



**The Keys to the Back Office:  
Building a Legal and Policy Framework to Attract IT-Enabled Outsourcing\***

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**I. INTRODUCTION**

Information technologies (IT) overcome physical distance, making it cost-effective for firms in more developed countries to “outsource” business processes to locations with lower wages. A number of countries have developed “back office” economies providing data processing and other IT-enabled services for corporations around the world. Part of the success of these efforts depends on the adoption of laws and government policies that are favorable to foreign investment in outsourcing based on IT.

“Outsourcing” is not a new concept: it occurs anytime one enterprise makes a contract with another to perform a process that used to be done internally by the first enterprise. In the late 1960s, however, outsourcing took a major leap forward when firms began to use data transfers to outsource their payroll administration, i.e., the task of calculating workers’ wages and deductions and issuing checks. This marked the emergence of a powerful concept: IT-enabled outsourcing. In the past decade, with the advance of information technology, outsourcing has expanded to many different functions.

**Scope of IT-Enabled Outsourcing**

- **Back office:** payroll; accounting; finance; tax preparation; internal auditing; processing of documents, transcripts, applications, or claims; data storage
- **Front office:** marketing & customer service through call centers, email, websites
- **Operation departments:** procurement, inventory and supply chain management
- **Special projects:** Y2K readiness, transition to new software

IT-enabled outsourcing is a rapidly growing market. Business process outsourcing as a whole totaled \$150-200 billion in 2000, and could reach \$550 billion by 2004. McKinsey

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estimates that IT-enabled outsourcing, in particular, will reach \$500 billion by 2008. Outsourcing of finance and accounting processes is growing 28% annually, faster than any other segment of the outsourcing market.

Though outsourcing contracts were principally domestic in the beginning, IT-enabled outsourcing quickly became international. New technologies increasingly enable firms to move data across borders quickly and inexpensively. As a result, firms are able to take advantage of other countries' competitive advantages, most importantly lower labor costs. For example, labor costs account for two-thirds of the operational costs of a call center. (A call center is a pool of service representatives who respond to customer telephone calls.) Outsourcing telephone-based customer service to a developing country where wages are low can generate savings of 40-50%.

#### **Advantages of International IT-Enabled Outsourcing**

- **Operational costs:** Typical cost breakdown is 70% labor, 15% real estate, 15% technology. Lower labor costs (and sometimes lower real estate costs) offset higher technology and monitoring costs.
- **Workforce availability:** The supply of skilled and semi-skilled labor (with language skills) in developing countries may be limited, particularly in small countries, but high. unemployment in developing countries and very low unemployment in the US, Europe, and Japan during boom years often results in greater workforce availability overseas.
- **Time zone:** International outsourcing can facilitate round-the-clock processing.
- **Regional markets:** International outsourcing can more efficiently support regional operations.

Countries that have successfully attracted IT-enabled outsourcing have boosted their economic development. For example, before Ireland created for itself a niche in providing services to European and US firms, it was struggling economically. Now it enjoys the EU's fastest growth: 7.5% in 2000. Its unemployment rate is the lowest in 18 years. India, too, is gaining from its competitive advantages as a site for outsourcing. In 2001, it attracted \$829 million in IT-enabled outsource contracts, which employed 68,000 people. Current projections are that this could grow to \$17 billion and 1.1 million jobs by 2008. One study predicts that IT-enabled outsourcing will contribute \$1 trillion to India's GDP over the next decade.

#### **Models of International IT-Enabled Outsourcing**

- **Out-tasking model:** export a task and, upon completion, import it for use in home country
- **7/24 model:** maintain a continuous work schedule by having teams in various time zones
- **Foreign local subsidiary model:** outsource tasks in support of operations in that country
- **Global model:** establish data and service center overseas to support global operations

Other countries are trying to copy these successes. From Caribbean islands to Russia’s “Cyberia,” countries are implementing strategic plans to make themselves ideal sites for IT-enabled outsourcing. Many of the principal factors supporting IT enabled outsourcing are essentially non-legal. But a nation can improve its potential to attract this kind of investment if it adopts a legal framework that supports IT-enabled outsourcing.

The purpose of this paper is to outline elements of the ideal legal framework for IT-enabled outsourcing. Section 1 has defined IT-enabled outsourcing and described in broad terms the factors that motivate firms to use it. Section 2 analyzes firms that are engaged in IT-enabled outsourcing to determine their legal needs. Section 3 analyzes the legal frameworks in several countries that have taken steps to develop an IT-enabled outsourcing economy. Section 4 presents a three-tiered legal framework that should help any country interested in attracting IT-enabled outsourcing.

#### **Principal Factors in Attracting IT-Enabled Outsourcing**

- **Operational costs:** labor, real estate, telecommunications, taxes & tariffs
- **Workforce availability:** employment rates, productivity, turnover, skills, language
- **Infrastructure:** IT infrastructure, transportation, power
- **Legal framework:** laws, enforcement, government incentives, stability, transparency

## **II. WHO ARE THE BUYERS AND PROVIDERS OF OUTSOURCING SERVICES?**

### **A. A Brief Overview of Outsourcing Markets**

To design the ideal legal framework, we first need to understand the needs of the firms that engage in outsourcing. These firms can be classified as “buyers” and “providers” and can be further categorized according to their role in the market, their size, their service specialty, and their geography.

