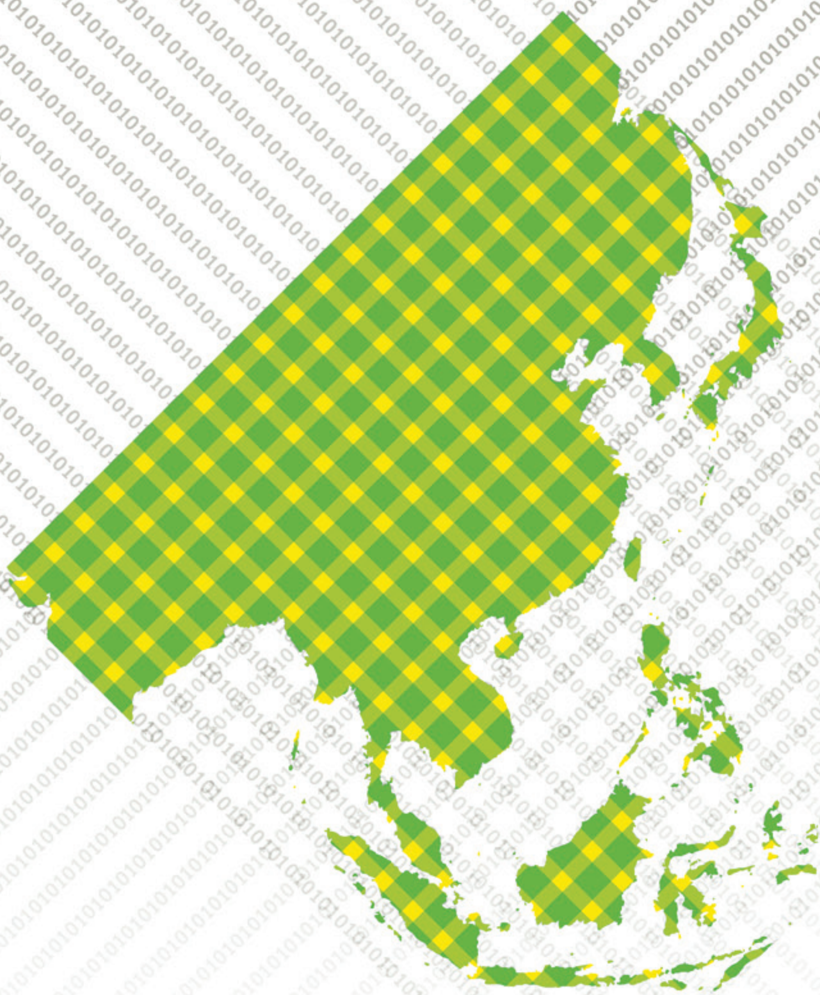
The Economist Intelligence Unit

Growing together?

Free trade and Asia's technology sector

An Economist Intelligence Unit report



Sponsored by

HSBC

Contents

Executive Summary 2

About the research 4

Introduction: The road often not taken 5

Chapter 1: Tangible benefits 7

Case study: TMA Solutions: Joining the club 10

Chapter 2: The struggle for knowledge 11

Case study: Sterlite Technologies: A trade lesson learned 15

Chapter 3: The wrong kind of free trade? 16

Chapter 4: The way forward 18

Case study: Fargo Telecom: One country, two systems—and one agreement 21

Conclusion: IT key to the free trade drive 22

Executive Summary

While global free trade negotiations are struggling, in Asia the free trade movement is alive and well. Bilateral and regional free trade agreements (FTAs) have proliferated at an astonishing pace in recent years and the promise of further liberalisation lies ahead through initiatives like the Association of South-East Asian Nations (ASEAN) Economic Community. Often borderless in nature, and one of the region's most dynamic and fastest-growing industries, the information technology (IT) sector would appear perfectly positioned to capitalise on this trend.

This paper, the third of a series sponsored by HSBC examining FTA usage among Asian exporters, focuses on IT and telecommunications companies in particular. The paper assesses how companies in this sector have adapted to and taken advantage of the regional free trade drive; whether the liberalisation trend has supported their success; and their perceptions of FTAs relative to other sectors. To shed light on these issues, The Economist Intelligence Unit (EIU) surveyed 123 IT and telecoms companies across eight Asia-Pacific markets, from Australia to India, as part of a broader poll of 800 Asian exporters. These findings were supplemented by in-depth interviews with technology companies throughout the region, as well as with economists and trade experts.

The key findings of the report include:

- **FTAs produce tangible benefits for IT firms:** Almost all of the technology companies polled report that the FTAs they are using have boosted their exports to corresponding markets, and a majority say trade pacts have also created new investment opportunities and clientele. Many also feel regional and global agreements have enhanced Asia's, and particularly South-east Asia's, image in the eyes of international companies and investors.

- **Despite the benefits, FTA usage is limited:** A mere 7% of the IT and telecoms companies surveyed use all the agreements open to them that they are aware of. The perceived complexity of FTA terms and conditions is the biggest factor behind the decision not to take advantage of them, and many firms also cited a shortage of internal expertise—despite a majority (68%) reporting they have an employee dedicated to trade issues.

- **The free trade movement has yet to address what matters to the technology sector:** While IT firms welcome the tariff reductions associated with FTAs, many executives feel existing agreements have done little to dismantle non-tariff barriers, which most companies see hitting their international revenues. Regional trade arrangements and negotiations have so far failed to promote change or harmonisation in the areas where technology firms see the biggest barriers to international expansion: differing technical and security requirements, restrictions on the movement of labour and inconsistent enforcement of intellectual property rights.

- **IT companies have a sceptical view of government when it comes to trade:** While governments remain the main source of information for technology firms on FTA-related issues, the perception of their ability to formulate and implement trade policies is not positive. Some 80% of technology firms say it is important for governments to do a better job of enforcing existing trade agreements, and nearly 60% agree that their interests are not considered in FTA negotiations. Technology executives express the view that governments and trade policy remain oriented towards "traditional" sectors like manufacturing and agriculture, historically the main sources of employment and generally more activist in trade matters.

- **Technology companies are multilateral trade cheerleaders:** Despite their mixed experience with existing free trade networks, IT firms are broadly pro-trade and hope to see trade liberalisation progress further. Where possible, they want their governments to pursue ambitious, global agreements rather than more limited bilateral pacts. Most (67%—the highest proportion of any industry in the survey) support a return to multilateral negotiations via the WTO, while many want the elimination of all tariffs, even if that results in more competition. This implies a high degree of support for the currently stalled talks on the expansion of the World Trade Organisation (WTO) Information Technology Agreement (ITA), which slashed tariffs on many technology products when it came into effect in 1997 but has not been updated to reflect changes in the industry. In this sector, expectations for the major trade initiatives currently being pursued at the regional level—the ASEAN Economic Community and the Trans-Pacific Partnership—appear less high.

About the research

The Economist Intelligence Unit surveyed 123 information technology and telecoms companies in the first quarter of 2014 across eight Asia-Pacific markets—Australia, China, Hong Kong, India, Indonesia, Malaysia, Singapore and Vietnam—with India and Vietnam accounting for the largest proportion of respondents. All the companies polled are involved in international trade and investment. To reflect the views of smaller and medium-sized enterprises, the survey was weighted in their favour, with some 76% of firms reporting annual revenues in the US$50-$150m range and the remainder with annual revenues in excess of US$150m. Around 20% of the respondents are chief information officers (CIOs) or technology directors and the remainder are mainly CEOs and other C-level executives or department heads.

