

## **Can NAFTA Forge A Global Approach to Internet Governance?**

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**ABSTRACT:** How will national competition policy, tax regimes, and information protection fare in the increasingly global, technologically dynamic, and network-oriented Internet marketplace? Managing the tensions between national jurisdiction and international transactions will determine how much individuals, firms, and countries benefit from the Internet marketplace. NAFTA has already achieved agreements on trade and on intellectual property. Building on the NAFTA relationship, can the United States, Canada, and Mexico forge a broader, globally interoperable approach to Internet governance that could be a model for the world? The conclusion is that there is a NAFTA approach characterized by a practical, cooperative, and evolutionary approach to interpreting law, which embodies national preferences as well as achieves international interoperability. Coordination and cooperation of government authorities, businesses, and consumer advocates would be further deepened with explicit understandings and agreements in the key areas of competition policy, taxation, and information protection. However, exporting this model to parts of the world where a rules-oriented approach to policy and legislation reign will be difficult.

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## I. Introduction

Economic activity via the Internet is complex and it bundles globally sourced goods, services, and information. In contrast, the jurisdictions of government policy and legislation remain national at best. Policy choices by one nation increasingly will impinge upon policy choices made by another nation. How do the NAFTA partners differ in their approaches to Internet policy issues? Are they working toward an approach that will reduce conflict and increase benefits from expanded use of the Internet? If the NAFTA partners—with their differing relationships between governments, citizens, and business, and varied level of Internet access and level of development—can find an approach that meets domestic needs, but is also internationally interoperable, it could be an important model for global Internet governance.

This paper focuses on three policy areas that are particularly affected by the tension between global marketplace and national jurisdictions, and considers the approaches being taken by the United States, Canada, and Mexico:

- ?? Business conduct: Global e-businesses pose challenges to both antitrust and to consumer protection.
- ?? Tax regimes: The Internet affects the classification and treatment of both domestic and cross-border transactions, as well as mode of raising revenues;
- ?? Information protection: The Internet uses information intensively so the coverage and method of protecting personal data are important.

Right now, each of the NAFTA partners is focusing on establishing approaches and legislation attuned to the domestic arena; there is relatively little attention being paid to the cross-border implications of these efforts or to creating explicit multilateral approaches. So far, this approach to Internet governance of “live-and-let-live” works because of existing cooperation arrangements and bilateral agreements (as well as shared experiences in various international Internet and e-commerce working groups under APEC, FTAA, OECD and the WTO).

However, the increasing economic integration of these three economies coming from CUSFTA and NAFTA, being accelerated and accentuated by the Internet, demands development of more explicitly interoperable approaches. Policymakers should take up the challenge now to forge a NAFTA approach rather than focus only on the domestic arena. It may be easier than you think!

The next section of the paper addresses why it matters that any international understandings emerge. Section three develops two issue areas where NAFTA has already helped to create a common treatment: classification of transactions and trade, and intellectual property protection. Section four addresses the three areas where the challenge lies ahead. Section five summarizes the NAFTA approach and considers its potential to emerge as a global approach to Internet governance.

## II The Potential Benefits of the Internet

Why should we care whether a NAFTA-based approach to Internet governance might be successful at a global scale? The Internet facilitates trade by enhancing traditional commerce mechanisms and by providing new instruments for transactions. The Internet creates new markets in time, space, and information that allow exchanges previously hindered by prohibitive transactions and coordination costs. However, these new markets in time, space, and information increasingly are cross-border and hard to trace (challenging tax collection and perhaps increasing fraud), involve personal information (raising concerns about improper use), and may be characterized by “winner-take-all” network externalities. The benefits of the Internet can come only if the policy issues are properly managed.

Conflicting national approaches to Internet governance can jeopardize the potential benefits of more global and efficient markets. But convergence to a single global policy is unrealistic given differences in national cultures, level of development, and so on. New and existing regulations must provide an environment of certainty (protecting consumers, privacy, intellectual property, and competition). At the same time, they must allow enough flexibility for national differences to be preserved and provide sufficiently strong incentives for innovation and expansion of the Internet.

A successful governance approach at the NAFTA level would provide an appropriate environment for the expansion of electronic transactions and thus contribute to the expansion of trade. Therefore an Internet governance model that maximizes the benefits of the Internet while managing the policy issues is a key policy tool to increase economic welfare. Building on the NAFTA relationship might be a good way to start.

Because Internet activities are new and evolving so rapidly (and with great volatility), it is difficult to measure what the potential macroeconomic benefits might be. Even measuring Internet activity and usage is difficult. There are several approaches to getting ballpark estimates of the macroeconomic gains. One approach is to aggregate-up the cost savings and increased economic efficiency associated with the diffusion of network technologies into businesses. A second approach investigates how trade flows might change with broader use of the Internet. A third strategy considers the long-run gains from broad structural policy reforms that allow information technologies to take hold.

?? Efficiency gains: Two studies aggregate-up sector estimates of the cost reductions and efficiency gains of using the Internet. Brookes and Wahhaj suggest that GDP growth in the industrial countries might average some 0.25 percentage points higher for the next ten years. Litan and Rivlin compiling work on the United States suggest that productivity gains might be on the order of 0.25 to 0.5 percent.

?? Trade flows: Freund and Weinhold, using a panel of industrial and developing countries, finds that a 10 percent increase in the relative number of web hosts in one country would lead to about 1 percent greater trade in 1998 and 1999 beyond what

would have been expected based on a simple gravity model.<sup>1</sup> Considering broad trade liberalization, Brown, Deardorff, and Stern find that global free trade (goods and services) would raise global welfare by about \$2 trillion—augmenting GDP of the NAFTA partners by more than 5.5 percent each.<sup>2</sup>

?? Structural reforms: UNCTAD, using a CGE model<sup>3</sup>, suggest that GDP in the industrial countries might be about 5 percent greater in the long-run (about \$1 trillion—similar to the results suggested by B&W and L&R) and GDP in developing countries might be 1.2 percent greater in the long run—smaller on account of the assumption that more policy reforms must be undertaken in the developing countries to achieve the gains.

### **III. A NAFTA Approach in Place for International Trade and Intellectual Property**

In two areas, there is already a NAFTA approach that differs from the global approach and that is more conducive to achieving the benefits of the Internet: Classification and coverage of international trade transactions and treatment and protection of intellectual property.

#### **1. Internet Transactions and International Trade**

A key distinction in the world of international transactions and trade negotiations is whether a product is a good or a service. This distinction is fundamental to the current structure of the World Trade Organization (WTO) because the two functional agreements on trade--the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS)--are characterized by very different commitments by the signatories towards liberalization. NAFTA, in contrast, has much more similar commitments for goods and services. Since Internet transactions increasingly blur the distinction between a good and a service, similar treatment and commitment toward liberalization is important.