#### **The Types of Firms Engaged in Outsourcing**

##### **Role in the Market**

- **Providers:** firms that provide IT-enabled outsourcing services consider a country’s legal framework, among other factors, when deciding where to locate their facilities.
- **Buyers:** firms deciding to which provider they should outsource their processes look for low cost, high quality, and predictability, all of which are influenced by the legal framework.

## Size

- **IT-integrators:** large companies that establish global networks of service centers at which they centralize the IT-enabled outsourcing work of multiple clients to achieve economies of scale. These service centers are becoming larger, making office space and bandwidth capacity critical.
- **Application Service Providers (ASPS):** Smaller providers that generally focus on one process or industry and handle medium-sized accounts. They, too, are growing larger, thanks to rapid consolidation and a geometric increase in total clients served by ASPS.

## Service specialty

- **Back office:** clerical, accounting, and software skills are more important than language skills because the IT-enabled outsourcing service provider interacts only with its client.
- **Front office:** Telecom is more important for front office operations (e.g., call centers) than it is for back office operations, and language skills are as important as other skills because the IT-enabled outsourcing service provider interacts with its client's customers.

## Geography

- **North America:** There is little distinction between United States firms and Canadian firms.
- **Europe:** Firms in European Union countries may start with a preference for outsourcing to firms in other EU countries, given the harmonized law within the internal market, especially concerning import-free treatment, data protection and labor regulations. (The same effect occurs within other free trade areas, such as NAFTA, CARICOM, etc.)
- **Asia/Pacific:** Australian firms outsource much more than do firms in the Asian Far East.

According to a 1998-1999 study, firms in the United States, Canada, and Australia outsourced business processes more frequently than did firms in Japan, Europe, and South America. Firms reported that they are likely to outsource highly clerical processes, such as payroll, benefits, and claims management, but other processes, including tax compliance and accounting, which call for significant professional expertise, are also outsourced (Appendix A). Cost savings are the chief reason why firms outsource (Appendix B). Uncertain performance standards are the principal factor that discourage them from doing so (Appendix C). When selecting an IT-enabled outsourcing service provider, firms consider a wide range of factors, including training and experience, but the most important consideration is whether the service provider will guarantee certain service levels (Appendix D).

Government procurement and the general climate for foreign direct investment (FDI) are also factors in site selection. Government contracts can attract an IT-enabled outsourcing service center that may subsequently expand to serve a larger range of clients. Similarly, many buyers of outsourcing services prefer providers located in a country in which the buyer has significant

business operations. Thus, policies that attract FDI in general will also attract IT-enabled outsourcing in particular.

## **B. Principles to Guide the Design of Legal Frameworks for IT-Enabled Outsourcing**

Based on these observations, one can ascertain several principles to guide policymakers in designing a legal framework to attract IT-enabled outsourcing:

- **Market reforms:** First generation reforms -- already instituted or in the process of being instituted by many countries -- include the introduction of competition (particularly in telecoms), privatization or private management of state-owned businesses, deregulation, tax simplification, fiscal discipline, labor market liberalization, and free trade.
- **Global legal integration:** Buyers of outsourcing services will demand predictability of the legal framework, measured by harmonization with international norms.
- **Enforceability of contract rights:** A buyer of outsourcing services will want to enter into a contract with the service provider that includes detailed performance measures, guaranteed costs, and rights to monitor quality. Such contracts often have complex terms that tie payment to performance. The buyer of outsourcing services must be confident that such a contract is enforceable in local courts.
- **Low trade barriers:** High tariffs imposed by countries whose domestic firms buy IT-enabled outsourcing can wipe out cost savings, which are the principal motivation for outsourcing. Import controls on technology (computers, internet routers, etc.) and export controls on data can also make IT-enabled outsourcing impossible.
- **Transparency:** Clear and accurate information on the legal system must be available to IT-enabled outsourcing providers, to buyers, and to the consultants who evaluate countries for their potential to provide outsourcing services.
- **Transaction costs:** Bureaucratic delays, cumbersome licensing requirements, and corruption increase the cost of doing business. Because cost is the most important motivation for IT-enabled outsourcing, the costs of regulatory compliance and corruption are very relevant to the site selection process.
- **Government investment and industrial policy:** Government procurement, investment, and tax incentives can be critical to ensure that a country has sufficient capacity (e.g., in telecom, skilled labor, office space) for large-scale operations.
- **Education and skills training:** Buyers and providers of IT-enabled outsourcing value workers with specialized training in the relevant process and industry.

### III. OTHER COUNTRIES' EFFORTS TO ATTRACT IT-ENABLED OUTSOURCING

A variety of factors can contribute to a country's ability to attract IT-enabled outsourcing contracts. Most important is the availability of suitable labor at lower wages than the outsourcing firm would have to pay at home. Undoubtedly, India is attractive because of its 30-50 million unemployed or underemployed English speakers capable of doing dependable clerical work for a tenth of the going rate in the United States. Unemployment rates can change, however, in part due to the success of IT-driven growth. Because Ireland was so successful in attracting IT-enabled outsourcing, its capital, Dublin, which once suffered from chronic underemployment, now has essentially no excess clerical capacity. As a result, Northern Ireland, which offers similar conditions, is now also attracting IT-enabled outsourcing. Language is another important factor. Certainly, language was important to India's early success. But the relative importance of language is changing, too. Whereas just a few years ago, English-speaking Barbados had an advantage over Spanish-speaking Dominican Republic in competing for IT-enabled outsourcing contracts with customers in the US, the growth of the Hispanic market in the US means that both countries have now found a niche, as has bilingual Panama.

