising profit margins</td>
<td>19.3</td>
<td></td>
</tr>
<tr>
<td>Risk management</td>
<td>13.6</td>
<td></td>
</tr>
<tr>
<td>No effect</td>
<td>4.9</td>
<td></td>
</tr>
<tr>
<td></td>
<td>6.3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>9.7</td>
<td></td>
</tr>
</tbody>
</table>

Reference: White Paper on Small and Medium Enterprises in Japan

Problems which SMEs are facing in cross-border e-commerce

• Some countries have laws and regulations which have adverse effect for e-commerce. Sometimes, such laws and regulations are ambiguous or complicated.
• Some countries do not have laws and regulations which promote e-commerce.

Barrier against e-commerce

<table>
<thead>
<tr>
<th>Laws and Regulation</th>
<th>Comments or Demands from Private Sector, includes SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulation of data flow</td>
<td>• Regulation of data flow cause lack of local marketing research.</td>
</tr>
<tr>
<td>Data localization</td>
<td>• Installing computing facilities in other countries costs a lot.</td>
</tr>
<tr>
<td>Disclosure requirement of source code</td>
<td>• Intellectual property or business secret will be disclosed at the same time.</td>
</tr>
</tbody>
</table>

Laws and regulations which promote e-commerce

<table>
<thead>
<tr>
<th>Laws and Regulation</th>
<th>Comments or Demands from Private Sector, includes SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customs procedures</td>
<td>• There are complex tax systems in some countries. • Simple and speedy customs procedures are needed.(Lead time of customs procedures are very long.)</td>
</tr>
<tr>
<td>Electronic settlement</td>
<td>• There are risks in payment in countries where the rate of owning bank account or credit card is low.</td>
</tr>
</tbody>
</table>
Scope of e-commerce chapter and fundamental rules

- Not only large companies but also SMEs have variety of business models using Internet, therefore e-commerce chapter in EPA/FTA should expand the scope and cover such business models.
- Cross-cutting and fundamental rules will facilitate SMEs to expand their business abroad because the business environment will be improved by these rules.

<table>
<thead>
<tr>
<th>Business Model</th>
<th>Creating a Conductive Environment for E-Commerce</th>
<th>Promoting Cross Border E-Commerce</th>
<th>Trade Facilitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>B to C (C to B)</td>
<td>• Online Consumer Protection</td>
<td>• Location of Computing Facilities</td>
<td>• Paperless Trading</td>
</tr>
<tr>
<td>B to B</td>
<td>• Online Personal Information Protection</td>
<td>• Disclosure of Source Code</td>
<td>• Customs Procedures</td>
</tr>
<tr>
<td>P to P</td>
<td>• Customs Duties</td>
<td>• Cross-Border Transfer of Information by Electronic Means</td>
<td>• Electronic Signature</td>
</tr>
<tr>
<td>HQ to Subsidiary</td>
<td>• Treatment of Digital Products</td>
<td>• Electronic Settlement</td>
<td></td>
</tr>
<tr>
<td>Machine to Machine</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6 rules are strongly demanded by SMEs

1. Cross border transfer of information

- Cross-Border Transfer of Information is necessary to all business activities, includes B2C, B2B, internal communication and future technologies such as ADAS and IOT.

Country A

- SMEs in every field
  - application
  - service
  - web access
  - inquiry by e-mail
  - Online payment

- Immediate and frequent communication
  - e-mail
  - Web meeting
  - server sharing

Country B

- Subsidiary / Business partner
- Maintenance information
- Software upgrade
- Condition of Machines

- Consumer
- Car owner
- Machine operator
- Car with ADAS
- Constructing machine with IOT

ADAS : Advanced Driver Assistant System
IOT : Internet of Things
2. Not imposing customs duties on electronic transmissions

- Not imposing customs duties reduce business cost.
- Not imposing customs duties permanently improve legal stability.
- Not only large company but also SMEs can enjoy the benefit.
- Based on the WTO ministerial decision, not imposing customs duties has been basically maintained since 1998.

<table>
<thead>
<tr>
<th>Country A</th>
<th>Supplier</th>
</tr>
</thead>
</table>
|         | • Music / Video  
|         | • E-learning |
|         | • E-book  
|         | • Game  
|         | • Software  
|         | and etc. |
|         | Zero custom duties for services or digital products exported online |
|         | • E-mail  
|         | • Video Conference  
|         | • Data Access  
|         | and etc. |
| Country B | Subsidiary |

3. Prohibition of requirement on data localization

- Data localization requirement makes SMEs or IT ventures spend high cost to introduce and maintain servers in other countries.

<table>
<thead>
<tr>
<th>Country A</th>
<th>No requirement</th>
</tr>
</thead>
</table>
| Server includes | • customers information  
|         | • Web data  
|         | • Application data  
|         | etc. |
| trade goods, services or digital products | Low cost |
| SMEs | access |
| Country B | Consumer |

<table>
<thead>
<tr>
<th>Country A</th>
<th>With data localization requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMEs</td>
<td>High cost</td>
</tr>
<tr>
<td>trade goods</td>
<td>access</td>
</tr>
<tr>
<td>Provide services or digital products</td>
<td>Consumer</td>
</tr>
</tbody>
</table>

8
3. Prohibition of requirement on data localization

- If many countries require data localization to SMEs, they have to put their servers in each country with extremely high costs. Finally, they will give up expanding their business overseas, and this has severe adverse effects for inclusive growth and regional economic integration.