The EIU also conducted in-depth interviews with a number of technology executives and regional trade experts. Interviewees included:

- Anand Agarwal, chief executive officer, **Sterlite Technologies**, India
- Xavier Dupont, chief executive officer, **Fargo Telecom Holdings**, Hong Kong
- Lili Yan Ing, economist, **Economic Research Institute for ASEAN and East Asia (ERIA)**
- Peter Kopitz, chief operating officer, **aCommerce**, Thailand
- Yuki Kuboshima, global strategy office leader, **Deloitte Tohmatsu Consulting**/Asia Pacific Manufacturing Industry leader, **Deloitte Consulting South-east Asia**
- Chris Leong, director of strategy, **Soft Space**, Malaysia
- Shailesh Naik, chief executive officer, **MatchMove**, Singapore
- Mathia Nalappan, vice president for global business, **NCS**, Singapore
- Nguyen Huu Le, chairman, **TMA Solutions**, Vietnam

The EIU would like to thank the survey participants and interviewees for their time and insights. The findings of this report are those of the EIU and do not necessarily reflect the views of the sponsor. This report was written by Jonathan Hopfner and edited by David Line.

Introduction: The road often not taken

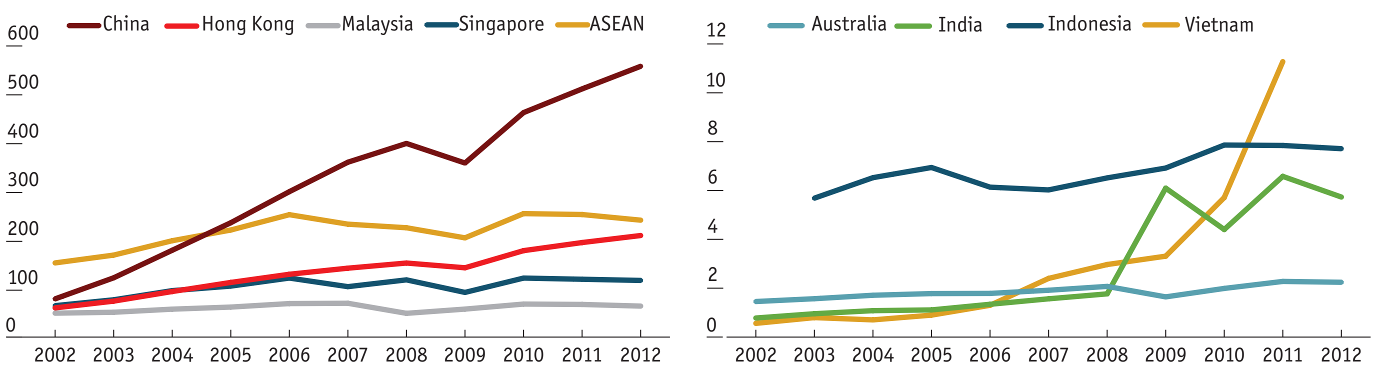
The regional free trade movement and the technology industry have seen similarly dynamic growth, but free trade pacts often fail to support technology companies and their goals

Asia has produced no shortage of incredible growth stories over the past decade, but the virtually parallel trajectories of the regional information technology industry and free trade arrangements may be among the most remarkable. Exports of information and communications technology by the eight countries in the EIU survey rose from US$500bn in 2003 to more than double that a decade later (Figure 1). Meanwhile the number of free trade agreements (FTAs) signed by Asian countries has proliferated vastly from a handful to over 50 among the eight countries in the survey, including several ground-breaking regional pacts.

It is tempting to draw links between these developments. And indeed like their peers in other industries, Asia's IT firms have benefitted from the lower tariffs, greater market access and increased investment flows that FTAs can bring. The EIU's survey of IT companies across key markets like Australia, China, India and South-east Asia shows a clear majority have a positive view of FTAs overall (see Figure 2) and believe they have contributed to their exports and business opportunities.

At the same time, while the IT industry may see the free trade movement as supportive, the general view is that it has fallen far short of transformational. In many ways the overall picture of the regional IT-free trade relationship seems to be one of squandered potential. Asian technology companies frequently feel other industries are given priority when free

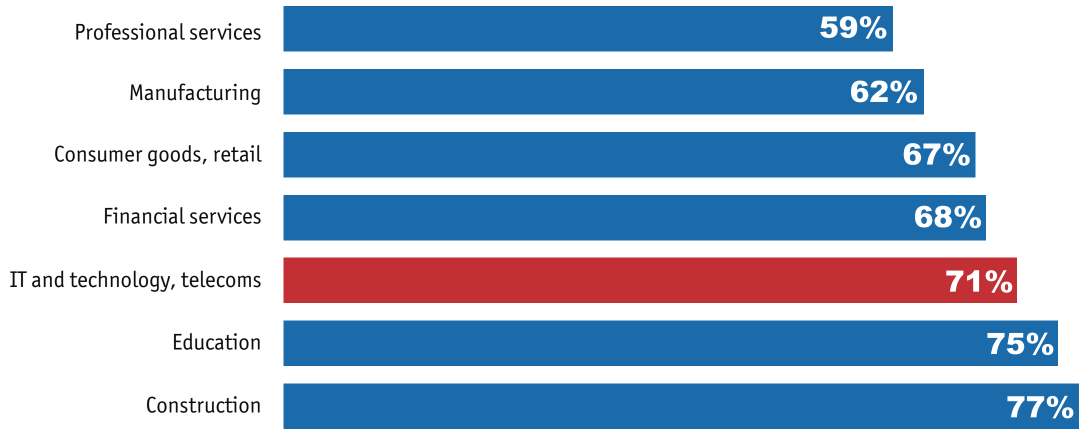
Figure 1a and 1b: Shipping more and more



Source: UNCTAD

Figure 2: High hopes

FTAs represent the best hope for the future of my overseas business
(% respondents agreeing or strongly agreeing)



trade arrangements are formulated. They also struggle to understand and implement the agreements that are already in force. Some of the most pressing cross-border issues facing the technology industry have yet to be substantially addressed by existing agreements or in ongoing negotiations.

This report explains why, in many respects, many IT firms feel left behind as the region marches towards a more liberalised trade future. Drawing on comprehensive survey data and the views of technology executives themselves, the report highlights some of the gaps between free trade policy and the needs of a complex and ever-evolving industry, and also suggests ways these can be addressed. It is in the interests both of the IT sector and policymakers that the free trade drive is better aligned with an industry that is increasingly vital to the region's future and growth prospects.

1 Tangible benefits

Regional trade liberalisation has generated direct and indirect rewards for Asian technology firms

Over the past few decades, Asia-Pacific IT firms have benefited from a number of pacts that have either directly or indirectly reduced tariffs or trade barriers in the technology sector. Arguably foremost among these pacts is the World Trade Organisation (WTO) Information Technology Agreement (ITA). Concluded in 1996, the agreement has since grown to include 70 signatories—all the markets covered in this survey among them—that collectively account for around 97% of global trade in IT products.

