Up a Level in Asia:
Improving the Business and Investment Environment in the Asia Pacific Region

Remarks to the Global Business Dialogue

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About one year ago, shortly after I joined IBM, I paid a visit to the company's headquarters in Armonk, NY. Wandering around the building in search of the cafeteria, I came across a long hallway filled with memorabilia from IBM's nearly 100-year history. I started at the end of the hallway recounting the modern-day company and worked my way backwards in time. There was a vintage IBM PC from the 1980s, a System/360 mainframe computer from 1964, an IBM punch-card machine from the inter-war years, and lots of photos of engineers in white shirts, horn-rimmed glasses, and very thin ties. But then I came across a plaque engraved with the words, "World Peace Through World Trade."

The display explained that in 1938, long before the Bretton Woods conference and nearly a decade before the GATT was signed, IBM's legendary chairman, Thomas Watson, Sr., had those words engraved onto the side of IBM's new headquarters building at 590 Madison Avenue in New York. Watson said he advocated "the exchange not only of goods and services but of men and methods, ideas and ideals." He worked closely with the International Chamber of Commerce and in 1937 was elected its president. As an unapologetic believer in the power of economic openness and free trade, I certainly knew I had come to the right company.

IBM established its first sales office in Asia in 1923, and has been growing in the region ever since. Like other major American companies operating in Asia, IBM's priority in its early years in Asia was to promote global commerce and economic integration in Asian nations that were, at the time, islands of economic isolation.

How things have changed. Nearly a century later, Asian nations that once looked only inward now rush to conclude trade and investment agreements with one another, and to build a new Asian economic architecture designed to promote innovation and growth. Ironically, though, today many in America seem hesitant about further economic engagement with Asia. Free trade agreements with vital Asian allies are stalled, opposition in Congress to further expansion of free trade networks in East Asia is growing, and trade tensions with China are on the rise.

This all couldn't be happening at a worse time, because America is more dependent than ever on business with Asia. Indeed, today the Asian region accounts for about one-third of U.S. trade. U.S. trade with Asia reached nearly $1 trillion last year, and Asia's economic importance is on the rise. While the region was responsible for only a tiny sliver of the global economy in 1923, today Asia accounts for nearly 40 percent of global output on a purchasing-power-parity basis. Asian economies are presently growing much faster than economies in other regions of the world, in a trend that seems likely to continue.

Asia is Trading and Investing – Increasingly With Itself

But what is perhaps most interesting is that Asia is increasingly trading and investing *with itself*. According to the World Trade Organization (WTO), nearly 60 percent of all Asian trade is today intra-regional, up from less than 50 percent twenty years ago. Meanwhile, the United States is losing market share in Asia. The United States is the source of only about ten percent of Asia's imports, down from 20 percent two decades ago. Only about 14 percent of foreign direct investment (FDI) in Asia comes from the United States; 48 percent of FDI in Asia comes from other Asian countries.

In light of Asia's rapid moves toward intra-Asian economic integration, today I'd like to discuss two aspects of the business and investment environment in the region. First is what the United States and other Asian governments should do to create an Asian economic architecture that is not exclusionary, but rather is inclusive, transparent, and open in fostering deeper economic integration across the Pacific. Second, I will discuss the factors that I believe are most critical for Asian economies to make the transition from manufacturing, export-led economies toward services and innovation economies of the 21st Century.

Let me focus first on governments and the economic architectures they are building that affect business and investment. As I mentioned, the salient factor is the rapid move toward intra-Asian trade and investment frameworks.

There are a number of reasons why Asia is moving quickly toward regional economic integration. Certainly rapid economic growth, especially in China, is driving more trade. Much of Asia's intra-regional trade and investment is due to the integrated, just-in-time global supply chains of modern corporations like IBM. Indeed, a typical IT product made in China contains significant materials, components, and sub-assemblies from elsewhere in Asia.