While these factors can change over time, one consistently important factor is legal and regulatory policy. Some of the legal reforms and public policies that attract IT-enabled outsourcing are policies that support economic development in general. For example, the adoption of the Euro has removed currency risk as a factor in IT-enabled outsourcing contracts signed within the European Union. Other factors favor FDI in general. For example, the Scottish government has joined with prospective employers and training firms to run an employee referral program, which attracts new firms to Scotland by making it easier for them to recruit prospective employees. Other innovations focus explicitly on IT. The Welsh Development Agency, for example, coordinates with local governments to offer fast-track regulatory clearance for IT firms of a certain scale. Still other government initiatives focus explicitly on IT-enabled outsourcing. The Labor office in Bremen, Germany, for example, runs a training program specifically for "call center" operations.

A review of four countries' efforts at attracting IT-enabled outsourcing provides a general sense of the most relevant legal and public policy factors.

#### A. Northern Ireland

Northern Ireland is striving to join the Republic of Ireland as the leading site for IT-enabled outsourcing in Europe. Its policy framework includes:

- **Global legal integration:** As part of the United Kingdom, Northern Ireland benefits from EU membership and the UK's well-developed and familiar legal system.
- **Favorable taxes:** The tax law in Northern Ireland includes accelerated depreciation (25% per year) for IT firms, a research and development (R&D) tax credit, and lower corporate taxes (30%) than anywhere in Europe except Ireland (20%) and Sweden. VAT does not apply to outsourced services like bank credit management.

- **Strong educational system:** Public universities & institutes produce 3500 graduates with IT degrees each year.
- **Government incentives:** The Industrial Development Board of the Ministry of Enterprise, Trade and Investment (i) has offices in North America, Europe, and Asia Pacific; (ii) designs tailor-made assistance packages; (iii) funds pre-employment training and provides grants for 50% of corporate training costs; and (iv) aids firms in employee recruitment. Government provides capital grants for building and equipment and recently created IT parks, which provide state-of-the-art office space and services at below-market prices. New IT office space is being developed by the Speculative Build Initiative, a public-private partnership, which also advises firms on office selection.
- **Competitive telecom market:** Northern Ireland is served by more than 60 telecom operators, including five fixed network operators.

## B. Jamaica

Jamaica may have a more extensive policy to attract IT-enabled outsourcing than any other developing country in the Americas and, as such, is competing with Canada for IT-enabled outsourcing work for US firms.

- **Strategic plan for IT sector:** The government's five-year plan (2000-2005) to promote the IT sector encompasses human resource development, infrastructure development, new legislation, and general policies to stimulate economic growth. The President's Information Technology Advisory Council conducts an ongoing review of the industry and helps fashion national industrial policy.
- **Global integration:** Bilateral trade treaties with ten countries. Member of CARICOM free trade zone, WTO, British Commonwealth.
- **Government incentives:** The Export Free Zone Act includes the following benefits: (i) exemption from income tax and from import duties, licensing, and quantity restrictions; (ii) accelerated depreciation of 50% on hardware annually if at least 20% of gross income is from exports; (iii) simplified customs procedures; (iv) no foreign exchange controls; and (v) access to Jamaica Digiport (see below). The Export Industry Encouragement Act provides a ten-year tax holiday for foreign export-oriented firms that do not qualify for benefits under Export Free Zone Act.
- **Human resources training programs:** The national training agency runs 80-hour IT-enabled outsourcing training programs and provides per-employee grants for firms to participate. Also provides per-employee grants for training by firms. The public university offers degrees in computer science. Under the five-year plan, the Caribbean Institute of Technology was established, and public-private partnerships are being formed to increase computer literacy training at all levels of the public school system.
- **Government investment in infrastructure:** The five-year plan includes development of government-owned parks for IT-enabled outsourcing operations. Jamaica Digiport provides

firms in the Montego Bay Free Zone (i) an independent power grid; (ii) a 100% digital, fiber optic network and excess-capacity bandwidth; (iii) international calling and Internet rates that are multiples lower than publicly available rates; and (iv) freedom for firms to develop their own telecom infrastructure using VSAT or to use leased line services via US domestic satellites. The government's IT Loan Fund finances office buildings, utility connections, hardware, and related expenses.

- **Telecom competition:** The Telecom Liberalization Act of 1999 provides for full competition by February 2003. The first two stages are underway, providing for new entrants in mobile and domestic voice services. Currently, there are two new wireless providers but just one land-line operator.

### C. New Zealand

New Zealand competes with Australia and the Philippines for first place among developed and developing countries in the Asia-Pacific region as a favorable site for IT-enabled outsourcing.