The agreement seeks to phase out or eliminate tariffs on a wide range of technological goods, including computers and peripherals, software delivered on media, semiconductors, telecoms equipment and testing equipment. While ambitious for its time, given the pace of change in the sector, the list of products that the near two-decade-old pact covers has quickly fallen out of date. Negotiations on an expanded version of the agreement, known as "ITA 2", have stalled due to disagreements over which products should be included.

The WTO ITA has been supplemented at the regional level by the implementation of the ASEAN Free Trade Area (AFTA) as well as ASEAN's various agreements with regional partners such as Australia, China and India, many of which

Figure 3: Industry leaders

Firms reporting export increases for FTAs used

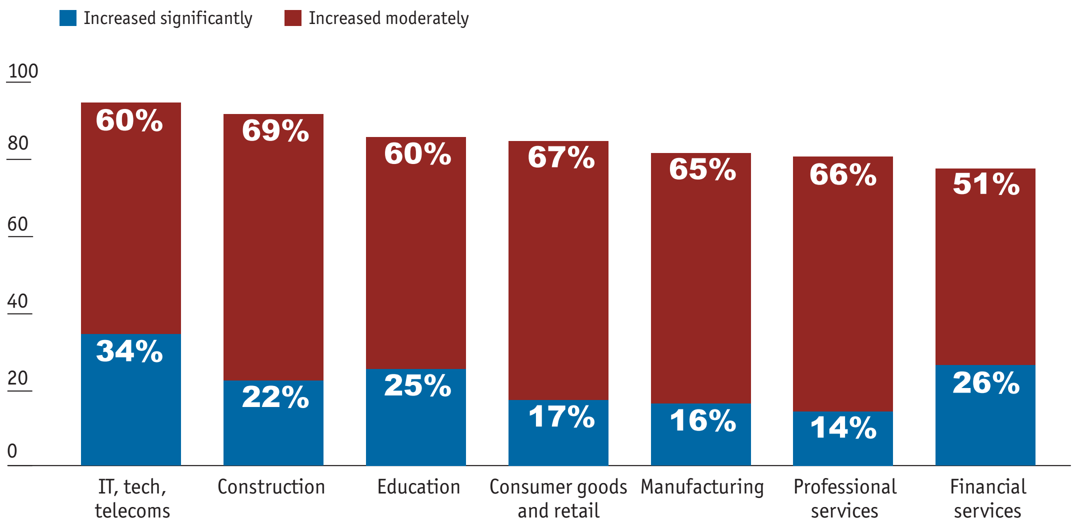
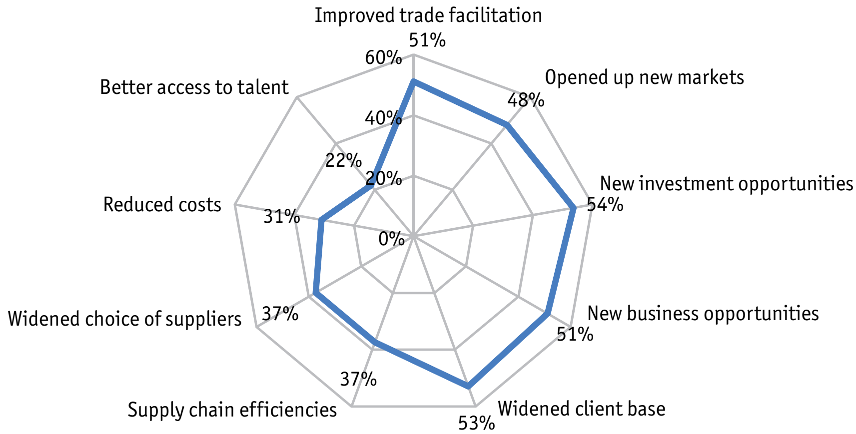


Figure 4: Reaping the rewards

(% respondents in IT/tech/telecoms sector reporting benefit from use of FTAs)



applied mutual tariff reductions or recognition arrangements to technology products or services. The ASEAN-China FTA, for example, allows some computer hardware and software service firms to sell directly to or establish fully owned subsidiaries in China. Countries have also spun a complex web of bilateral arrangements with trading partners, with Australia and Singapore among the most active pursuers of trade deals.

That the explosion of free trade pacts has been broadly positive for technology firms seems clear. Just under three-quarters of the companies surveyed (all of which trade internationally) said tariffs and duties had a major impact on their international business; only economic growth was rated cited as a more significant factor. Almost 95% of the firms putting FTAs to use said they had helped increase exports to the markets they covered—the most positive response of any industry in the survey (Figure 3). Moreover, a majority in the IT/technology sector also saw these agreements widening their client base and creating new market or investment opportunities (Figure 4).

These benefits seem to be most tangible among technology firms that deal in goods. Anand Agarwal, CEO of India-based data and power transmission equipment vendor Sterlite Technologies, credits the WTO's Generalised System of Preferences (GSP) scheme—which allows developing nations to export certain products to developed countries under preferential tariffs—with allowing the company to gain a foothold in the US and Europe. Meanwhile, Bangkok-based logistics and e-commerce solutions provider aCommerce has leveraged the ASEAN-China FTA to help its clients sell products directly to China's burgeoning consumer class, says the company's COO Peter Kopitz.

That said, the positive impact of tariff reductions extends well beyond exporters of physical products. Nguyen Huu Le, chairman of Vietnamese software outsourcing company TMA Solutions, points out that FTAs have allowed Vietnamese firms to import more technology and equipment, "so we are more competitive... [and] can do more R&D outsourcing work."

Perhaps even more valuable, if less immediately apparent, is the "halo effect" that free trade pacts can produce in the eyes of other markets and investors, and the business opportunities that result. Mr Nguyen of TMA Solutions, for example, credits Vietnam's WTO accession in 2007 with essentially kick-starting the country's then-nascent outsourcing industry (see the case study below). ASEAN-based technology companies seem particularly conscious of the role trade liberalisation can play in raising the region's profile.

"By creating an 'atmosphere' of FTAs and therefore freer trade, more cross-border and regional companies are turning to us to provide digital services," says Shailesh Naik, CEO of MatchMove, a Singapore-based firm that helps companies develop and deploy branded games and apps. "The climate seems to be affecting the readiness of countries to consider cross-border services, in anticipation of inevitable, albeit slower, closer integration."

The bureaucratic procedures or shifts generated by the implementation of FTAs themselves can generate new lines of business. Regional integration in South-east Asia, for example, has allowed IT companies "to take a role in facilitation of customs clearance, logistics tracking and supply chain optimisation," points out Yuki Kuboshima, global strategy office leader at Deloitte Tohmatsu Consulting and Asia Pacific Manufacturing Industry Leader at Deloitte Consulting South-east Asia.

Singapore-based IT services provider NCS has seen FTAs stoke government demand for portals and web platforms that support the inter-agency processes and systems that such agreements require, according to the company's vice president for global business, Mathia Nalappan. In addition, he says, "when our customers across industries expand into new markets partly driven by economic growth supported by free trade, they would require IT and communications engineering support in these markets."

When viewed individually, ASEAN markets are perceived as "too small" compared to regional giants China and India, says Mr Kopitz. "But everybody loves the whole story that we have about 600m people in all these countries together... Investors are quite interested in what we're doing here."