There are more than 100 free trade agreements (FTAs) in existence or under negotiation within Asia today, and the number is growing fast. As of February 2008, Japan has bilateral economic partnership agreements with Singapore, Malaysia, Thailand, the Philippines, Brunei, and Indonesia, and is negotiating with Korea, Vietnam, India, and Australia. China has a goods-based FTA with ASEAN and is working to expand this to cover services and investment; it recently signed an FTA with New Zealand. Korea has an FTA with ASEAN and is negotiating with others. ASEAN has reached agreement in principle with Japan, and is busy working on FTAs with Australia and India. China has proposed a Northeast Asian FTA that would include Japan, China, and Korea. Japan would go even further, with a regional economic partnership arrangement involving all of Northeast Asia, ASEAN, Australia, New Zealand, and India.

Perhaps by now you've noticed – none of these regional trade arrangements include the United States.

The simple fact is that **America is falling behind** as Asian nations rush to integrate their economies. While more and more business networks are built between Asian economies, here in Washington, we're stuck reliving the trade debates of the 1980s. Congressional leaders demand managed trade in automobiles with Asia; labor unions want to cancel NAFTA; and China has replaced Japan as our chief economic bogeyman.

An Opportunity for American Leadership… But Not For Long

When I listen to Members of Congress argue that we should take a time-out on new trade initiatives, I think one of Thomas Watson's simple and declarative statements. He said, "There is no such thing as standing still. You cannot stay in one place; you either go forward or go backward."

And that is the choice facing policymakers today. America cannot stand by idly as a silent witness to Asia's rapid economic integration. Instead, the United States and its companies should be a *driver* in pushing forward a pan-Pacific economic architecture that includes the United States.

The Obama Administration has recognized the vital economic importance of Asia, and has made a good start by embracing the Trans-Pacific Partnership negotiations. But in the face of the rapid proliferation of intra-Asian economic agreements, the Administration should go one step further and announce a comprehensive Asian trade and investment strategy with at least five key elements:

1. **Pass the U.S.-Korea Free Trade Agreement**;
2. **Complete the TPP before** the APEC leaders meeting in 2011 and actively look to include other ASEAN countries as full members;
3. **Launch a significant new economic initiative with Japan**, such as a bilateral agreement in services;
4. **Keep the economic relationship with China on track** and complete negotiations for a Bilateral Investment Treaty;
5. Use APEC as a vehicle to launch **new sectoral liberalization initiatives**. IBM and seven other leading companies have proposed the creation of an International Digital Economy Agreement (IDEA) to liberalize trade in computer-related services and ICT products.

Ambitious? Yes. But these steps could lay the cornerstone for a larger Free Trade Area of the Asia Pacific (FTAAP) to be proposed during America's chairmanship of APEC in 2011. The TPP provides the template… America could come to the 2011 Leaders' Meeting with a strong core of countries agreed on the basic framework of a pan-Asian trade agreement, giving a strong incentive for still others to sign on.

It is not something that will happen overnight, but our strategy must be to work toward an FTAAP to achieve APEC's core agenda of trans-Pacific economic integration. It would have the benefit of bringing under one umbrella the plethora of sub-regional and bilateral free trade agreements which now exist in Asia, with harmonized rules and disciplines. It could serve as a useful catalyst for multilateral trade negotiations in the WTO, or could liberalize trade even further through WTO-plus commitments. And, perhaps most importantly, FTAAP would include the United States.

Economic Transformation in Asia

So far, I've talked about what the **United States** needs to do to catch up with the rapid pace of economic integration in Asia. But there are also key questions facing **Asia** as the region grows and seeks to diversify away from traditional manufacturing of increasingly commoditized goods.

IBM knows about economic transformation. Long known for manufacturing computers, IBM over the past decade has transformed itself from top to bottom. In 2009, hardware accounted for only 7% of the company's pre-tax income. More than 80% of the company's pre-tax income now comes from services and software. We have moved away from commoditized businesses like personal computers and hard disk drives, and invested in areas such as next generation data centers, business analytics, cloud computing, and green solutions. Our business is focused on consulting, software, and outsourced management of the IT and business-process operations of many large multinational enterprises. For most of the 20th Century, large IBM factories churned out computers and machinery. Today, IBM Global Delivery Centers employ many thousands of software engineers and service experts – in buildings filled with cubicles and team rooms instead of hard-hat areas and assembly lines.