In the GATT (precursor to the WTO and originating in the late 1940s), signatories committed to free trade in goods. While derogations have been common, unless a country explicitly negotiates a tariff, quota, or other constraint, the transaction in the good is presumed to receive free-trade and nondiscriminatory treatment. However, in the GATS (which only came into force as an agreement in 1993), countries made no basic

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<sup>1</sup> Caroline Freund and Diana Weinhold, "On the Effect of the Internet on International Trade," International Finance Discussion papers 2000-693 Federal Reserve Board, (December 2000).

<sup>2</sup> Drusilla Brown, Alan V. Deardorff, Robert M. Stern, "Impacts on NAFTA Members of Multilateral and Regional Trading Arrangements and Initiatives and Harmonization of NAFTA's External Tariffs," presented at Industry Canada conference "North American Linkages: Opportunities and Challenges," June 20-22, 2001.

<sup>3</sup> Adjusted to be consistent with the other work. See discussion in Mann, Eckert, and Knight. *Global Electronic Commerce: A Policy Primer*, Washington: Institute for International Economics, 2000; p 24.

commitment to free trade in services instead using schedules of “commitments” to liberalize within certain modes of supply.<sup>4</sup>

Electronic transactions or means of delivery were not explicitly considered in the GATS scheduling process, and how they should be treated is not clear.<sup>5</sup> So far, all economies have adhered to the moratorium (agreed at the 1998 Geneva Ministerial) on any new customs duties on electronic transactions. But disquiet over the potential to lose tariff revenue has increased.

In the NAFTA, treatment of goods and services is more similar, with the underlying principle of liberalization preserved. First, with respect to goods trade, tariffs were eliminated between Canada and the US under the CUSFTA and NAFTA. By 2003 customs duties will be phased out with Mexico. (Of course derogation remain in all the bilateral relationships.) Additionally, the three countries agreed to implement uniform customs procedures, documentation, and regulations to facilitate trade.

Second, NAFTA’s provisions on services are more liberal than the GATS. NAFTA uses a “top-down approach” i.e. all services are covered unless they are specifically excluded in the agreement. The GATS is a “bottom-up” arrangement and applies only to services included in the agreement. This difference is significant when it comes to information technology and the Internet since new services arising from technological innovation would be automatically covered by the agreement under NAFTA and would not require new negotiations.

NAFTA’s provisions for cross-border service trade are broad and include production, distribution, marketing, sale and delivery of services. While virtually all services are covered by Chapter 12 of the NAFTA,<sup>6</sup> each country excluded “sensitive” sectors from coverage: health, education and cultural industries in Canada; services specifically reserved to nationals by the Mexican Constitution in Mexico (energy and petrochemicals, telegraph services, postal services and railroads, public law enforcement, social welfare, public education); and marine transportation in the United States. Going forward liberalization of services key to the effective use and diffusion of the Internet (telecom, finance, and delivery) will be necessary.

## **2. Balancing Protection of Intellectual Property and Innovation**

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<sup>4</sup> This is an extremely cursory overview of the WTO and its two main components, GATT and GATS. For more detail and analysis, see John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations*, Cambridge: The MIT Press, 1997; for a good “side-by-side” comparison of the rights and obligations under GATT vs. GATS, see Richard N. Snape and Malcolm Bosworth, “Advancing Services Negotiations,” in *The World Trading System: Challenges Ahead*, edited by Jeffrey J. Schott, Washington: Institute for International Economics, December 1996.

<sup>5</sup> See Mann and Knight in J. Schott, ed. *The WTO After Seattle*, Washington: Institute for International Economics 2000

<sup>6</sup> Financial services and telecommunications are covered in separate chapters of the NAFTA.

Intellectual property laws establish the rules for ownership and rules of digital content key to the development of e-commerce. Ongoing international initiatives (WIPO, FTAA, APEC, OECD) are trying to find a way to address IP issues such as rules of ownership, access to content, liability of Internet intermediaries, trademarks and domain names, database protection. One of the major challenges of the Internet for IT legislation is that the Internet is international and the scope of some IP laws is national.

As a general statement, the architects of intellectual property law are faced with balancing the need to protect intellectual property that is expensive to produce but easy to replicate, against the desire to promote competition and further innovation that builds on existing knowledge.<sup>7</sup> How have the Internet and e-commerce changed the nature of the balance between users and creators of information? First are the characteristics of information: information is an increasingly important component of the product bundle. Information, by itself, is nonrival (my use does not impede your use). Information in aggregate (databases) has externalities (value beyond just the individual data points). Second are the characteristics of replication: digital delivery of perfect copies is double-edged—sometimes desirable (database of medical knowledge underpinning an expert system)—sometimes not (perfect theft). Looking at IP law and electronic commerce through this lens, the enormous potential of electronic commerce cannot be realized without assurance that a seller's intellectual property will not be stolen, and that buyers are confident they are obtaining authentic products.

Third is the dynamic relationship between protection and innovation. Open standards and protocols and ease of entry have been key to the exceedingly rapid development of the Internet and electronic commerce thus far. Network effects mean that information and intellectual property have increasing value the more people have access to it, use it, and augment it (consider an auction site, for example). IP protection that limits the ability of firms to create interoperable software will constrain the value of the whole network, as well as keep out new firms and participants. Thus the extension of TRIPS 20-year protection to so-called business-method patents (such as Amazon One Click shopping basket) is a concern.

The NAFTA contains a very comprehensive multilateral intellectual property agreement. NAFTA's intellectual property provisions provide high legal standards for protection and enforcement of intellectual property. NAFTA's scope of intellectual property protection includes copyright, trademarks, trade secrets, and patents. In addition, NAFTA also protects semiconductors, geographical indications, satellite broadcast signals, industrial designs, and sound recordings. NAFTA's benefits are not limited to those industries whose primary goods rely on intellectual property rights protections, but rather for any company that seeks to protect its trademarks, logos, or trade secrets.

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<sup>7</sup> This section draws on pp. 117-120 in *Global Electronic Commerce: A Policy Primer*, op. cit. See also Keith Maskus, *Intellectual Property Rights in the Global Economy*, Washington: Institute for International Economics, 2000 for a comprehensive analysis of the economics of intellectual property, and empirical analysis and policy discussion.

#### **IV. A NAFTA Approach in the Making: Business Conduct, Taxation, Privacy**

In the three areas of business conduct (competition policy and consumer protection), taxation of domestic and cross-border transactions, and protection of personal information the NAFTA partners are at different stages of domestic understanding and legislation and have achieved different degrees of multilateral cooperation and consultation. But, there is a good foundation to work with. In the area of business conduct, there is a deepening relationship based on a positive comity principle. In the area of domestic taxation, there is a need to consider the implications of the Internet for tax administration; and in the area of cross-border transactions a need to develop a common set of principles. In the area of protection of personal information there are domestic developments, which have at their root practicality and flexibility, which is the basis for a multilateral understanding.

##### **1. Business Conduct: Competition Policy and Consumer Protection in a Global World**

New technologies give unprecedented access to global markets to consumers and producers accelerating world economic integration. The resulting interdependence between nations is in general beneficial for competition and for consumers as more suppliers become available to producers and consumers have a wider choice of products and more merchants to choose from. Anticompetitive practices are no exception to this trend. Some areas of new technology allow for large accumulation of market power posing new challenges for competition regulators. The scope for large-scale exploitation of consumers, anticompetitive conduct and restraints on innovation is enormous.