- **Competitive telecom sector:** Competitive telecom and Internet market, with network redundancy, high capacity, decreasing line costs, private sector investment in fiber optics systems, and decreasing line costs. More than 60 ISPs; numerous wireline and wireless telecommunications service providers; four international cable systems with terminal sites in New Zealand and satellite links. Government ensures link availability of 99.8 percent so that outsourcing service providers can guarantee it in their service level agreements.
- **Liberalized business law:** Non-discrimination between domestic & foreign firms. No special restrictions on foreign investment or investors. No capital gains tax.
- **Liberalized labor market:** Full contract rights under the Employment Contracts Act. No payroll tax. Worker's compensation is the only mandatory employee benefit.
- **Human resources:** The New Zealand Qualification Authority works with the private sector to establish national standards for IT-enabled outsourcing training (especially for call centers). Firms receive per-employee training grants. Public universities offer an e-commerce degree, and secondary schools offer technical training for call center jobs.
- **Government support:** The Immigration Service expedites visa applications for employees in the IT sector. The New Zealand Trade Development Board (in partnership with the private sector) attracts call centers and other IT-enabled outsourcing by providing information and other assistance during the investigation stage in order to decrease the costs of establishing operations in New Zealand. Its services include introductions to recruitment companies, government agencies, telecom and technology providers; streamlined immigration procedures; VIP fact-finding trips and briefings; detailed studies of projected operational costs; and publications and a promotional and informational website.
- **Infrastructure:** The government provides capital grants for building and equipment and has recently created IT parks, which provide state-of-the-art office space and services at below



market prices. New IT office space is being developed by the Speculative Build Initiative, a public-private partnership, which also advises firms on office selection.

- **Benchmarking:** In order to prove its productivity and other competitive advantages, New Zealand participates in international performance surveys. Placed first in the 2001 Teleperformance Grand Prix Telephone Service Awards.

#### **D. India**

By many measures, India is the leading IT-enabled outsourcing site among developing countries in Asia and Africa. But this development has occurred despite barriers in the Indian legal system that are only now beginning to be corrected. As a result, the spread of IT in India has actually been limited, and Indian society as a whole has not fully benefited from the information economy. India still ranks behind other countries on many measures of ITC development. Therefore, we caution other developing nations in considering the India model. Nevertheless, among the factors supporting the undeniably dramatic growth of IT-enabled outsourcing in India are:

- **Human resources:** Massive public expenditure on higher education, particularly the Indian Institute of Technology and other business and technology schools. Bangalore, home to the best universities, is the IT-enabled outsourcing “capital.” The state of Madras spent \$10 million to install computers and teach computer skills in schools.
- **Special regime for foreign IT firms:** The Software Technology Parks of India (STPI) program (i) exempts participants from 30-40% duties on technology imports, so long as premises are customs bonded; (ii) sets revenue targets that, if met, trigger a five-year tax holiday; and (iii) allows repatriation of profits, calculated in accordance with approved accounting rules.
- **Intellectual property:** Standard laws protect intellectual property. Privacy and security of proprietary data can be protected by contract.
- **Subsidies for infrastructure:** In response to the poor service quality and high tariffs of the state telecom carrier, Bangalore city government supported the establishment of high-tech industrial centers, which have access to sufficient bandwidth and office space. The government of Madras spent \$85 million to build a state-of-the-art technology park.
- **Employment contracts:** Very flexible labor terms, allowing long hours and 24/7 operations, as well as unrestricted use of part-time or temporary workers. Unionization is minimal among skilled and semi-skilled workers and is distrusted generally.

On the other hand, India has not been able to take wider advantage of its IT potential as it is still hampered by legal and regulatory deficiencies:

- **Telecom & other infrastructure:** The state telecom carrier, VSNL, provides very poor service at high rates. Its monopoly on domestic and international phone and Internet service ended only last year.

- **Bureaucracy and public corruption:** Police, customs officials, and bureaucrats are often slow in acting and frequently corrupt.

#### IV. THE LEGAL AND POLICY FRAMEWORK FOR IT-ENABLED OUTSOURCING

Economic growth depends upon a number of factors, but chief among these are legal institutions like property and contract rights and the rule of law in general, as well as other governmental policies. The legal and policy framework has three elements: (i) formal legal norms, (ii) an execution and enforcement infrastructure, and (iii) informal social and cultural norms. In the sphere of intellectual property rights, for example, the first element includes the WIPO Copyright Treaty and domestic patent law. The second includes IP competence in the judiciary, the seizure of infringing copies by the police, and IP registration and protection agencies. The third includes popular appreciation for innovation and respect for IP rights. For a legal and policy framework to work, it must unite all three elements in practice.

##### Three Tiers of a Legal Institution

- **Formal legal norms:** treaties, laws, regulations, judicial rulings, public policies
- **Enforcement infrastructure:** organizations and personnel, both governmental and private
- **Informal social and cultural norms:** tradition, values, public opinion, market habits

##### A. Formal Legal Norms and Governmental Policies

The legal and governmental policies recommended here are described in substance, but it is left for individual countries to determine how to adopt the rules or policies within their systems. Further, each country must decide whether the norms described here can serve as a general legal framework or should be limited as a special set of rules applicable only to foreign firms, or only to IT firms, or only to IT-enabled outsourcing providers and buyers.

As discussed previously, buyers and providers of IT-enabled outsourcing respond to the whole set of issues that affect foreign direct investment (FDI) in general. These include, among others, contract enforceability and the rule of law, transparency, intellectual property, taxes, trade barriers, business regulations, labor regulations, and data privacy. The policies established in each of these spheres can serve not only to create an environment supporting FDI in general but also to address the particular needs of IT-enabled outsourcing. For example, foreign firms of any type are concerned about taxes on asset transfers, but the issue is especially important for IT-enabled outsourcing, since many IT-enabled outsourcing contracts are structured as transfers of the assets that are associated with the outsourced business process. Obviously, labor laws also take on greater import, since IT-enabled outsourcing's chief reason for being is to tap a broader and less expensive labor force. And IT-enabled outsourcing is very concerned about intellectual property and privacy.

Following are some of the key areas that should be addressed in developing a framework for attracting IT-enabled outsourcing contracts.