Case study: TMA Solutions: Joining the club

Executives view Vietnam's WTO accession as a decisive moment in the development of the country's highly successful software outsourcing industry

From a minimal base, Vietnam has quickly become a software outsourcing force to be reckoned with. According to the Vietnam Software and IT Services Association, the country now ranks among the world's top 10 software exporters, and the industry's total annual revenue tops the US$1bn mark. This success has been attributed to a variety of factors, including a relatively youthful, educated workforce and improving infrastructure, but for Nguyen Huu Le, chairman of leading outsourcer TMA Solutions, it can be largely traced back to a single development: Vietnam's WTO accession in 2007, which came after over a decade of negotiations.

In the eyes of the outsourcing industry, Vietnam's joining the WTO marked an economic coming of age, clearing the way for more foreign companies to invest in the country or entrust services to local outsourcing providers. "When Vietnam is integrated into the global economy, more companies come to Vietnam to do business and are more confident dealing with Vietnamese companies. It helps us attract more overseas clients," says Mr Nguyen.

WTO accession has also resulted in savings for firms like TMA, which has been active since 1997. "It's easier to import or export services and equipment, with lower tariffs that help reduce our and our customers' costs when doing business with us. So we are more competitive," Mr Nguyen adds.

Six years after Vietnam's WTO entry, TMA has expanded from 13 to 25 markets and seen revenue double, according to Mr Nguyen, opening offices in the US, Japan and Australia. It's no surprise, perhaps, that he says in the view of TMA "any free trade agreement is good."

Mr Nguyen is not even taken aback by signs of a skills shortage in parts of the labour market as more foreign companies turn to Vietnam for their outsourcing needs. "We need to compete with these companies to attract good people… but we believe that when the demand increases, the supply of resources will be increasing too."

"We want more foreign IT companies investing in Vietnam because it will demonstrate the attractiveness of the country as a good destination for high-tech outsourcing," he says.

2 The struggle for knowledge

A lack of awareness and the complexity of trade agreements prevents the technology industry from using them to the full

Given their perceived advantages one would expect Asian technology companies to be enthusiastic and consistent adopters of FTAs, but the reality is somewhat more mixed. Just 7% of companies in the sector use all the FTAs that are open to them—and that they are aware of. Usage is sometimes hampered by a basic lack of awareness or knowledge. Just short of half (43%) of firms polled admitted to having a limited understanding of some FTAs open to them (Figure 5), with a lack of relevant publicity or internal resources to track FTA-related developments as the biggest reasons (Figure 6).

Most rely on governments—including government industry associations, special government agencies and central government bodies—as their main source of information on FTAs and their potential benefits (Figure 7). But while governments are often happy to extol free-trade related achievements to the media, or hold dialogue with heavily affected and politically sensitive sectors like agriculture, the lines of communication with the technology industry seem more tenuous.

Most rely on governments—including government industry associations, special government agencies and central government bodies—as their main source of information on FTAs and their potential benefits (Figure 7). But while governments often hold dialogue with

Figure 5: A little understanding, please

Lack of understanding of one or more FTAs by industry
(% respondents)

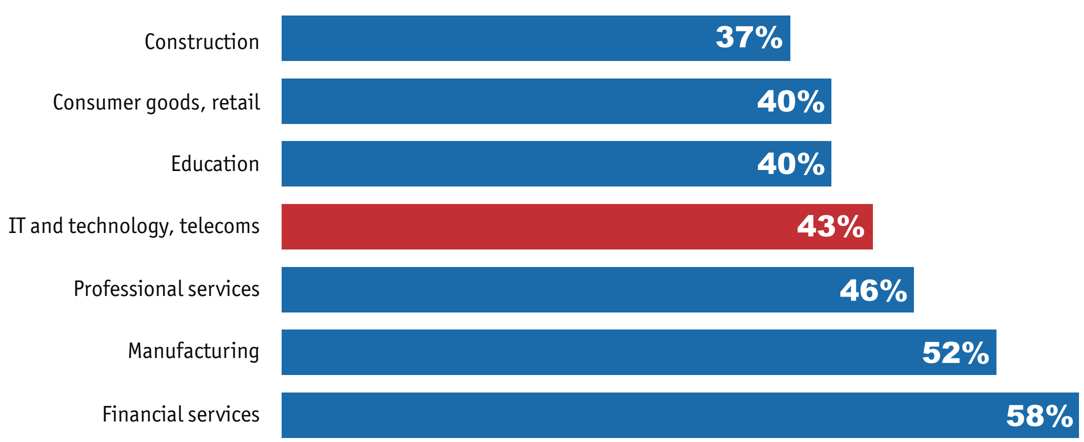


Figure 6: Not in the know

Reasons for lack of understanding of one or more FTAs in the IT/tech/telecoms sector

(% respondents)

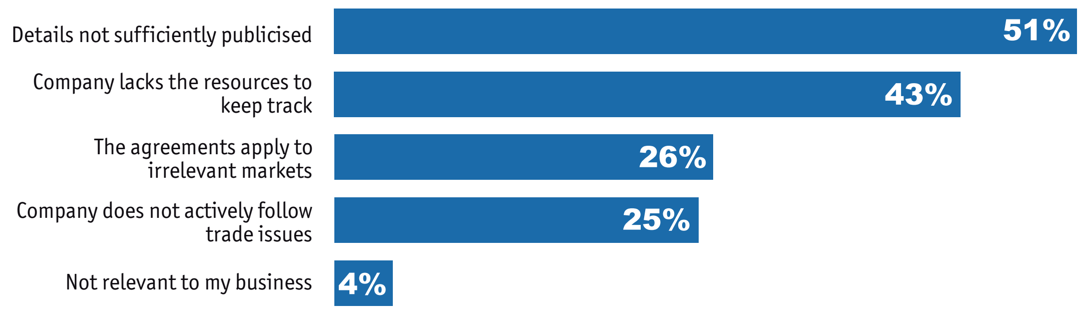
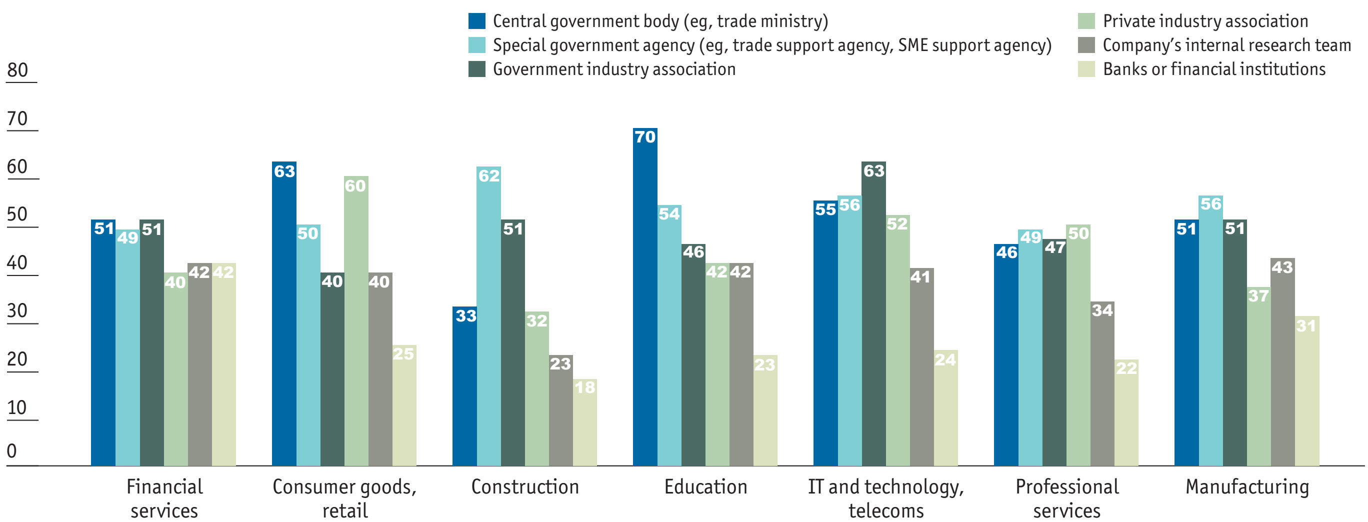