E-businesses are global in nature because websites can be physically located anywhere, and can be accessed by anyone. This raises a number of enforcement challenges in the aggregation and use of market power forcing cooperation between competition agencies of different countries and thus enhancing the international dimension of competition policy and protection against fraud.

Cooperation among countries becomes increasingly necessary as new technologies allow for a dramatic increase in transactions with a cross-border dimension. Products that are the expression of ideas ignore borders. Sectors like computers, software, biotechnology, pharmaceuticals, international banking and finance, or international media operate at a global level. Additionally, the volume of international trade transactions conducted over the Internet is growing rapidly. There need to be rules that both businesses and consumers can live with—otherwise e-commerce will not flourish.

##### *NAFTA, Competition Policy and Deceptive Marketing Practices*

The NAFTA accelerated the pace of integration of North American markets and is allowing businesses to operate in the three NAFTA countries as they would in the absence of national boundaries. This trend stressed the need for collaboration in competition policy matters.

Chapter 15 of the NAFTA requires the parties to maintain competition laws and cooperate in their enforcement through mutual legal assistance, notification, consultation and exchange of information. NAFTA's Chapter 15 also provides for a Working Group of competition and trade officials from the three countries to report and make recommendations regarding the relationship between competition policy and trade in NAFTA.

Cooperation between the NAFTA countries in the area of competition policy is not new. At the bilateral level Canada and the United States have been cooperating since 1959, when US and Canadian officials agreed to notify one another in antitrust matters.<sup>8</sup> Subsequent arrangements established more comprehensive cooperation procedures.<sup>9</sup> In particular, the 1995 Canada-US Agreement Regarding the Application of Competition and Deceptive Marketing Practices Laws requires the parties to notify about enforcement activities that affect the interests of the other party; to cooperate in the detection of anticompetitive activities and deceptive marketing practices; to share information and locate evidence and; to coordinate enforcement investigations of anticompetitive activities and deceptive marketing practices with transborder dimensions. Additionally, a positive comity provision allows competition officials to request the other country's authorities to investigate suspected anticompetitive activities eliminating duplicative enforcement efforts, and decreasing extraterritorial enforcement concerns.<sup>10</sup>

This agreement institutionalized consultation procedures by requiring semi-annual meetings. Increased interaction between officials on both sides of the border make communications more efficient. Requests for assistance have become part of the competition enforcement process in Canada and the United States, joint or parallel investigations as well as informal cooperation between the competition authorities have become a standard practice. As a result, competition agencies of Canada and the United States can better address anticompetitive activities with impact on the economies of both parties.

Cooperation with Mexico is more recent as Mexico's competition law was only passed in 1992. In fact, one of the main purposes of NAFTA's Chapter 15 was to accelerate and ensure the passage of a competition law in Mexico.<sup>11</sup> In 2000, Mexico and the United States signed a competition policy cooperation agreement.<sup>12</sup> This agreement is similar to the Canada-US accord discussed above but does not include deceptive marketing practices. Given the short history of Mexican competition policy technical

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<sup>8</sup> This informal notification and consultation arrangement is known as the Fulton-Rogers Agreement.

<sup>9</sup> The 1985 Canada-US Treaty on Mutual Legal Assistance in Criminal Matters provided specific mechanisms, like search warrants or orders for oral examination, to assist investigations. The 1995 Canada-U.S. Agreement Regarding the Application of Competition and Deceptive Marketing Practices Laws

<sup>10</sup> See Valentine, Debra. "Cross Border Canada/U.S. Cooperation in Investigations and Enforcement Actions" in *The Canada-United States Law Journal*, 2000. "The Management and Resolution of Cross Border Disputes as Canada/U.S. enter the 21<sup>st</sup> Century". Case Western University. Cleveland. Vol.26:271:297

<sup>11</sup> Lloyd, P. J. and Vautier, K.M., 1999. *Promoting Competition in Global Markets*. Massachusetts: Edward Elgar Publishing, Inc.

<sup>12</sup> Agreement between the Government of the United States of America and the Government of the United Mexican States regarding the application of their competition laws.

assistance from the United States and Canada is a key part of the cooperation activities as Canadian and US enforcement officials are actively involved in the training of Mexican investigators.

Examples of the NAFTA type of cooperation can be found both in the fight against fraud and in antitrust investigations. The “Consumer Sentinel Database,” for instance, is used by both Canadian and US officials to fight Internet fraud. Law enforcement agencies in Canada and the United States have access to this consumer complaints database facilitating the identification of fraud schemes. This database is rapidly growing; Internet-related complaints increased from 1 percent of all complaints in 1996 to 22 percent in 1999 (in 1999 there were 18,622 internet related complaints, more than half of these complaints were about Internet auctions).

Another example of cooperation is the Free Trade Commission’s “international Internet surf days” initiative that promotes voluntary compliance. On these dates, enforcement agencies look for a particular scam and warn those who are breaking the law. On average 20-70 percent of web operators receiving warnings come into compliance with the law (taking down sites or modifying their claims).

At the international level, a recent cooperative initiative regarding consumer protection resulted in the creation of a web site that provides information in four languages on consumer protection legislation in the 13 participating countries (Canada, Mexico and the US among them) and allows for the filing of complaints. Although, a useful tool for exchange of information, this mechanism does not provide for further cooperation between enforcement agencies.

### *Towards a NAFTA Understanding on Business Conduct*

The existence of positive comity agreements eases extraterritorial problems. However, positive comity agreements are unlikely to provide a solution for e-commerce since geographic location of Internet transactions is difficult to establish. This approach might be an option in the future once international standards on permanent establishment, transaction and jurisdiction are established.

NAFTA-type cooperation does not necessarily lead to harmonized competition and antifraud enforcement procedures in Canada, Mexico, and the United States. The text of the agreement does not include any formal commitment on policy harmonization and national enforcement agencies are ultimately responsible for implementing their different statutes and serve their particular goals. However, to a certain extent there has been an informal convergence derived from the increased exchange between enforcement officials. Because there is no dispute settlement procedure relating to competition law matters, any disagreement between members has to be resolved through cooperation.<sup>13</sup>

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<sup>13</sup> Competition Policy in a Global Economy --Today And Tomorrow, speech by Robert Pitofsky, November 4, 1998. At <http://www.ftc.gov/speeches/pitofsky/global.htm>

With the borders becoming increasingly irrelevant in the North American context there will be a need for more intense cooperation and eventually a tripartite enforcement agency might be the most effective means of implementing competition and consumer protection laws.