## 1. Telecommunications Reform

**Telecom liberalization:** IT-enabled outsourcing, like all applications in the information age, depends on telecommunications. To ensure that there is sufficient and reliable bandwidth at a high enough speed and low enough price, the telecom sector should be fully liberalized -- starting with the introduction of competition and free-market pricing, followed by privatization. Demonopolization and the other aspects of liberalization have increased supply, improved service quality, and decreased the cost of telecommunications services in many countries.

## 2. Business Regulations

- **Licenses:** The delay in starting a new business due to “red tape” should be reduced to a minimum by streamlining licensing procedures. No government approvals should be required for an IT-enabled outsourcing provider to take on a new client, and business licenses should cover IT-enabled outsourcing as a whole rather than restricting firms to a particular process or industry.
- **Zoning permits:** Local planning boards should expedite the processing of zoning permits.
- **Telemarketing restrictions:** The relationship of a call center with individual consumers will normally be subject to the rules of the place where the consumers live. In the US, for example, the Federal Trade Commission and state agencies enforce telemarketing regulations (including do-not-call lists, third-party verification approval requirements, and time-of-day limits) against firms dealing with US consumers through off-shore call centers. In order to avoid duplicate or conflicting regulations, it should be made clear that regulations on telemarketing within the country where the service center is located do not apply to contacts made with consumers in other countries.

## 3. Intellectual Property

- **Multilateral agreements:** The country should ratify the Berne Convention, which requires recognition of IP rights, including well-known trademarks. The country should also join the World Intellectual Property Organization (WIPO), and ratify the WIPO Copyright Treaty and the TRIPS agreement of the World Trade Organization (WTO).
- **Registration:** If the country does not already have an efficient IP registration system, it should join a regional registration system, such as WIPO’s in Geneva. Well-known trademarks registered in other countries should enjoy protection against domestic later-filed applications. IT-enabled outsourcing providers and any third parties should be prohibited from registering intellectual property that was previously registered in another country by the IT-enabled outsourcing buyer and disclosed by it pursuant to an IT-enabled outsourcing contract. Proprietary business processes should be protected as trade secrets or other intellectual property as appropriate.
- **Statutory protection:** Unauthorized use or interference with a copyright (including on the Internet), trademark, patent, trade secret, or domain name should be actionable through a

private suit for compensatory and/or punitive damages, an administrative enforcement action (resulting in a fine and/or injunction), or, in the case of willful or reckless action, criminal prosecution.

#### 4. Cross-Border Restrictions

- **Import rules:** Software and hardware (including both computers and telecom equipment) should be exempted from import duties and quantity restrictions. Though the ideal would be a general exemption, it could alternatively be granted only to foreign firms that register a business plan satisfying certain revenue or job creation goals or that qualify for a free trade zone. Limiting the exemption to only some firms would require customs bonding, however, which increases regulatory compliance costs and the potential for bureaucratic corruption.
- **Export rules:** Software developed in-country should be exportable without restriction and without fee. Otherwise, IT-enabled outsourcing buyers will be denied one of the principle benefits of outsourcing.
- **Immigration:** Expedited visa processing should be available for personnel associated with IT-enabled outsourcing. Reciprocal visa waivers should be reached with countries that are key IT-enabled outsourcing markets, if possible.
- **Foreign currency:** There should be no restriction on transfers of foreign currency into the country, and the same quantity as imported should be exportable without restrictions or fees.
- **Foreign ownership:** There should be no restrictions on foreign participation in domestic industries (including telecom), whether through acquisition, partnership, or original investment. Nor should foreign firms be required to incorporate their operations within the country or to take on a domestic partner.
- **Free trade agreements:** Countries should join the WTO and all appropriate regional free trade blocs. Bilateral trade treaties should also be negotiated with principal IT-enabled outsourcing markets. Trade negotiations should pursue terms that allow free data flow, free import and export of technology, and zero taxes & tariffs on cross-border IT-enabled outsourcing.

#### 5. Contract Rights

- **No restrictions on performance metrics and payments:** Complete freedom of contract should be guaranteed, provided that the negotiated terms have a commercial purpose and are construed to include a duty of good faith and fair dealing. In particular, performance metrics and payments specified in IT-enabled outsourcing contracts should be a matter solely for negotiation between the parties. Service level agreements are very technical and should not be subject to revision or invalidation by function of law (such as the provision under one country's law that invalidates penalties for missing a performance standard unless there was a reasonable pre-estimate of damage).
- **Choice of law and language:** The parties to an IT-enabled outsourcing contract should be able to specify that their contract will be governed by the laws of the country they designate.

Contracts should be enforceable whether written in the national language or another language.

- **Joint ventures:** IT-enabled outsourcing relationships are increasingly structured as joint ventures. Given this, international joint ventures should be recognized explicitly in the law, and the contracts that give them form should be accorded the same legal weight as incorporation documents.

## 6. Data Flow and Privacy

- **Cross-border data flow:** Cross-border data flow should be protected from fees, restrictions, interception, or interference by any third party (with the limited exception of government surveillance as discussed below). Interception or interference by an unauthorized party should be criminalized.
- **Encryption:** Encryption of private data should be allowed, and no particular technology should be mandated. Imported encryption equipment should be duty-free.
- **EU's Data Privacy Directive:** Data security and privacy protections should be adequate to meet the EU's data privacy laws. Disclosure of protected information by the IT-enabled outsourcing provider should be actionable with both civil and -- if the disclosure was willful or reckless -- criminal penalties against the firm and/or the responsible employee.
- **Government surveillance:** Government surveillance of private email, Internet transmissions, or other telecommunications should be strictly limited and subject to prior judicial approval. Uncontrolled surveillance will discourage many IT-enabled outsourcing providers and buyers.
- **Content controls:** The government should engage in no content regulation of telecommunications, including on the Internet.