Figure 7: Fonts of FTA know-how

(% respondents naming as main information sources on FTAs)



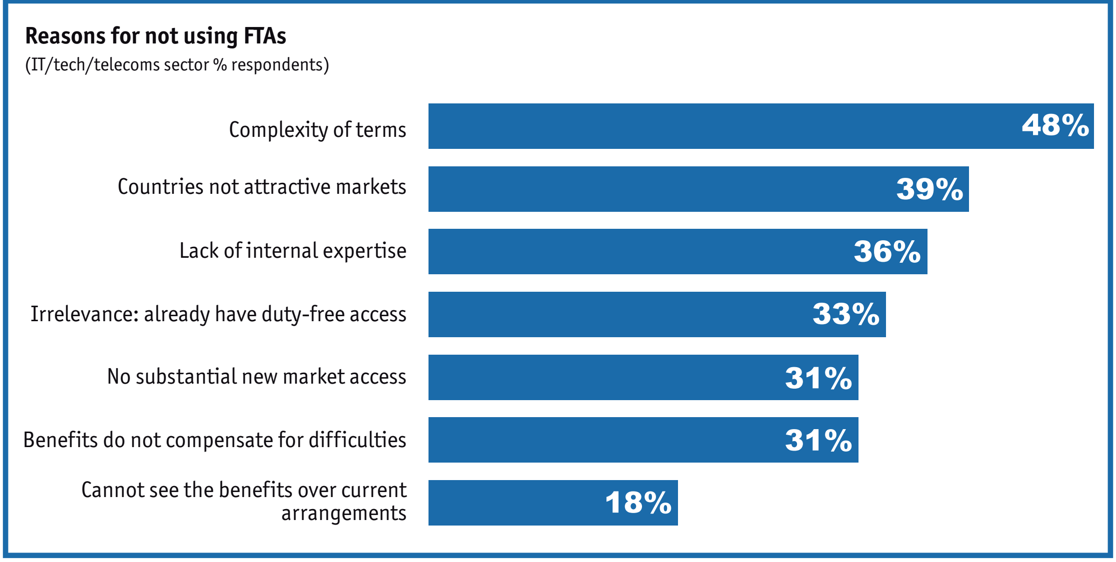
heavily affected and politically sensitive sectors like agriculture, the lines of communication with the technology industry seem more tenuous.

"[FTAs] are traditionally seen, reported and discussed as raw material or large-segment focused," explains Mr Naik of MatchMove. "In the last five years, I have never heard FTAs brought up at any of the national industry, start-up or government agency forums in any of the five countries where we have offices."

"You really have to know your source," says Mr Kopitz of aCommerce. "If you ask an agency in Thailand in general about something, you will not get an answer, nor will they necessarily even know the policy."

Even if a company is alerted to the regular shifts in the trade landscape, putting free trade pacts into practice is another matter. Sifting through the region's intricate and evolving web of agreements, many with annexes and tariff reduction schedules running into the hundreds of pages, is a task many companies simply lack the resources for. All the firms surveyed reported there were FTAs that they were aware

Figure 8: Why FTAs remain on the shelf



of but elected not to use, with their complexity the top factor behind that decision (Figure 8).

Lili Yan Ing, economist at the Jakarta-based Economic Research Institute for ASEAN and East Asia (ERIA), says the "benefit margin"—the difference between the costs of obtaining the certificates of origin (COO) that allow products to qualify for free trade concessions, and the benefits in terms of tariff savings—is relatively small for ASEAN trade agreements. "While the official costs of obtaining an FTA COO are perceived to be reasonable, the procedure to obtain COOs is perceived to be quite cumbersome."

A lack of internal expertise is also cited as a barrier to FTA usage by over 35% of respondents. These shortfalls are most keenly felt by small and medium-sized enterprises (SMEs). "SMEs can hardly benefit from FTAs," says Xavier Dupont, CEO of Hong Kong-based wireless technology manufacturer and distributor Fargo Telecom Holdings. "They're very complex, you need to hire lawyers, professional firms to explain them to you, and that's expensive… for a company our size it doesn't make any sense."

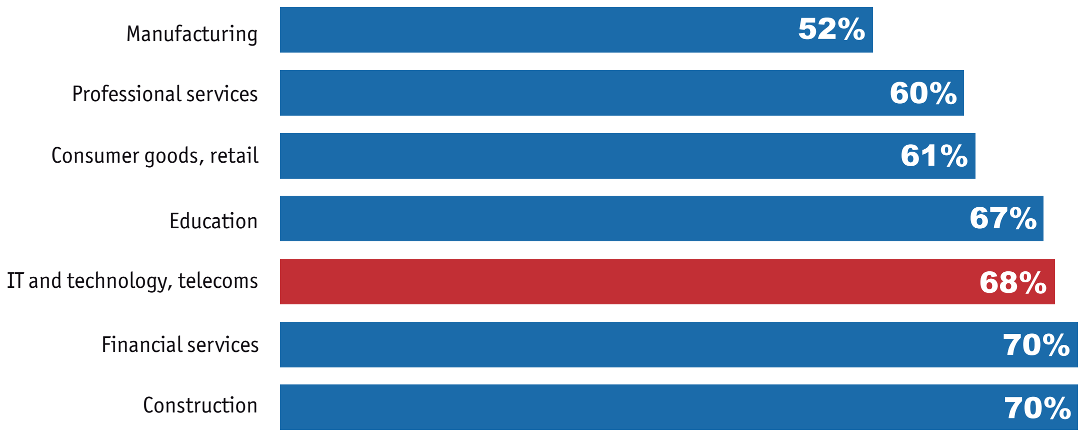
This lack of capacity persists despite over 68% of companies polled having an employee solely responsible for trade issues—among the highest of any industry polled—and another 30% of firms planning to create such a role (Figure 9). This suggests that even these specialists are struggling to keep up or to access the information they need. "It may be available of course, and maybe we don't spend enough time studying it, but what's relevant for us might be lost in the middle of a pile of information," says Mr Dupont. Sterlite has established an export-import team, but has to regularly reassess its role and methodologies to keep up with trade trends—and even then is not entirely successful, says Mr Agarwal (see case study).

Given the industry's dynamics and focus it is no surprise that many companies turn to technology—and each other—to plug knowledge gaps. Over half of survey respondents named private industry associations as another key source of FTA-related information, the highest proportion behind consumer goods and retail of all industries surveyed.