In very concrete terms, national laws continue to limit information sharing, giving the impression of less cooperation between Canada and the US than between the European Union and the United States. In Canada, Article 29 hampers information sharing with US law enforcers. Similarly, US legislation prohibits the FTC from disclosing information obtained by compulsory process. Changes in the law or harmonization of interpretations of these laws could improve enforcement without harming confidentiality. Canada and the United States have comparable consumer and confidentiality laws that would facilitate this process. Integrating Mexico might be more of a challenge. US legislation regarding information sharing in competition cases states that the United States can enter into an agreement with another competition agency if it provides a level of confidentiality protection equivalent to the United States and if they have a comparable competition law.

## 2. Internet Transactions and Tax Regimes

Tax administration, to a greater or lesser degree, require knowing the “who, what, and where” of the transaction. Policymakers are concerned about the potential erosion of their tax revenue<sup>14</sup> and businesses want to know their tax liability so the focus has been on administrating *existing* taxes in the changing environment.<sup>15</sup> However, e-commerce and the Internet blur the “who, what, and where” of transactions. Therefore, tax policymakers should also be asking, “How should tax regimes evolve in the face of the Internet?”

### *Taxes and Tax Systems In The NAFTA Partners*

The three NAFTA partners differ in their dependence on direct and indirect taxes for government revenues, in the administrative complexity of the systems, and on the degree of compliance (see table 1). Only the United States has directly considered the impact of Internet transactions on its tax system. And none of the countries has considered the international implications of Internet transactions on taxes. Progress internally is necessary for each. With respect to cross-border transactions, whereas

<sup>14</sup> Efforts to measure the potential loss of tax revenue are difficult because of dynamic response. For the US, Austan Goolsbee and John Zittrain, “Evaluating the Costs and Benefits of Taxing Internet Commerce,” *National Tax Journal*, vol. 52 no. 3, September 1999, pp 413-428 calculate a loss over the next few years of less than 2 percent of sales tax revenues. For the full range of countries around the world, Susan Teltscher, “Revenue Implications of Electronic Commerce: Issues of Interest to Developing Countries,” mimeo, UNCTAD, April 2000, also finds loss of tax revenues of less than 1 percent overall, although the figure is higher for some countries.

<sup>15</sup> See *International Tax Review*, September 1999, for a review of how the following countries and regions are addressing interpreting existing tax law for electronic commerce: Australia and New Zealand, Canada, Germany, India, Ireland, Israel, Japan, Latin America, the Netherlands, Singapore, South Africa, United Kingdom. See also the June 2001 OECD organized conference, “Tax Administration in a Networked World,” <http://www.ae-tax.ca>

bilateral tax arrangements exist, the NAFTA partners should work on a NAFTA-basis agreement for apportioning taxes earned on cross-border sales and on income earned.

In the US states, the federal government raises 60 percent of its revenues from individual income taxes and about 10 percent from corporate income taxes; there is no federal sales or value-added tax. States, on average, raise 25 percent of revenues from sales taxes, 20 percent from property taxes, 15 percent from individual income taxes, and the rest is raised through miscellaneous tax and user charges. For the state sales taxes, the final user (usually at the retail level) pays the taxes, which are applied principally on tangible property (with exceptions) and usually not on services. Business inputs generally are exempt from tax. The administrative burden of the sales tax system comes principally from the 30,000 different tax rates applicable depending on location. Tax ignorance, as opposed to tax avoidance or evasion, is a real issue.

Like the United States, most of Canada's federal tax revenue comes from income taxes. But there is a federal level consumption tax that accounts for somewhat less than 20 percent of revenue. This Goods and Services Tax (GST) of 7 percent is collected on the sale of most goods and services in Canada, is levied on all taxable imports, but is zero on exports. Basic groceries, agricultural products, prescription drugs and medical devices have a zero-rate GST. Also exempted are health and medical services, tolls, education, and financial services. Foreign-based organizations providing services in Canada must register for the GST in order to claim input tax credits. This federal set of taxes is augmented at the provincial level, with the Provincial Sales Tax (PST) that varies by province and is only payable on imports that are not for resale. Several provinces have an agreement with the federal government to combine the GST and the PST, so the resulting Harmonized Sales Tax (HST) is a 15 percent flat rate.<sup>16</sup>

Whereas in the structure of its tax revenue Mexico appears rather similar to the United States and Canada, the success of its tax administration effort is quite different. At the federal level, 40 percent of total tax is raised through income taxes. Like Canada, Mexico has a federal indirect tax, which accounts for 30 percent of total tax revenues. This value-added-tax of 15 percent is applied to all sales of goods and services but with broad and many special exemptions: food and drugs have a zero rate, the border-regions have a tax rate of only 10 percent, and there are exemptions for entire sectors—land transportation, agriculture and fishing.<sup>17</sup> Thus, the key difference for Mexico is apparently low administrative compliance: Mexico's federal value-added tax revenues amounted to 3.3 percent of GDP; and the income tax only 4.6 percent of GDP. Thus, with

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<sup>16</sup> The HST applies to Nova Scotia, New Brunswick, and Newfoundland.

<sup>17</sup> Exemptions for goods transactions include sales of land; residence buildings, not hotels; construction materials; books; magazines; certain authors copy rights; currency; shares; credit instruments; sales by nonprofits, farmer groups, labor unions, or government agencies. Exemptions for rendered services: services from state and local government, social security institutions, official education, insurance, banking, public entertainment, medical services, public transportation by land, except train. Imports are subject to the same VAT (the taxable value of tangible goods is the value declared for import duties plus the duties). Exports: zero rate of VAT. This provides an incentive for exporters since they have the right to the refund VAT charged by others on supplies and services used in the production of exports. Zero-rate goods include food, water, patent medicines, farm equipment and chemicals. International freight and international air passenger service are among the zero rate services.

a tax to GDP ratio of just 11.5 percent in 1999 Mexico is well below the average ratio for OECD countries (28 percent).<sup>18</sup>

Recognizing both the complexity and compliance issues, President Fox on April 3, 2001 sent to Congress his fiscal reform initiatives. In order to broaden the tax base he proposed changes on the VAT eliminating exemptions and the zero rate (although as is common with VAT systems, the zero percent rate would still apply for exports). Additionally, tax payments will be carried out when the disbursement takes place not the sale.<sup>19</sup>

Only the United States has explicitly considered the impact of Internet transactions on its tax system. In the United States, when the Congress passed the Internet Tax Freedom Act in 1998 (which kept domestic Internet transactions free from any “new” taxes for three years but did not revoke existing sales or use taxes), it mandated review of the implications of electronic commerce for domestic sales taxes. A majority of members of this Gilmore Commission opined<sup>20</sup> that digital products downloaded over the Internet (including software, books, or music) should not be taxed and that, in the interests of tax neutrality, their tangible equivalents also would be tax exempt. Since services to the final consumer often are not taxed in the United States, this strategy apparently would classify digital products as services and would “harmonize down” the tax treatment of their tangible equivalent.

One objective of the Commission’s proposal was to encourage states and localities to harmonize their own rates and reduce the myriad state and local taxes (some 30,000), which are both administratively cumbersome and encourage tax-strategizing behavior. The National Governors Association is examining how to simplify sales and use taxes so as to apply computer technologies to tax administration, although not all states are participating in this study effort.<sup>21</sup> Any implications at the international level were not addressed, since the Commission did not have the mandate to address cross-border issues.