## 7. Taxes

- **Corporate tax:** Ideally, the general corporate tax rate should not exceed Ireland's 20%, which is Europe's lowest and thus a competitive benchmark. In some countries, training expenses, the full cost of any labor contracts assumed under the EU's Acquired Rights Directive, and software and process development costs are fully deductible. Accelerated depreciation is available for real estate and hardware. Depending upon the country's principal competitors, foreign firms should also be able to claim a special tax credit calculated on the basis of revenue and jobs generated, thereby creating incentives for IT-enabled outsourcing firms to expand in return for tax forgiveness.
- **Value-added tax:** VAT should not be charged on outsourcing contracts. If it is, it should be refundable on international outsourcing contracts, so as not to violate WTO export subsidy controls. VAT should also not be charged (or should be refunded) on international telecom services, which are so essential to IT-enabled outsourcing.

- **Stamp and transfer tax:** No tax should be imposed on international transfers of assets or stock, whether repatriation of profits or incoming transfers. This is especially important because outsourcing contracts are often structured as asset transfers. No stamp tax should be charged on legal documents.
- **Advance tax rulings:** Foreign firms of sufficient size should be eligible to negotiate binding advance tax rulings so that their tax treatment is predictable and stable. For firms with concerns about the direction of future legal reforms, the rulings could include stability clauses, guaranteeing the present terms for a certain period, even if the law changes.
- **Tax treaties:** Treaties avoiding double taxation should be negotiated with countries whose IT-enabled outsourcing providers or buyers may be a major source of business.

## B. Enforcement Infrastructure

In order to give laws and policies their intended effect, a country must have in place a system to ensure compliance and dispute resolution. That system depends upon trained personnel. Whether formal legal norms will successfully attract IT-enabled outsourcing also depends upon efficient provision of public services. Finally, the way the public sector is organized -- the various state agencies and how they interact -- affects both the compliance/dispute resolution system and the provision of public services.

### 1. Compliance and Dispute Resolution

- **Statutory enforcement:** Private enforcement suits and administrative claims should be authorized.
- **Independent regulators:** The agencies responsible for intellectual property, telecommunications, and/or consumer protection should be independent and have sufficient - and sufficiently well-trained -- staff to investigate complaints and enforce the laws.
- **Judiciary:** The constitution should guarantee judicial independence and due process. There should be a right to appeal administrative decisions. Judicial procedure should be published and adhered to.
- In some countries, specialized judges or specialized tribunals in the government's administrative agencies have been created to handle high-tech classes. Because IT-enabled outsourcing is a new topic and IT-enabled outsourcing contracts are highly technical, training should be offered to select judges on IT and IT-enabled outsourcing.
- **Alternative dispute resolution:** Because judicial reform is a long-term process, it is desirable to allow parties to an IT-enabled outsourcing contract to use alternative dispute resolution (ADR). The law should recognize any form of ADR chosen by the parties, whether within or without the country and binding or non-binding, and should enforce the results of any binding ADR process.

- **Self-regulation:** One method for minimizing dispute is through self-regulation. This effort could include the establishment of an IT-enabled outsourcing trade association and a public private partnership to establish a voluntary quality program, which IT-enabled outsourcing providers can join in order to demonstrate that they satisfy the level of service expected within the industry.

## 2. Workforce Development and Training

- **Educated workforce:** IT-enabled outsourcing requires a workforce that is IT-literate. Government can take several steps toward an IT-educated workforce: (1) IT should be included at all stages of the public education system; and (2) an IT-enabled outsourcing training program should be established, possibly with training grants for IT-enabled outsourcing providers whose employees participate.
- **Attorneys:** IT-enabled outsourcing is very contract-intensive. In order to ensure that the legal profession quickly develops IT-enabled outsourcing expertise, the government could (i) include instruction on IT-enabled outsourcing in the law curriculum of public universities; and (ii) use the country's membership in multilateral organizations to help local attorneys gain comparative legal knowledge (through international consultants, conferences, study-tours, professional exchanges, etc.)
- **Accountants:** IT-enabled outsourcing as a whole and outsourcing of finance and accounting processes in particular are very dependent upon the local accounting profession. The government can influence the curriculum in public universities and can encourage international cooperation by the profession. In addition, the government should offer special incentives (e.g., tax rebates, office space, etc.) to attract at least one of the major international accounting firms, since its presence will be a positive signal to IT-enabled outsourcing providers and buyers.

## 3. Public Services

- **Information:** The government can reduce the costs of setting up an outsourcing operation by providing IT-enabled outsourcing providers and buyers with information about the legal framework. The information should include: (i) legal summaries and guides to establishing and operating an IT-enabled outsourcing business in the country; (ii) detailed labor statistics and cost estimates for IT-enabled outsourcing operations; (iii) web directories of useful contacts, including government offices, telecom and other service providers; real estate firms; recruitment and training firms; and (iv) benchmarks and comparisons with other countries.
- **IT parks:** Numerous countries have established IT parks or IT-enabled outsourcing free trade zones. These parks often include cutting-edge telecom links, a separate power grid, and modern tech-equipped offices. In addition to the lower taxes and other incentives that may be offered, such parks can create a "cluster" effect. Creating an IT-enabled outsourcing center in the country could entice IT-enabled outsourcing providers, which would be attracted by adequate infrastructure and the connections and economies of scale generated by proximity to others in the industry. IT parks also serve as ideal laboratories, if the

government determines that some of the laws recommended in this paper should be of limited application rather than being applied generally.