"In general, we rely on industry collaboration," says Chris Leong, director of strategy at

Figure 9: Trade is a full-time job

(% respondents with an employee solely responsible for trade issues)



Malaysia-headquartered payment solutions provider Soft Space. Mr Kopitz, meanwhile, has found his network on LinkedIn a valuable source. "The news feed picks up media or stories that are posted and pre-screened by professionals, so the content is of a high standard," he explains. And MatchMove's Mr Naik has one short answer for all his FTA-related queries: "Google."

Case study: Sterlite Technologies: A trade lesson learned

The sudden appearance of low-cost imports in its home market prompted India's Sterlite Technologies to reassess its trade strategy

India-based data and power transmission specialist Sterlite Technologies was long aware of multilateral trade agreements, which played a key role in building its business in Western markets. But it took less notice of the various bilateral arrangements that India has pursued with trading partners like South Korea and Japan—until it started noticing competing products from these countries appearing in the domestic market under preferential tariff schemes. "We came to know that certain agreements were done that we were actually caught unawares about," says the company's CEO, Anand Agarwal. "We're in a phase where we're increasing awareness about it; we're realising what ought to be our degree of presence whenever these get negotiated and what our role ought to be when we move forward."

One of the first steps Sterlite took in response was broadening the scope of its dedicated export-import team, tasked with monitoring trade issues. While previously the group looked largely at the broad duty structures governing imports to India and exports to other markets, it has been strengthened to examine these at a more microscopic level. The team now pores over agreements to find out whether there is any targeted impact on the duties on specific products Sterlite sells as well as the raw materials it buys. It has drafted a comprehensive table that outlines the duty levels on specific products articulated in the various bilateral arrangements India has signed, along with regional and global pacts. "We are going deeper and seeing whether [FTAs are] really hurting us, impacting us, or can benefit us. That internal strengthening is being done just by adding a 'level two' to what we used to do earlier," Mr Agarwal explains.

With this additional knowledge, Mr Agarwal says, comes responsibility to adopt a more activist stance in the development of India's trade policy and the government's negotiations with trading partners. "Definitely it boils down to what are the next steps, now that we realise that there is information, it means that we've got to increase our presence in chambers of commerce [and] on the bodies that participate in discussions with the Ministry of Commerce as and when they happen," he says. "Depending on where we see the impact and where we see it going we are prioritising the role that we have to play when [agreements] get decided."

3 The wrong kind of free trade?

Asia's technology firms often feel trade agreements are drafted with other industries in mind—and few expect that to change anytime soon

Beyond the difficulties associated with understanding and applying for trade concessions, many Asian IT firms feel existing free trade agreements are not designed with their needs in mind. With regional governments traditionally more focused on sectors like manufacturing, agriculture and services, free trade negotiations have concentrated mainly on the reduction of tariffs on products, which is of limited use for an industry increasingly geared towards trade in services.

"Up until now, the most tangible benefit of FTAs or economic partnership agreements has been the liberalisation of the trade in goods," explains Mr Kuboshima of Deloitte. "Though it is expected that the liberalisation of trade in services and other non-tariff areas will see dramatic changes in business conditions, the hurdles seem to be much higher... [IT] companies have already toned down their expectations due to various conflicting factors that are clearly not ready to be resolved."

Most technology exporters have much more than tariffs to contend with. Non-tariff barriers—a grab-bag of regulations and policies that can hamper the entry of goods and services into foreign markets—were cited as of importance or major importance to the ability to increase international sales by 59% of companies surveyed. That result was in line with the manufacturing industry but a lower proportion than in the consumer goods and retail sector. Particularly vexing for the technology sector are the varying technical, safety and security requirements adopted by different administrations, which FTAs have done little to harmonise. Mr Kuboshima cites data from the European Commission indicating regulatory inconsistencies of this kind are equivalent to tariffs of 10-20% on some goods.

"Discussion with businesses has raised concerns that while tariffs have been reduced, the incidence of non-tariff measures has been increasing," says ERIA's Ms Ing.

Companies like Fargo Telecom, which deals in products that use sensitive wireless spectrums, have to secure separate approvals in virtually all the Asian markets they operate. "We would have thought that there'd be a trend for this need for local approval to disappear, but no," Mr Dupont explains.

In some markets, only local companies can kick-start the approval process, making it virtually mandatory for an exporter to team up with a domestic partner or distributor, while in others "it can be something like having to pay a lab to get your factory audited, so it can be a very heavy process, depending on the product complexity," Mr Dupont says. With the region still beset by geopolitical tensions—and regulations like these one of the only remaining means to shelter local industry in an increasingly tariff-free environment—technology executives don't expect them to disappear or be standardised across markets anytime soon.

Many IT firms are dependent on proprietary technology or solutions that they can spend years developing, making intellectual property another key concern. Pacts like the WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPs) agreement have attempted to promote cross-border protection of intellectual property rights, and ASEAN's pacts with trading partners like China include broad agreements to "cooperate" on intellectual property issues. But these contain little in terms of concrete commitments or provisions, and in the eyes of regional technology executives have yet to result in a regional environment where intellectual property regulations and enforcement are consistent or actively applied. "IP is a concern for us and to date we've been very careful about what we need to share... Definitely it's on the wish list, that wherever we're going IP rights are really respected," says Sterlite's Mr Agarwal.

IP loss is a particularly potent risk for the growing number of IT companies that are themselves outsourcing functions to deal with shortages of technology talent. aCommerce, for example, develops proprietary e-commerce solutions but sometimes outsources their coding or construction to companies in China, Vietnam and Indonesia. The concern is, says Mr Kopitz, that they will "keep it, adjust it and sell it to somebody else. That's a big risk, and in the region nothing is really being done to address that, not even remotely. For us specifically that's very worrying, because we're not a logistics provider, we're a technology company that's building out IP on top of all our other services. We have to be innovative to compete."

The free movement of labour is another priority for the technology sector that the regional free trade drive has largely failed to tackle. With local technology talent in short supply in some markets, companies frequently want to import additional labour or training resources, but getting approval to do so can be onerous, particularly in South-east Asia's less developed economies.

"If we set up shop in the Philippines or Vietnam, it's very important for us to hire people from outside of the country," says Soft Space's Mr Leong. "At the end of the day, if we're looking at ASEAN, [the number of] knowledgeable IT and high-tech workers is limited and there's a lot of companies here competing for talent. So we hope that there's flexibility in terms of hiring in the places we're going to."

Regional IT firms also see non-tariff barriers hampering the growth of e-commerce. Varying electronic banking and online payment standards and regulations are among the "biggest bottlenecks" to the development of e-commerce and the online services trade in Asia, says Mr Kopitz of aCommerce.

MatchMove's Mr Naik hopes to see governments tackle e-commerce issues early and proactively, "rather than a knee-jerk response or attempt to view the situation through the lens of existing, outdated or irrelevant regulations that apply to banking or telecoms."

"Many countries are still struggling to understand and keep up with the pace of change. The standard approach is to apply existing regulations to incoming players. This will stifle growth... What is needed I think is a coordinated approach to both in-country and cross-border regulation," Mr Naik adds.