#### *How Do Internet Transactions Stress These Tax Regimes?*<sup>22</sup>

There are two main forms of raising tax revenues: direct and indirect tax regimes. The Internet challenges them both, but in different ways. For indirect taxes, the issue is how to apply sales and value-added taxes when tax treatment of goods and services differs, where transmission is via electronic channels, and when transactions cross borders. For direct taxes the issues are how e-commerce activities should be treated and income apportioned under the rules of permanent establishment, as well as the equity of taxing capital vs. labor earnings.

<sup>18</sup> See OECD Economic Surveys. Mexico, 2000, No. 13. OECD, July 2000

<sup>19</sup> Secretaria de Hacienda y Credito Publico at <http://www.shcp.gob.mx>

<sup>20</sup> The Commission could not formally recommend a plan of action to Congress, because no supermajority view was reached.

<sup>21</sup> See Streamlined Sales Tax project [http://www.nga.org/nga/newsRoom/1,1169,C\\_PRESS\\_RELEASE^D\\_1067,00.html](http://www.nga.org/nga/newsRoom/1,1169,C_PRESS_RELEASE^D_1067,00.html) December 22, 2000.

<sup>22</sup> For a more extensive treatment of this issue see Chapter 6 in *Global Electronic Commerce: A Policy Primer*, Institute for International Economics: Washington, July 2000 by Mann, Eckert, and Knight.

The indirect tax system used to be simple to administer and audit—thus its popularity. As is clear from the discussion of NAFTA taxes, indirect taxes have tended to become situation-specific (rather than broad-based) as policymakers try to target specific transactions or users. Moreover, the Internet fuzzes the “who, what, and where” of the transaction, which makes such targeting more difficult. In particular, since cross-border transactions are growing quickly tax authorities do not have the luxury of considering the domestic environment in isolation.

All told, inconsistencies in the indirect tax system increasingly will lead to tax-strategizing business and consumer behavior—both within and across borders. Thus, despite the trend toward increased prevalence of the GST or VAT in recent years, the pressures of the Internet environment will force countries to re-evaluate their dependence on this regime.

For direct taxes, the key issues are international apportionment of income earned on these transactions. A mixing-and-matching of the two ways to account for business income earned in a cross-border—source-based and residence-based—will subject some income to double taxation.<sup>23</sup> Consequently, bilateral and multilateral tax treaties attempt to allocate income earned to the source and to the residence according to “permanent establishment” and give tax credits to minimize double-taxation.<sup>24</sup>

Permanent establishment in the context of the Internet is an evolving concept. The Internet facilitates new corporate relationships (partnerships, strategic alliances), new types of intermediaries (application service providers), virtual communities (B2B exchanges), and a host of new business models (auctions, reverse auctions). Where profits will be taxed will become an important issue since firms (particularly dot-coms) can easily relocate to jurisdictions where tax laws are more beneficial. Consequently, the allocation of income to different governmental jurisdictions will be increasingly difficult. The threat of double taxation increases, along with the incentives for noncompliance. The pressure will be to reduce capital income tax rates.

These observations lead us to examine the third significant source for raising tax revenues: individual income. Among the sources of income to tax, individual income probably remains the least affected by the Internet and electronic commerce. Labor, by and large, remains within the same political jurisdiction as the tax authority—which

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<sup>23</sup> As a general statement, income earned by US firms and individuals is taxed at US rates regardless of where the income was earned—so-called “residence” based taxation. Other countries, particularly developing countries, tax income earned by non-resident firms operating in the country—so-called “source” based taxation. See Ned Maguire, “Taxation of E-commerce: An Overview,” *International Tax Review*, pp 3-12.

<sup>24</sup> See The OECD Model Tax Convention, which is a blueprint that many countries have used as a framework for bilateral tax treaties. It apportions tax responsibility and revenue so as to avoid double taxation of income earned through foreign investment. An overview is available at <http://www.oecd.org/daf/fa/treaties/treaty.htm>. See also: [http://www.oecd.org/daf/fa/material/mat\\_07.htm#material\\_Model](http://www.oecd.org/daf/fa/material/mat_07.htm#material_Model) for the most recent information on the articles of the model convention.

supports the notion of taxation *with* representation.<sup>25</sup> Firms keep close track of how much they pay workers, even in the Internet markets; so, labor income can be taxed by the government authority so long as reporting, audit, or declaration is adhered to by the firm. Then, the tax revenue can be apportioned to countries depending on where the value was added. From an administrative standpoint, taxing individual income represents the fewest number of transactions to trace, probably the most carefully documented set of transactions, and the factor of production least prone (or allowed) to move in response to tax differences—exactly the recipe for an efficient tax regime.<sup>26</sup>

### *Towards a NAFTA Tax Agreement*

Right now, there is no NAFTA agreement on tax issues; rather these issues are addressed in a bilateral manner. Canada and the US have had an income tax treaty since the 1980s. Changes to the treaty were proposed in September 2000 to clarify the issue of residence status of corporations and avoid double taxation. Mexico and the United States signed an income tax treaty in September 1992 to avoid double taxation on income and provide limits on the taxation at the source of royalties, dividends and interest.<sup>27</sup> With respect to taxation of Internet transactions, there are no explicit North American bilateral or multilateral agreements, but there is ample cooperation and discussion among customs and tax officials in the three countries.<sup>28</sup>

The NAFTA partners should move beyond cooperation and discussion to create an explicit trilateral tax agreement. Each country will be able to maintain a system based on a combination of direct and indirect taxes that will meet their redistributive preferences, although the pressure will increase to focus taxation on the bigger targets (income not transactions) and at the ultimate source of value (people not firms). The foundation for tax apportionment among the member countries already exists in the rules of origin agreements, in the customs and tariff preferences and drawback procedures. Achieving a trilateral tax agreement will deepen the integration of NAFTA by raising tax efficiency even as each of the partners retains the individual flavor of its relationship between government and citizenry.

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<sup>25</sup> This is not to say that labor cannot move; but it is relatively less mobile than firms, particularly at the margin of electronic commerce.

<sup>26</sup> The questions of fairness inevitably arises when labor income is taxed relatively more than capital income and evasion of labor and capital income taxation is one reason for choosing the VAT or GST systems. Moreover, tax systems often are used to redistribute income across geography as well as class. These issues remain. But the reduced ability to tax value-added, transactions, or corporations raises the stakes on finding appropriate answers and charting a course towards changing tax regimes to reflect the realities of the global and networked production-space and marketplace.

<sup>27</sup> See <http://www.mac.doc.gov/nafta/8504.htm> (4/11/01)

<sup>28</sup> At a conference in Washington DC on April 30, 2001, the Mexican Finance Minister confirmed that there is ample cooperation between Mexican and US officials but that such cooperation has been more difficult lately given the change in US Administration and the delays in Treasury Department appointments.