However, planners need to pay attention to a countervailing consideration: IT-enabled outsourcing providers are often concerned that the local labor market will be saturated. Accordingly, those creating IT parks must be sure not to exceed the capacity of the local labor market.

#### 4. Public sector organization

- **IT-enabled outsourcing specialization:** The government should develop some IT-enabled outsourcing specialization. There are two main ways to organize this expertise: (i) maintain an IT-enabled outsourcing office at each major state agency, e.g., a Vice Minister of IT-enabled outsourcing at the Ministry of Trade, IT-enabled outsourcing training specialists at the Ministry of Education, etc.; or (ii) establish a centralized IT-enabled outsourcing agency to implement IT-enabled outsourcing policy. Probably the best model melds these two with a national coordinator in the President's Office, who presides over a national IT-enabled outsourcing council composed of all relevant Ministries (and business and civil society).
- **Strategic planning:** A coordinated campaign to attract IT-enabled outsourcing requires a national strategy developed by a consultation process involving government, business, and civil society. A National Advisory Counsel for IT-enabled outsourcing could play an ongoing role in monitoring progress and recommending new policies.
- **Government's promotional role:** A key element of the government's role is to provide information to potential outsourcing buyers and providers. This could include government-sponsored inspection trips or presentations for IT-enabled outsourcing firms and consultants investigating the country, conferences, trade fairs, etc.
- **Public-private partnerships:** The framework described here includes more programs than most governments can likely finance or operate on their own. Furthermore, if the government is to develop a framework to appeal to private sector parties, it must work closely with the private sector in designing and implementing it. Thus, the government should seek private sector partners -- businesses and trade associations, but also universities and other civil society actors -- both to formulate policy and to carry out programs.
- **Government procurement:** One of the best ways to "jump-start" the IT-enabled outsourcing economy is for the government to outsource its data-processing. In the UK, government outsourcing was the initial driver behind IT-enabled outsourcing, until sufficient infrastructure and expertise had been developed to entice private sector clients.

#### C. Informal Social and Cultural Norms

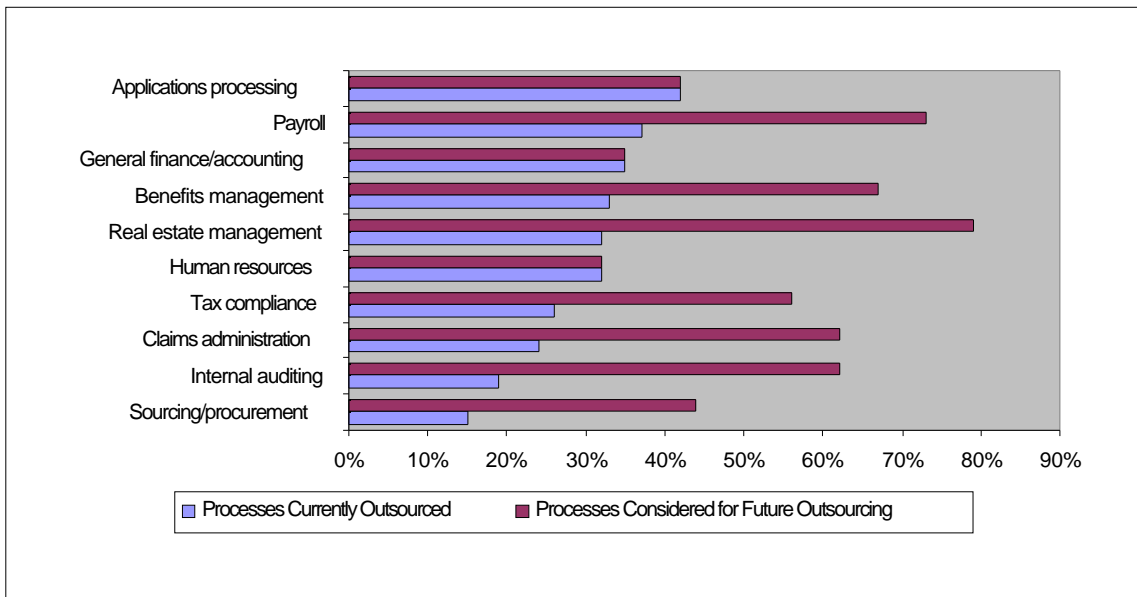
The final element of an effective legal framework is the complex network of underlying conventions that affect how employees, employers, government officials, and civil society relate to the formal legal norms and enforcement infrastructure:



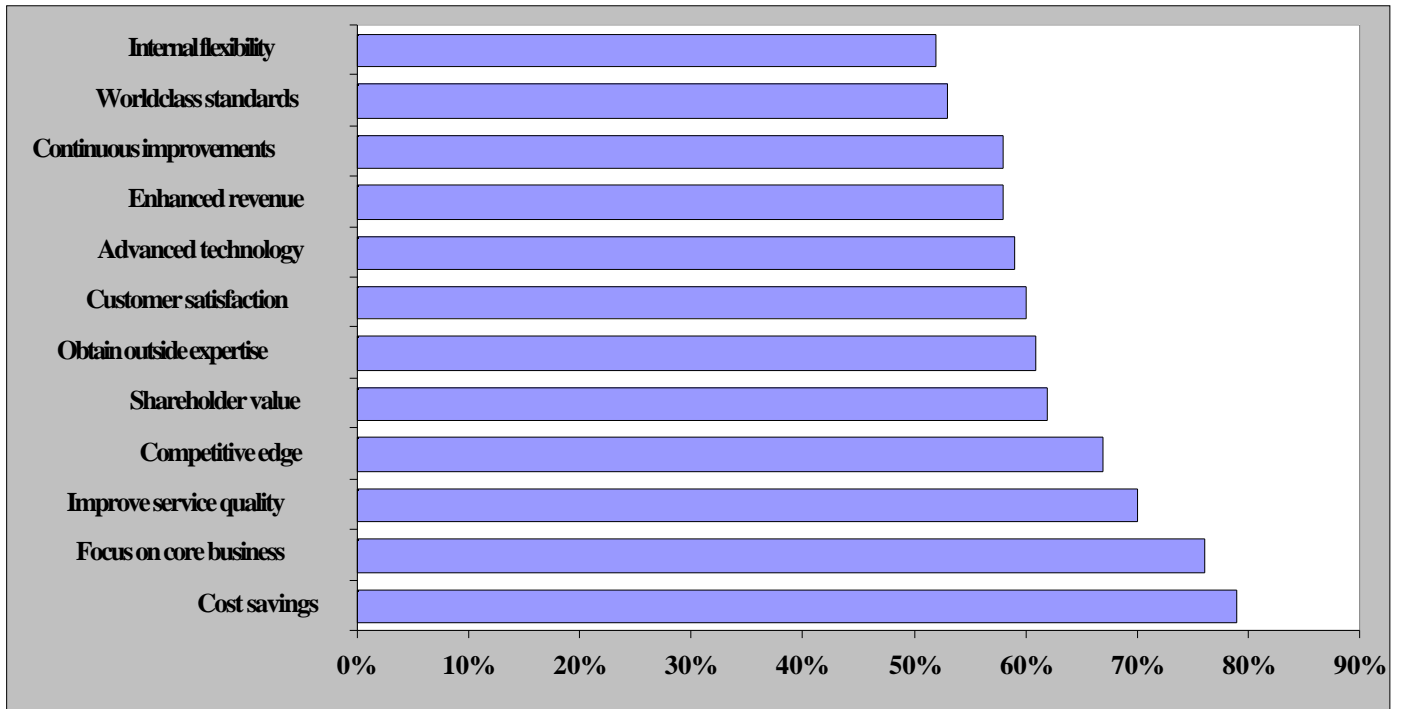
- **Democratic, free market ethos:** The international business community believes that, in order to sustain a pro-business environment, a country's government and business elite must subscribe to a democratic, free market ethos. Democratic processes and the free market principles of private property, contract rights, the rule of law, and limited government should be guaranteed.
- **National consensus:** A country's success in attracting IT-enabled outsourcing depends on cooperation between government and civil society, based on a process of consensus-building that involves government, business, labor, universities, religious and civil organizations, etc.
- **Transparency:** Unless the legal framework and government processes are transparent, IT-enabled outsourcing providers and buyers will not have enough information on which to base their decisions about site selection/provider selection. As a result, the "country risk" will be too high to justify an investment.
- **Corruption:** Public corruption increases the cost of operations and decreases legal predictability -- highly unfavorable to IT-enabled outsourcing, which is very cost-sensitive and depends upon detailed, enforceable contracts. Furthermore, corruption poses a special problem for US firms, which face severe civil and criminal liability at home if they engage in corrupt business practices overseas. Countries should enforce laws against corruption and improve enforcement mechanisms so that firms can report corrupt public officials confidentially.

For more information, contact Jim Dempsey, GIPI Policy Director, [jdempsey@cdt.org](mailto:jdempsey@cdt.org).

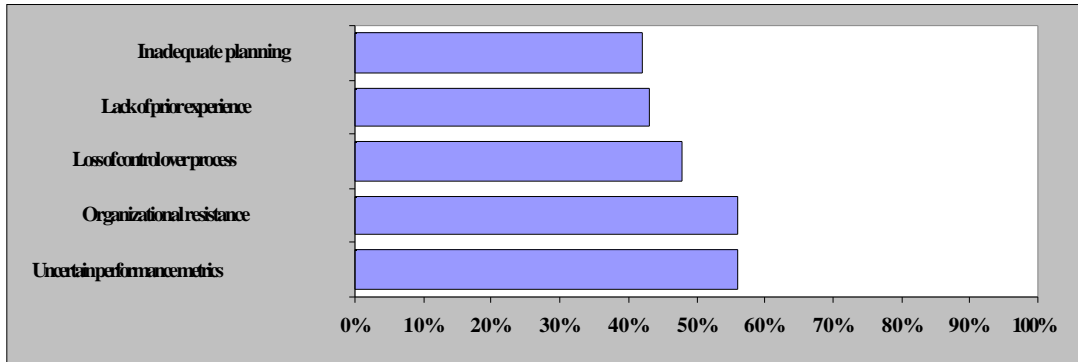
Processes Outsourced



Expected Benefits of Outsourcing



### Barriers to Using Outsourcing



### Service Provider Selection Factors