4 The way forward

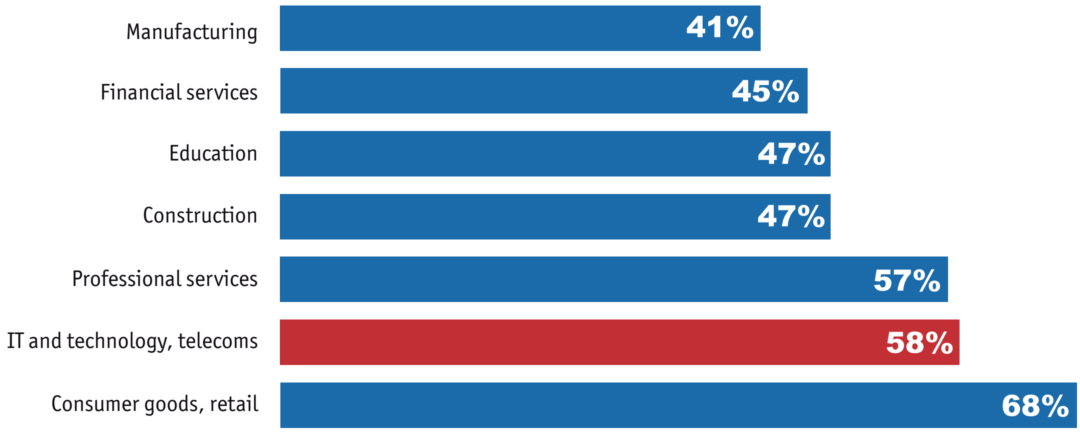
Despite the mixed views on free trade so far, regional technology companies are keen to take a more active role in trade talks and to see liberalisation progress further

Technology companies don't appear especially optimistic about FTAs developing to address the issues most pertinent to the sector. The technology trade negotiations currently capturing the lion's share of government attention—those on the WTO ITA 2—look set to remain squarely tariff-focused if they progress at all. Policymakers may be placing too much hope in more contentious technology-related issues being tackled at the multilateral level, with the result that they receive insufficient attention in negotiations for some bilateral and regional deals. Indeed, some 58% of those polled agreed or strongly agreed with the view that governments don't consider their needs and interests when conducting FTA negotiations, a higher proportion than in most other industries (Figure 10).

But some executives believe the government-industry disconnect is at least partly self-created. MatchMove's Mr Naik explains that with many firms involved in the delivery of Internet-enabled, "over the top" services that face relatively few restrictions in moving across borders, they often lack the motivation to lobby for more favourable policies. Governments, meanwhile, tend to be more beholden to more vocal—and employment-intensive—sectors like manufacturing. "So there's neither push from the authorities nor pull from the local players."

Figure 10: Is anyone listening?

The government does not consider my interests and needs when conducting FTA negotiations
(% respondents agreeing or strongly agreeing)



Some companies are moving to address this by boosting their participation in government-industry consultations. "Whenever there's a dialogue we'll be there to ensure we voice our opinions and comments… and are well aware of how it affects us. We don't have anyone internal but we join industrial groups to make sure that the voice of the industry is well represented," says Mr Leong of Soft Space.

"If something is in the process of negotiation and you reach [officials] at the right time via a proper organisation, i.e. an industry association, then you find them definitely receptive," says Sterlite's Mr Agarwal. "While we have been with industry associations for a long time, we were not really paying that much attention to the FTA aspect… so now we're going to tend to see what's in the play over the next few years and how it impacts us."

Encouragingly, even though tariff reductions have turned up the competitive pressure on firms like Sterlite and Fargo Telecom—and despite the limited utility of some existing agreements—the technology sector is broadly supportive of free trade and wants to see more of it, not less. Over half—54%—of companies surveyed said they would like to see all tariffs eliminated, even if that opened their home markets to cheaper competition. Some 79% felt their government signing more FTAs could play an important or very important role in boosting their exports, and a similar proportion said better enforcement of existing agreements would do the same (Figure 11).

IT companies also appear to be keen supporters of multilateral trade negotiations, despite the very visible recent setbacks the multilateral movement has suffered. Efforts to expand the WTO ITA to cover more products have stalled amid an acrimonious dispute between China, which had a lengthy list of "sensitive" technology it wanted excluded from the agreement, and the US, which was unwilling to accept these restrictions. Critics of the US position, meanwhile, argue it is attempting to expand the agreement to non-IT products. According to the Washington-based Information Technology & Innovation Foundation, the failure to update the agreement represents an US$800bn trade opportunity lost.

Some 67% of companies surveyed agreed or strongly agreed with the view that their governments should stop negotiating limited agreements and focus on global (i.e. WTO) trade pacts (Figure 12), making IT and telecoms the most WTO-supportive industry. In terms of future policy, 56% in the sector said they wanted to see a return to multilateralism in WTO negotiations, among the highest proportion of any industry surveyed.

Figure 11: The to-do list

(% IT/telecom firms citing as important or very important for governments to do next to help boost exports)

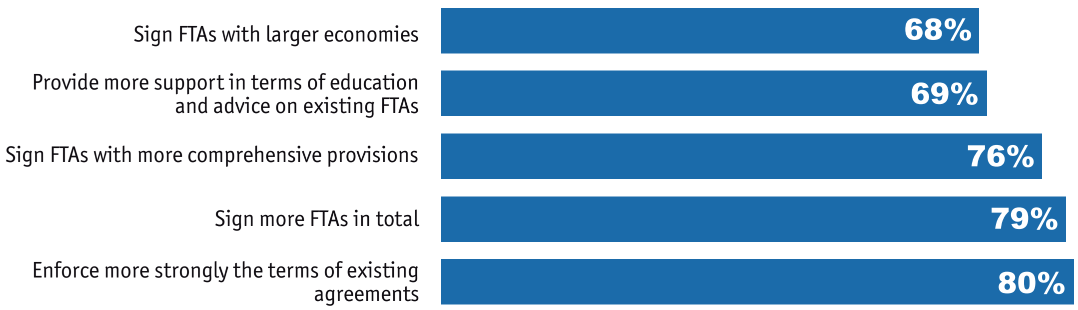
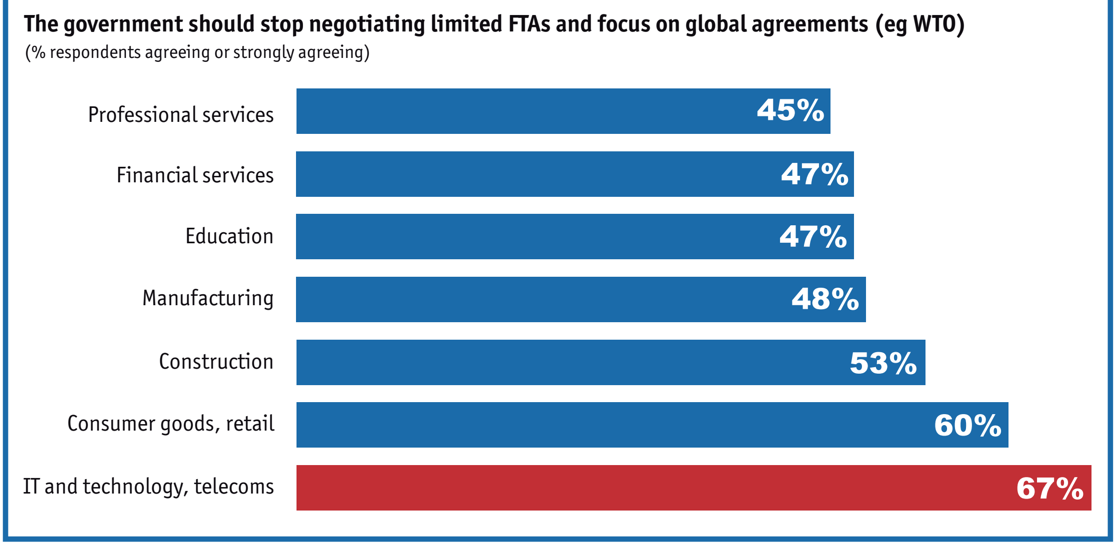