4. Prohibition of requirement on disclosure of source code

- Source code includes core technologies and an important asset for the company.
- If a government requires companies to disclose source code of their products, intellectual property and business secret will be disclosed at the same time.
- Therefore, government should provide legal stability to companies by ensuring they will not require companies to disclose, and then companies can expand their overseas business at ease.
5. Customs procedures and trade facilitation

- To facilitate E-Commerce Customs Procedures and Trade Facilitation are important because it is critical to the lead time of e-commerce.

6. Electronic settlement

- Electronic Settlement is essential for e-commerce.
- User confidence of Electronic Settlement is enhanced by legal framework to proscribe fraudulent and deceptive commercial activities.
Conclusion

• Cross border data flows and E-Commerce transactions have been expanding and will continue to expand.

• Many SMEs are facing problems of foreign laws and regulations when they expand their business abroad.

• Fundamental rules in e-commerce chapter will promote not only B2B, B2C e-commerce but also every business activities.

• SMEs can promote their business at ease in foreign countries which have introduced such rules.

Annex
Fundamental Rules Promoting E-Commerce and Foreign Business Activity

• We are thinking that international fundamental rules below will promote e-commerce and foreign business activity of not only large companies but also SMEs.

1. Cross Border Transfer of Information
   ➢ SMEs can capture foreign demands easily.
   ➢ This rule contributes to increase investment in advanced technologies and promote innovations.

2. Not imposing Custom Duties on electronic transmissions
   ➢ SMEs can export their products transmitted electronically with lower cost.
   ➢ Domestic consumers can buy products cheaper.

3. Prohibition of requirement on data localization
   ➢ SMEs can expand their business overseas with lower cost.

4. Prohibition of requirement on disclosure of source code
   ➢ This rule provides secured investment environment, and contributes to increase investment and promote innovations.

5. Customs Procedures and Trade Facilitation
   ➢ Simplified customs procedures make expeditious clearance of goods.

6. Electronic Settlement
   ➢ Fraudulent and deceptive commercial activities are proscribed by legal framework.

Over View of 6 Fundamental Rules

1. Cross Border Transfer of Information
2. Not imposing Custom Duties on electronic transmissions
3. Prohibition of requirement on data localization
4. Prohibition of requirement on disclosure of source code
5. Customs Procedures and Trade Facilitation
6. Electronic Settlement
### Annex

<table>
<thead>
<tr>
<th>Rules</th>
<th>TPP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not imposing Custom Duties on electronic transmissions</td>
<td>○</td>
</tr>
<tr>
<td>Prohibition of requirement on data localization</td>
<td>○</td>
</tr>
<tr>
<td>Cross Border Transfer of Information</td>
<td>○</td>
</tr>
<tr>
<td>Prohibition of requirement on disclosure of source code</td>
<td>○</td>
</tr>
<tr>
<td>Customs Procedures and Trade Facilitation</td>
<td>○   (another chapter)</td>
</tr>
<tr>
<td>Electronic Settlement</td>
<td>×</td>
</tr>
</tbody>
</table>

### Exception Clause

#### 1. Legitimate Public Policy Objective (TPP)

Nothing in this Article shall prevent a Party from adopting or maintaining measures inconsistent with paragraph 2 to achieve a legitimate public policy objective, provided that the measure;

(a) is not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on trade; and

(b) does not impose restrictions on transfers of information greater than are required to achieve the objective.

#### 2. General Exception (Article 14 of GATS and Article 20 of GATT)

Article 14 of GATS (The concept is the same as Article 20 of GATT)
Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:

(a) necessary to protect public morals or to maintain public order;

(b) necessary to protect human, animal or plant life or health;

(c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:

(i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;

(ii) 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;

(iii) safety;

(d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members;

(e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound.

#### 3. Security Exception (Article 14bis of GATS and Article 21 of GATT)

Article 14bis of GATS (The concept is the same as Article 21 of GATT)
Nothing in this Agreement shall be construed

(a) to require any Member to furnish any information, the disclosure of which it considers contrary to its essential security interests; or

(b) to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests:

(i) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;

(ii) relating to fissile and fusible materials or the materials from which they are derived;

(iii) taken in time of war or other emergency in international relations; or

(c) to prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.
### Scope of “TRIPS” and “Source Code in E-Commerce Chapter”

<table>
<thead>
<tr>
<th>Source Code</th>
<th>Disclosed</th>
<th>Undisclosed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mandatory disclosure requirement by Governments</td>
<td>Scope of E-Commerce</td>
<td></td>
</tr>
<tr>
<td>Used by competitor in a manner contrary to honest commercial practices</td>
<td>TRIPS Article39 if it satisfies following condition</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(a) unknown or inaccessible</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(b) commercial value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(c) lawfully controlled</td>
<td></td>
</tr>
<tr>
<td></td>
<td>TRIPS Article10 (Copyright such as computer programs)</td>
<td></td>
</tr>
</tbody>
</table>

**Notes:**
- TRIPS Article39 covers undisclosed source code that meets the specified conditions.
- Scope of E-Commerce applies to disclosed source code.
- TRIPS Article10 applies to copyright such as computer programs.