### 3. The Internet and Personal Information

Data collection on the Internet is pervasive and valuable. Electronic commerce “cookies” and “bugs” track, collect, and compile personal information, which allow the creation and combination of data banks of specific information and preferences. Yet clearly there is a tension between collectors of information (firms as information aggregators) and providers of information (individual business or consumers). Moreover, there is a spectrum of businesses, consumers, and information, meaning that the tension between users and providers of information is multi-dimensional and dynamic.

Is there a role for policy intervention to modulate this tension between the individuals who want to protect their personal information and those who would use it to create new products and services? Are policymakers in the NAFTA countries weighting the various parties the same way and choosing the same approach to intervention? Not only is the balancing act difficult, but different governments see their role (and citizens see their government’s role) in the balancing act differently.

#### Treatment of personal information by the NAFTA partners

The US privacy landscape appears wild and unruly—unlike that of the rest of the world. Most countries that protect privacy through national regulation, including Canada and Mexico, have opted for comprehensive data protection laws. These laws establish government data protection agencies, require registration of databases, and call for institutions to seek consent before processing personal data. However, the NAFTA partners may be more similar than appears. The manner in which the government agencies implement and enforce the environment has yielded a similarity in outcomes, which bodes well for achieving a clearly stated set of principles and approach for NAFTA as a whole.

The US approach to protecting personal information relies on a mix of legislation, self-regulation, and regulatory enforcement. In terms of legislation, there are around 600 federal and state laws addressing the confidentiality of personal information within the US. These laws take the form of sectoral protections (such as for financial information) that, when combined with self-regulatory provisions and case law, loosely cover American citizens' bank records, cable television subscriptions, children's online activities, credit reports, video rental records, library loans, medical records, tax records, and telephone services.<sup>29</sup> And the number of privacy laws is increasing. In 2000, US state legislatures debated approximately 4,000 legislative privacy proposals, resulting in over 300 new laws. Furthermore, two federal laws were passed that include privacy protections for financial and medical information and omnibus privacy legislation was considered by the 2001 US Congress.<sup>30</sup>

<sup>29</sup> Also, there is specific legislation to restrict certain practices such as unauthorized use of IDs and passwords—more a fraud issue than a privacy issue.

<sup>30</sup> See Alexander Fowler at <http://www.aaas.org/spp/dspp/sfrr/per/per24.htm>

A hallmark of the US approach is that innovation and self-regulatory commitments are backed-up by oversight and enforcement. Innovative approaches to protecting information in a way that the user controls are emanating from both individual firms and standards groups. Widely available and inexpensive software programs such as Junkbusters and Anonymizer permit users to block sites from sending cookies. The Platform for Privacy Preferences<sup>31</sup> is browser-embedded software that will allow users specify the types of information they are willing to divulge, as well as whether such information can be shared with third parties.

In terms of self-regulation, organizations such as BBBOnline and TRUSTe provide guidelines as well as an enforcement mechanism through the use of Web-site privacy seals. Such seals are awarded to companies meeting specific standards, such as a satisfactory complaint record, and the posting of privacy policies that meet the standards of notice, disclosure, choice, consent, and security. Codes of conduct, such as BBBOnline's Code of Online Business Practices and BBBOnline Privacy Programs provide merchants with guidelines to implement and abide by.

These self-regulatory efforts are being backed-up by oversight and enforcement both by private sector interest groups (e.g. Electronic Privacy Information Center, EPIC) and by government agencies. The Federal Trade Commission (FTC) has considered several cases (e.g., DoubleClick/Abacus, eToys, Amazon, and others) where questionable data protection practices have emerged. In some cases, the onslaught of publicity by privacy groups or just the threat of FTC consideration has changed the behavior of firms; but not always.

In Canada, personal information is protected by both federal legislation and provincial and territorial legislation. For some time now, privacy legislation at the provincial level<sup>32</sup> has covered the collection, use and disclosure of personal information held by *government* agencies. Since 1994, comprehensive privacy legislation in Quebec has also covered personal information in the provincially regulated *private* sector. The legislation provides Canadians with a general right to access and correct their personal information and provide oversight through an independent commissioner authorized to receive and investigate complaints.

Comprehensive privacy legislation was passed in April 2000. Bill C-6 (Personal Information and Electronic Documents Act) lists 10 principles for fair information practices (accountability; identifying purposes; consent; limiting collection; limiting use, disclosure and retention; accuracy; safeguards; openness; individual access and; challenging compliance). The Act states that any covered organization must obtain an individual's consent to collect, use, or disclose any collected personal information. Individuals have a right to access the information held on them by organizations, challenge its accuracy and request it be held private. Personal information includes name,

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<sup>31</sup> P3P developed by the World Wide Web Consortium—W3C—an international academic and industry body devoted to applications, engineering-standard setting and research.

<sup>32</sup> Except PEI and Newfoundland.

age, opinions, evaluations, comments, "intentions," dispute records (such as complaints to a business) and loan or credit records. The Act will enter into force in three stages.<sup>33</sup>

The first two phases cover federal transactions. In January 2001, the Act will apply to personal information about customers or employees (except "personal health information," which will be covered from January 2002<sup>34</sup>) that is collected, used or disclosed by "federal works, undertakings or businesses" in the course of commercial activities. Federal works, undertakings and businesses include organizations such as the banks, telephone companies, cable television and broadcasting companies, firms engaged in interprovincial transportation, and air carriers. The Act will also apply to personal information that is shared or disclosed for profit or any kind of benefit across the borders of Canada or a province, where the information itself is the subject of the transaction.<sup>35</sup>

By January 2004, the law will cover the collection, use or disclosure of personal information in the course of any *commercial* activity within a province, including provincially regulated enterprises such as retail stores. The Act will apply to all personal information in all interprovincial and international transactions by all organizations in the course of their commercial activities. The federal government may exempt organizations and/or activities in provinces that have their own privacy laws that are substantially similar to the federal law.<sup>36</sup>

The Bill does not require companies to obtain explicit consent: "consent can be either express or implied".<sup>37</sup> It does not apply when organizations use personal information for journalistic, artistic and literary purposes, or personal and domestic purposes. Bill C-6 does not define what constitutes "sensitive data" nor does it prohibit the collection of such data. The Act also lists several specific situations where personal information (including data that can be considered sensitive in Europe) may be collected,

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<sup>33</sup> This section with information from [http://www.privcom.gc.ca/information/guide\\_e.asp?V=print](http://www.privcom.gc.ca/information/guide_e.asp?V=print)  
<http://www.privcom.gc.ca/legislation> <http://www.e-com.ic.gc.ca/english/privacy/632d30.html>

<sup>34</sup> Health Canada is coordinating a federal/provincial/territorial working group, the Protection of Personal Health Information Working Group, to develop a Harmonization Resolution for the treatment of personal health information in Canada. While not legally binding, this resolution would set voluntary principles for the protection of personal health information across Canada in the public and private sector. Some Canadian jurisdictions already have legislation to deal specifically with the collection, use and disclosure of personal health information by provincial health care organizations and other approved individuals and agencies. (Alberta, Ontario, Saskatchewan, and Manitoba have such legislation. To date, only Manitoba's Personal Health Information Act is in force.)