Figure 12: Back to the WTO, please



"In terms of effective use of time and resources it'd be great if [a multilateral deal] could be done," says Sterlite's Mr Agarwal. He remains relatively optimistic about multilateral negotiations despite some countries citing India's recent review of its trade policies as a barrier to progress. "We see these manoeuvres more as solutions to get more benefits for the short term, rather than any longer-term restrictive policies."

Technology companies are also watching talks on the Trans Pacific Partnership (TPP), a separate free trade arrangement involving 12 Asia-Pacific economies that between them account for 26% of world trade, with a mix of excitement and trepidation. The TPP is seeking commitments on reducing impediments to cross-border data flows and the digital trade in services that businesses hope will streamline privacy and security standards while eliminating impediments like requirements to use local computing infrastructure.

While industry seems broadly supportive of the TPP, some companies are concerned about its possible intellectual property implications. Mr Leong of Soft Space says indications the partnership will make it easier to register patents in markets like Malaysia could present problems for local software firms that have less experience with the process than firms in markets like the US, where it's more ingrained. "If the laws change and companies like us are not ready to patent some of our processes we might be limiting ourselves in terms of where we can go and how we do business," he explains.

Few hopes seem to be attached to the establishment of the ASEAN Economic Community (AEC) slated for 2015, which aims to put the region on the path of European Union-style integration.

"If it could be done as an EU-style arrangement I think it would be very exciting… [but] the level of maturity in terms of infrastructure and economy, the gap between countries is very big compared to the EU. If it's somewhere like Myanmar of course there is a stronger case for them to ensure that the interests of their local companies are not adversely affected," says Mr Leong of Soft Space.

"Finding consensus will be very difficult and slow," agrees aCommerce's Mr Kopitz. "Protectionism will prevail in the short term."

Case study: Fargo Telecom: One country, two systems—and one agreement

A Hong Kong-China pact helped Fargo Telecom cement its presence on the mainland

Hong Kong-based wireless equipment vendor Fargo Telecom Holdings has long-standing ties to China, both as a market and manufacturing base. But the conclusion of the Mainland (China) and Hong Kong Closer Economic Partnership Agreement (CEPA) in 2003 helped Fargo Telecom take its China business to another level.

Implementation of CEPA, which is ongoing, has given goods of Hong Kong origin tariff-free status on the mainland and also opened segments of China's services industry to Hong Kong firms. Fargo Telecom CEO Xavier Dupont used the agreement to open a wholly owned subsidiary on the mainland, which was incorporated in 2007. The venture includes sales and research and development functions, and also gives the company the ability to invoice its China customers in renminbi. "To open a wholly foreign-owned enterprise in China… in the past was very complicated, and the CEPA helped a lot," Mr Dupont says.

Prior to its mainland incorporation, to sell its products in China Fargo Telecom was forced into sometimes difficult relationships with local forwarders and distributors. "They're buying your goods and reselling them in China on your behalf, and you didn't really know what was happening, they could put their own margins on them… Having our own subsidiary and being able to import our products ourselves we're of course more in control of the whole chain, and sure that goods are being properly imported as per the law, and also in more control of our prices. In this regard I think the Hong Kong and China relationship, and the CEPA, helped us."

Mr Dupont says even post-CEPA, the mainland can be a tricky place to do business. "You still have to deal with the government, tax, money transfers, et cetera… it's doable but still quite heavy, and costly." But he compares the establishment of a China subsidiary favourably with a recent move to do the same in India. Approval to set up a 100%-owned unit there was "very difficult," requiring approvals from the government that took months to secure, especially as the company's home base in a low-tax jurisdiction meant it was subjected to more scrutiny. "We had to get the help of lawyers and chartered accountants to help us with Indian law, which cost us a lot of money. If I look at my India operation, it's a cost centre right now."

5 Conclusion: IT the key to driving free trade

With information technology set to be one of the region's main future growth drivers, policymakers should ensure the free trade drive is formulated to match

The findings of the EIU survey of technology companies and the interviews for this report paint a picture of both deficiency and opportunity. On one hand, usage rates of FTAs by IT and telecoms firms remain low. Free trade pacts, and the policymakers who shape them, have also failed to keep pace with the developments currently shaping an industry that is in a near-constant state of reinvention—the failure to expand the WTO ITA agreement being a case in point. On the other hand, a clear majority of technology companies see these agreements as vital to their future business, are strong supporters of multilateral trade initiatives and hold positive views on trade liberalisation overall.

This suggests that if governments do more to engage the technology sector when formulating trade policy, and ensure trade pacts also tackle harmonisation in areas like technical standards, intellectual property rights enforcement, data and e-commerce, these agreements would be enthusiastically adopted by IT firms. They would also accelerate the development of an already dynamic sector by opening new lines of business and reducing barriers to cross-border services in some of the world's most promising consumer markets. This could only be good for the region's economies, particularly as the developed world grapples with a slowdown and traditional growth engines—such as manufacturing and, more recently, property—can no longer be relied on.

Even if the more pessimistic predictions concerning free trade in the region—that the AEC is created in name only, or that negotiations on the TPP, like those on the extension of the WTO ITA, founder—come true, to a certain extent the technology sector has little to fear. It has already demonstrated the ability to thrive with a minimal level of targeted policy support and under—or perhaps in some cases, because of—an often outdated network of regulations. Perhaps this degree of independence comes naturally to an industry where innovation is often the only genuine currency.

The biggest risks of trade policymakers failing to engage with the IT industry or to take its needs into account may not be to the sector, but to governments and the free trade movement itself. The exclusion of a dynamic, economically vital and broadly pro-trade industry will deprive free trade of one of its biggest potential champions, and a much-needed dose of legitimacy. The fuller participation of the technology industry is vital if regional free trade is to truly thrive, and could serve as a catalyst for further integration and future economic growth.

The Economist Intelligence Unit

LONDON
20 Cabot Square
London
E14 4QW
United Kingdom
Tel: (44.20) 7576 8000
Fax: (44.20) 7576 8500
E-mail: london@eiu.com

NEW YORK
750 Third Avenue
5th Floor
New York, NY 10017, US
Tel: (1.212) 554 0600
Fax: (1.212) 586 0248
E-mail: newyork@eiu.com

HONG KONG
6001, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com

GENEVA
Rue de l'Athénée 32
1206 Geneva
Switzerland
Tel: (41) 22 566 2470
Fax: (41) 22 346 9347
E-mail: geneva@eiu.com