Manufacturing prowess was the key to the Japanese economic miracle of the 1960s, the rise of the Four Asian Tiger economies, and China's economic boom. But how is Asia positioned to compete in the 21st Century knowledge economy, where expertise in services, software, and innovation will be the keys to national economic competitiveness?

There are four key factors that matter most in "moving up a level" in Asia as countries seek to be competitive in a services and innovation economy:

1. Workforce Policy and Skills. Services and software businesses are, in a very real sense, labor-intensive – they depend on access to skilled human capital. IBM alone employs more than 400,000 people in the 170 countries where we do business. Only those Asian counties that can reliably produce a large pool of skilled talent – with technical skills, language skills, and management skills – will effectively compete.

It is also important in the modern services and software economy that labor policies and regulations are updated to reflect modern working conditions. Software engineers don't punch a time clock or sit on an assembly line, yet in many Asian countries they work under labor regulations written for workers who once did. In services and software companies, employees may work non-traditional hours, may work from home, may travel for short-term assignments for clients, or may report to supervisors in other countries. It is important that labor laws and regulations take into account that new reality.

2. Innovation and IPR Policies. Cutting-edge technology businesses look closely when making investment decisions at government innovation policy, which means both non-discriminatory government incentives to support research industries, as well as protection of intellectual property rights. Technology innovation today is characterized by its open, collaboratory nature; products and services incorporate technology from many different companies and countries. With developers in multiple countries contributing to new innovations, it is difficult to say that software is written in any single place – it may often be the result of collaboration among developers in many countries.

The best way to promote investment in innovative industries is to allow open collaboration on ideas across borders, to give nondiscriminatory treatment to all good innovations rather than trying to assign a nationality to them, to avoid country-unique technical standards, and to provide strong protection for intellectual property.

3. Infrastructure. To effective provide services across borders, and to develop software in a globally collaborative environment, companies in services and innovation sectors will look to a technology economic infrastructure, especially the broadband telecommunications infrastructure. As IBM CEO Sam Palmisano recently wrote in the Wall Street Journal, today's economic infrastructure is infused with ever-increasing intelligence that generates huge amount of information and intelligence. One vital key to making ours a Smarter Planet is to ensure the deployment of modern broadband networks.

4. Tax Policy. And finally, globally integrated companies also look to competitiveness measures like tax structures on innovative industries. The U.S. is sadly lacking in this area, with both a statutory and effective corporate tax rate that far exceeds the OECD average, and certainly the average of many key Asian economies. As the Technology CEO Council recently demonstrated, the effective corporate tax rates paid by competitors in Korea, India and China are far less than effective rates paid by major U.S. technology companies such as IBM, Dell, and Intel.

And the U.S. R&D tax credit, which remains temporary and has expired, has slipped from being the best in the world to the 24th best in terms of tax relief provided per dollar of R&D invested. Japan, China, India, and Korea all have R&D tax credits that are far more attractive than that of the United States.

Conclusion

One wonders was a committed internationalist like Tom Watson would have thought of the current debate over America's economic relationship with Asia. Watson devoted himself to expanding American commercial relations with the world. He hosted so many world leaders at IBM's headquarters that Franklin Roosevelt once said, “"I take care of them in Washington. I have learned to rely confidently on Tom Watson to take care of them in New York." For Watson, the benefits of economic openness and international engagement were plainly evident.

Eighty years later, there are twin challenges to taking business and investment relationships with Asia to the next level. The first is the continuing specter of American economic isolationism – the risk of standing still at a time when Asia itself is catapulting toward greater economic integration. The second challenge is Asia's ability to come to grips with its own need for transformation – changing economies from manufacturing workshops built on exports toward more consumer-driven, service and innovation-oriented economies.

While I am a relative newcomer to IBM, I can predict what advice Watson would give us today: THINK. Think of the benefits of greater American economic engagement with Asia, the fastest-growing region of the world. Think of the perils of falling behind if America turns inward while Asia moves toward greater economic cooperation. Think of the possibilities if dynamic Asian countries can turn their considerable energies toward being more open and innovative services-led economies. Think of the societal benefits in Asia where infrastructure is not just bigger, but also smarter. Just think of it.

Thank you.