<sup>35</sup> Additionally it will cover all businesses and organizations engaged in commercial activity in Yukon, the Northwest Territories, and Nunavut.

<sup>36</sup> There are other laws that contain provisions to protect privacy of Canadians. The federal Bank Act regulates the use and disclosure of personal financial information by federally regulated financial institutions. Similarly, provincial statutes regulate the activities of financial institutions, such as credit unions and insurance companies. Additionally, consumer protection laws at federal and provincial levels offer limited protections and remedies against illegal and unethical business practices that may constitute an infringement of privacy.

<sup>37</sup> See Canada's Privacy Commissioner "Guide for Businesses and Organizations to Canada's Personal Information Protection and Electronic Documents Act" page 5, at [http://www.privcom.gc.ca/information/guide\\_e.asp?V=Print](http://www.privcom.gc.ca/information/guide_e.asp?V=Print)

used or disclosed without the knowledge or consent of the individual. There is no prohibition on the collection of sensitive data. However, it requires organizations to take into account the sensitivity of the information in determining the form of the consent sought for its collection, and recommends that an organization “should” generally seek express consent when the information is likely to be considered sensitive. It does require that more sensitive information be safeguarded by a higher level of protection.

Industry Canada is the guardian of the interpretation of the legislation. Use and disclosure of personal information without the knowledge or consent of the individual is regulated by Industry Canada which limits the secondary uses of the data and provides sufficient and adequate safeguards for this type of data.<sup>38</sup>

Mexico has not yet passed any comprehensive new legislation regarding privacy issues but has amended existing regulations to address the challenges of information sharing on the Internet. A new chapter in the Mexican Consumer Protection Law (Ley Federal de Protección al Consumidor) includes provisions for transactions made through electronic media, optic media or other new technologies. The provisions address the issue of confidentiality of information provided by consumers.

Suppliers of services must: Use information provided by consumers in strict confidence. Transmit such information to third parties only with explicit authorization of consumer or by legal order. Use appropriate technology to ensure safety of consumer information. Provide the consumer with information about where and how to make a claim or find additional information on a product. Avoid commercial practices that could mislead or confuse consumers about the goods/services offered. Provide necessary warnings of unsuitable content for vulnerable population groups (children, elderly and sick people).<sup>39</sup>

With respect to government activities, the Mexican Penal Code protects against the disclosure of personal information held by government agencies. The law prohibits electronic surveillance in cases of electoral, civil, commercial, labor, or administrative matters and expands protection against unauthorized surveillance to cover all private means of communications, not merely telephone calls. Additionally, messages sent by Internet have the same protection in Mexico than communications sent by mail. Furthermore, Mexican Constitution and Federal Criminal Law punish with 3 to 180 labor community journeys the unauthorized opening of correspondence and any other kind of writing materials.

*Economic Theory as a Guide to Policy to Protect Personal Information*<sup>40</sup>

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<sup>38</sup> See “The adequacy of the Canadian Personal Information and Electronics Documents Act,” [http://www.europa.eu.int/comm/internal\\_market/en/media/dataprot/wpdocs/index.htm](http://www.europa.eu.int/comm/internal_market/en/media/dataprot/wpdocs/index.htm)

<sup>39</sup> See <http://www.natlaw.com/e-commerce/docs/e-commerce-initiative-mexico.htm>(4/23/01)

<sup>40</sup> For a more extensive discussion of the economics of protecting personal information, see pp 37-41 in *Global Electronic Commerce: A Policy Primer*, op cit and (Rome and Georgetown papers—citations).

The flow of information is important for economic development and key for an efficient functioning of some sectors of the economy. Information flows have greatly increased in recent years and will grow further with the spread of the Internet. While posing new regulatory challenges and opening new opportunities for abuse, electronic exchanges of information present a unique opportunity for economic growth and integration. As new national, regional, and local regulations are developed to address the challenges posed by the Internet, conflicting regulation could impose restrictions on data exchanges reducing the potential benefits of the new technologies and causing disruption in important sectors of the economy.

There are two approaches that policymakers can take to try to achieve the proper balance of rights and make sure that the spillover inherent in the collection of information is internalized by the information aggregators. Policymakers can mandate a comprehensive approach for how information aggregators will treat data. Or, they can focus on creating incentives for innovative effort so that aggregators improve the range of choices on whether and how data are collected, compiled, and cross-referenced. Which better balances the benefits of aggregation of personal information with individual preferences for restrictions?

The economic theory of the second best shows that the market and mandate solutions cannot be ranked as to which one comes closer to achieving the highest levels of economic well-being for a *country* as a whole. And in neither case are all *individual* demands met. On the one hand, because there are many users and few aggregators, the market approach is likely to yield an incomplete set of information-use policies. So, the privacy preferences of each unique user may not be met. On the other hand, the rules-oriented solution is a sort of “one-size-fits-all” policy that assumes that each person or business has the same preference over revealing information as is spelled out in the rule. Because people and businesses are not all alike in their attitudes toward privacy, some specific preferences will not be met.

In either case, the network benefits of the Internet will be lost—in the first case because of fear of losing personal information and in the second case because of insufficient personalization. But, it is tough to measure which approach will result in the greater number of unhappy users and so we can’t rank the alternative policies in terms of their impact on efficiency or society’s well-being.

So, what is the difference between the market-oriented versus the rules-oriented approaches? Under the market approach, firms continue to face incentives to try to satisfy individuals’ privacy demands, particularly if those demands are effectively communicated to the aggregators and are backed by government enforcement. The incentives come in part from the very network benefits that are being lost if the privacy policy is insufficient and users defect. In contrast under the mandate approach, the private sector has fewer incentives to innovate to resolve market imperfections (since there are common rules for all to follow) and the enforcement issues remain. In such a technologically dynamic environment, retaining the incentive for private sector response is crucial. This calls into question a strict rules-based environment.

### *Toward A NAFTA Framework for Data Protection*

The challenge of international privacy legislation is to protect information from misuse while allowing international flows of data. The NAFTA partners appear to be taking very different approaches to regulating privacy: Canada has opted for new comprehensive legislation while the US relies heavily on self-regulation. Mexico is struggling with basic protections, but the wording of its new law is quite strict.

How different are these approaches in fact? A key observation is that Canadian legislation, while comprehensive, is actually quite open to the self-regulatory/agency enforcement model currently being followed by the United States. The language on “explicit consent” and role for Industry Canada puts Canadian practice into the model of self-regulation backed-up by private sector and federal agency enforcement. Mexico’s strict language notwithstanding, the three countries, in fact, are not that far apart in practice.

Moreover, while there is not a common NAFTA approach yet, there are regular contacts between the regulating authorities of the three countries, furthering the consultative and practical ties that will form the foundation for a NAFTA framework for the protection of personal data. In the end, the increasing economic integration in North America will be the market incentive that will lead to a set of privacy solutions to meet the needs of the differing populations.

