Bulletin

Water
Energy
Environment
Retailing
Transport
Financial services
Healthcare
Telecoms
Media
Post
Competition policy
→ Policy analysis and design
Regulation
Strategy
Contract design and evaluation
Dispute support services
Market design and auctions

JANUARY 2016

What's in IT?

THE GAINS FROM TRADE IN INFORMATION TECHNOLOGY

A recently signed initiative to liberalise trade in Information Technology (IT) good represents a rare advance at the WTO, with the potential for significant economic benefits given the connectivity between IT goods and services and other sectors. These benefits offer a powerful reminder of the costs of protectionism, and show why a proper focus on the evidence remains a priority both in spurring domestic reforms and persuading WTO Members to engage with multilateral liberalisation.

One of the rare good news stories to emerge from the latest WTO ministerial conference, held in Nairobi last month, was the signing off by a group of 53 countries on commitments to further free-up trade in information technology. The deal, which expands on previous commitments concluded in 1996, is known in the trade jargon as a "plurilateral agreement" i.e. one whose signatories are a subset of the WTO's membership, but who extend their commitments to the whole membership on a MFN basis. This approach is already touted by some as a workable model for future negotiations; specifically, as a way of breaking through the deadlock that has paralysed so much of the multilateral trade negotiating agenda.

Whether or not that is the case, it is better to begin by reflecting on the underlying economics of IT liberalisation. The agreement reportedly covers 201 products that collectively account for nearly 10% of world trade. But while these statistics about supply are interesting, they should not obscure the fact that the major gains from liberalisation reflect the value to society derived from the end-uses to which IT products are put.

IT: IS MORE BLESSED TO GIVE…

In this regard, it is useful to note that research consistently shows that 80-90% of the gains from IT development and innovation are found outside IT sectors. This seems intuitive, given the wide range of applications and sectors that rely on IT products, including sectors that have very high social rates of return such as healthcare, infrastructure and education

These gains are set to increase as connectivity between objects and processes increase. Thus, recent research by Frontier Economics, found that the spread of the Internet of Things could increase growth in world GDP to around 1.5%, on a conservative estimate, above its trend rate out to 2030. Liberalising trade in IT products will only contribute to these benefits, by making them more affordable, and by stimulating innovation through competition.

Put another way, the main gains from free trade in information technology are likely to accrue to the countries doing the liberalising. If we look at the signatories to the deal, we see that in addition to the advanced OECD nations, China and a number of other emerging nations – notably Colombia, the Philippines and Malaysia – have signed on. These emerging nations are ones that see ICT services activities as areas of comparative advantage (the Philippines, notably) or as crucial inputs into other sectors.

In China's case, it is not only the world's top exporter of IT and communications products, but also its leading importer, accounting for around 18 % of world imports in the sector and 34% of electronic component imports (UNCTAD 2014). This reflects the organisation of production in IT sectors: along global value chains, in which countries specialise in specific parts of the production process in a particular sector. The iconic example of this being the production of Apple smartphones – a range of suppliers from various countries specialise in the production of components put together by Foxconn in China and then exported.

There are, however, prominent absentees, such as Brazil, Russia and India; and not a single country from the African continent, or from the group of poorest countries (the least-developed countries in WTO-speak). The reasons for these absences may vary. For some, there may be a perception that continued protection is necessary to stimulate local IT sectors.

But such thinking should be challenged, even if one adopts a narrow view that focuses only on the benefits of protection to domestic IT industries. As China's example illustrates, such industries operate on a global value chain basis. To successfully integrate into such value chains, countries need to source input from the most efficient of sources, in turn requires the removal of tariffs on imports.

It is revealing, in this context, to consider how reliant on imports domestic IT and related sectors are. Table 1 presents some results for a group of countries. In particular, it shows that for three countries that did not sign up to the WTO's IT initiative (Brazil, Indonesia and India), exports in IT-related sectors are considerably more reliant on foreign suppliers than their exports generally, and specifically more reliant on foreign suppliers of IT products.

Table 1. Foreign sources of value added in exports (percent)

	Brazil	China	India	Indonesia
Foreign value added in all exports	10.8	32.2	24.1	12.0
Foreign value added in exports of computing, and related equipment	24.1	55.0	31.2	27.1
Foreign value added attributed to imports of computing equipment in exports of computing and related equipment	32.0	33.0	35.4	45.0

Source: Calculations based on OECD/ WTO Trade in Value Added Database 2015.

The data recall the old adage that a tax on imports is really a tax on exports. And remember, this is before we come to the wider benefits of IT products that lie outside the IT sectors.

THE NEEDLE AND THE DAMAGE DONE....

It is likely that in addition to infant-industry type arguments, trade negotiators remain hostage to a particularly mercantilist mentality, that liberalisation commitments are in fact "concessions" to be prised from them under protest.

For the least-developed countries in particular, a reflexive aversion to liberalisation commitments is costly. Indeed it makes little sense in light of another decision agreed to in Nairobi that allows suppliers of services from the least developed countries to be granted preferential market access by other, more advanced members. But such access is likely to remain a paper commitment for as long as service suppliers remain uncompetitive, and a key input into practically all services sectors is access to IT.

That it remains so difficult to get countries, particularly poorer ones that form the bulk of the WTO's membership, to sign on to commitments that are first and foremost in their interest offers an insight into the difficulties that have plagued the WTO for more than a decade. In the mercantilist mindset of trade negotiators, obtaining preferential market access and not signing on to liberalising commitments is a double win. This is foolish– equivalent to shooting oneself in the foot when being offered the possibility of a head-start.

Unlike other collective action problems that require international commitments– climate change being a good example - countries stand to benefit from their own trade reforms regardless of what others may or may not do.

That narrow interests or misplaced political calculation gets in the way suggests that either the benefits of reform are not understood, or that they are ignored by parties making trade policy decisions at the international level.

HARD SELL, HARD YARDS....

If the WTO and its members wish to get round this problem, more will be needed than tinkering with decision-making processes or thinking of models for treaty negotiations. What is required is a concerted effort to make sure the social costs of protectionism, and by implication the benefits of liberalisation, are understood. Some advanced countries have institutions that are geared to do this – Australia with its Productivity Commission being a prime example. But most emerging and poorer countries do not have such institutions.

One way round this problem would be to invest much more heavily in the WTO's surveillance mechanism, the Trade Policy Review Mechanism (TPRM). Designed initially to provide all members with a transparent understanding of each other's trade policies, it is also clear the mechanism has a lot to offer citizens and stakeholders in terms of understanding the effects of their own governments' policies. In collaboration with other partners, notably the World Bank and regional development banks, the aim would be to develop domestic institutions and, importantly, constituencies that are pro-liberalisation.

None of these ideas are particularly new. Indeed, the idea that the TPRM should help create accountability, by costing the effects of protectionism, has been floated by WTO officials repeatedly over the two decades of the organisation's existence. But if the recent experience in Information Technology, in its successes and its incompleteness, tells us anything, it is less about negotiating models and more about the need to return to and relearn the oft-forgotten basics of trade reform.

CONTACT	**Amar Breckenridge** amar.breckenridge@frontier-economics.com
	Ian Hathaway ian.hathaway@frontier-economics.com
	Frontier Economics Ltd
	FRONTIER ECONOMICS EUROPE BRUSSELS | COLOGNE | DUBLIN | LONDON | MADRID
	www.frontier-economics.com