What will the NAFTA privacy framework look like? It will keep the national legislation as is. But the private sector will have the incentives to continue to innovate privacy solutions to meet the needs of the differing populations in the NAFTA marketplace. This market-driven set of innovations will need to be backed-up by federal enforcement by Industry Canada, the FTC, and their Mexican counterpart. These three agencies will need to work more closely together to create a common environment of oversight and enforcement.

One model for this arrangement is the positive comity agreements. When more than one country has the authority to investigate, a positive comity referral makes sure the officials closest to the problem take charge avoiding duplicative efforts. Canada and the US have advanced cooperation schemes in competition law, each country has its laws but they are compatible enough to allow for coordination of procedures.

### **V. Conclusion: A NAFTA Approach? Yes. A Global Model? Probably Not.**

Business conduct, tax regimes and personal information are areas where there are potential conflicts between national jurisdiction of policy and the economics of the Internet marketplace. Policymakers must recognize the demands of their constituents (the voters). But in this fast-paced technologically dynamic environment they must avoid predetermining solutions or codifying exclusionary rules. The key is to create incentives for the private sector to help manage the differences between individuals and businesses

and the problems of cross-border jurisdictional overlap. Because the private sector reaps the rewards from network benefits as well as niche markets, it will seek interoperable approaches to solve the problems of spillovers and jurisdictional overlap. Interoperable policies allow national policies to reflect differences in national attitudes yet also allow the network benefits of the global marketplace to shine through. Imposing tight rules and mandates runs the risk of locking in sub-optimal and non-interoperable solutions. *However, to make sure that the market works towards these goals, policymakers along with private sector representatives must backstop private sector efforts with oversight and enforcement.*

In all three countries new regulations are being developed to deal with the new economic reality of the Internet. Because of the economic integration and the NAFTA institutional structure, there is substantial on-going interchange between businesses and between government personnel. As a result, domestic legislation while not homogeneous it is not confrontational. Right now, problems arising from differences are addressed through bilateral agreements, cooperation arrangements and other forms of informal cooperation such as information sharing, discussions, technical assistance and training. The three countries should build on these working relationships to create a NAFTA Tax Agreement, a NAFTA Framework for Information Protection, and a North American Understanding on Business Conduct.

NAFTA procedural cooperation would not necessarily lead to common rules or harmonized procedures. Countries have different histories and cultures, enforce different statutes, seek different welfare goals, and respond to concerns that reflect different levels of economic development. The North American approach comes less from negotiated agreements, and more from sustained informal interaction, from a daily exchange of information. North American researchers, government officials and private citizens meet frequently and exchange ideas. Growing economic integration has increased the interaction between public servants and private businesspeople of the three countries in all sectors and at all levels. Government officials have come to know personally their North American counterparts and email and phone contacts have become a routine means for consultation that in time translate into more uniform interpretation of the situation and therefore of the appropriate response.

This “North American model” at a minimum, allows the NAFTA countries to benefit from each other’s experience with different policy approaches and permits the adoption of those proven to be more successful while adapting them to fit existing legislation and particular domestic situations. The greatest advantage of the North American approach is its flexibility. If a particular line of action is unsuccessful or impractical it can be easily changed. Even among the NAFTA partners, a detailed set of international agreement would be more difficult to attain given the different cultures, country histories and legislative processes.

Can this NAFTA model be “exported” to the rest of the world? Canada and the United States closely resemble each other in their economic systems and living standards, although they differ substantially in terms of how citizens perceive the role of the

government. Mexico differs both politically and economically. *How these countries are more similar than it might appear at first blush is in their attitudes toward the role for the private sector as leader, and government and advocacy sectors as back-stopper. And, they are similar in their practicality and flexibility rather than advocacy of strict rules.*

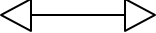
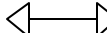
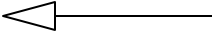
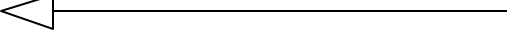
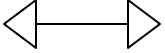
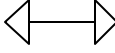
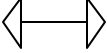
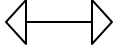
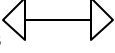
The key issue for whether a NAFTA Tax Agreement, a NAFTA Framework for Information Protection, or a NAFTA Understanding on Business Conduct are exportable is not economic integration, level of development, or “trust” in government, but rather whether there is workable respect to achieve common goals in the relationship between private and public sectors.

**Table 1. Taxation in NAFTA**

	<b>Canada</b>	<b>Mexico</b>	<b>United States</b>
Total Tax Receipts (% GDP)	37.4	16.0	28.9
Tax Structure (% Total Tax)			
Personal Income Tax	37.8	n.a.	40.5
Corporate Income Tax	10.5	n.a.	9.0
Taxes in Goods and Services	24.7	51.3	16.2
Other Taxes	13.6	n.a.	11.9
Tax Rates			
Personal Income Tax	46.0	40.0	45.6
Corporate Income Tax	46.1	35.0	39.5
Taxes in Goods and Services			
Federal	7%	10-15% <sup>a</sup>	None
State/Province	None to 10%	None	None to 7%

Sources: Revenue Statistics, 1965-1998, OECD. US Federation of tax Administrations at <http://www.taxadmin.org/fta/rate/sales.html>. Revenue Canada. Hacienda Publica Mexico. Notes: a. The 10 percent VAT in Mexico applies to the border states.

Table 2: Overview of NAFTA Partners

	Mexico	United States	Canada
<b>Legislation</b>	Mostly Federal	Sectoral Self regulation	Federal Provincial Self regulation
<b>Taxation</b>	VAT at the Federal level	State sales tax	Federal and Provincial GST
<b>Oversight agencies and enforcement</b>	Procuraduria Federal del Consumidor Instituto Nacional del Consumidor (consumer protection)	Free Trade Commission Department of Justice Internet Fraud complaint center (FBI) (antitrust, internet fraud)	Privacy Commissioners Consumer Affairs Canadian Competition Bureau
<b>Private sector oversight</b>		Truste BBBonline	BBBonline
<b>Cooperation Initiatives</b>			
<b>Tax treaties</b>	1992 Income tax treaty (amended 2000)		 1980 Income tax treaty (amended 1983, 84, 96, 97)
<b>Technical assistance</b>		 	
<b>Cooperation Initiatives</b>			
Competition Deceptive Marketing	2000 Agreement on Competition laws		 1995 Agreement on Competition and Deceptive Marketing Laws
Consumer protection			 Consumer Sentinel Database
	<a href="http://www.econsumer.gov/">http://www.econsumer.gov/</a>	<a href="http://www.econsumer.gov/">http://www.econsumer.gov/</a>	<a href="http://www.econsumer.gov/">http://www.econsumer.gov/</a>
<b>Informal cooperation</b>		 Consultations. Meetings. Conferences Rutine contacts between government officials	
<b>Participation in International Forums</b>	APEC FTAA OECD WTO	APEC FTAA OECD WTO	APEC FTAA OECD WTO