



# Australian Services Roundtable

Submission by the Australian Services Roundtable

Productivity Commission

Barriers to Services Exports

25 June 2015

## Executive Summary

- The Australian Services Roundtable (ASR) is pleased the Government has directed the Productivity Commission to undertake a review of barriers to growing exports of Australian services (the “Review”). The ASR welcomes the Review and the opportunity to provide this Submission.
- The ASR represents the Australian Services Industry across a range of sectors including professional services, including architecture, engineering and legal services), ICT, education and financial services.
- The Australian services industry is a crucial driver of economic growth in the Australian economy and a major employer. The prominence of services continues to heighten as the mining investment boom ebbs.
- The shift in the centre of global economic growth to Asia and the growth of incomes in our region brings substantial opportunities for Australian industry to high quality services to the region.
- ASR represents industry and seeks policy outcomes both domestically and internationally. In particular ASR seeks domestic policy reform to enable the productivity of Australian services industry to improve domestically and to enable it to compete regionally and globally.
- This Submission examines domestic barriers to increasing exports and international barriers.
- It also reviews and suggests refinements to Australia’s trade negotiation strategy, agenda and practice.
- The ASR makes a number of recommendations which are intended to frame and influence the debate and the Government’s domestic policy agenda affecting services.
- These recommendations include:
  - An allocation of resources by Government on the Services plurilateral through the WTO;
  - A consideration of a framework employed by the United States which leads to more open trade negotiations;
  - A review of domestic barriers such as state based professional licensing and currency restrictions and payment systems;
  - A focus by Australian Government Departments on enabling the Australian Services industry to understand, benefit from and implement business strategies and initiatives which are made possible by trade agreements; and
  - Consideration of a Government portfolio and bureaucratic structures to reflect the prominence and importance of services to the Australian economy.

## Recommendations

1. That Australia pursues multilateral free trade negotiations through the WTO as its highest priority.
2. Australia to continue to lead negotiation of the services plurilateral through the WTO.
3. An acknowledgement by the review panel that Australia is facing diminishing returns to investing in negotiating bilateral FTAs.
4. Australia to continue to lead negotiation of the services plurilateral through the WTO including a reallocation of resources once existing bilateral FTAs are finalised.
5. A consideration of a revised trade negotiation framework modelled on the principles and structure of:
  - a. The open trade negotiation regime used by the United States; and
  - b. The trade committee system used in the United States.
6. Development of an execution plan to highlight opportunities in bilateral FTAs for industry.
7. Consideration by Australian regulatory agencies to:
  - review and implement key concepts from FTA with a view to implementing the harmonisation of domestic regulation such as licensing arrangements; and
  - identify opportunities to harmonise regulation independently of FTA negotiations both bilaterally and at a regional level.
8. Seek to remove currency restrictions and harmonise payment systems when negotiating bilateral or regional FTA's.
9. Discuss regulation of payment systems at a regional forum with a view to harmonisation.
10. Consider reviewing the Department of Industry to ensure it has a capability and mandate to understand and represent the Australian Services Industry.
11. Incorporate within departments, such as Treasury Health, Education and Communications, the mission statement of enabling industry to increase exports.
12. Review, complete and release the Federation White Paper as a matter of priority.

## 1. International barriers

### 1.1 Australia's trade negotiations – the case for Multilateral FTAs

The outcomes of Australia's trade negotiations are a significant factor in determining the success of Australian services exporters. It is through trade negotiation that barriers to trade can be reduced or eliminated.

Multilateral trade agreements through the WTO have the greatest potential to increase Australia's trade in services and hence economic growth.

The economics of trade liberalisation are clear. The broader the scope of liberalisation across the greatest number of countries and the most number of sectors on a most favoured nation basis, then the greater is the trade and economic growth that follows. The more protection can be reduced and the broader the coverage, then the lower are the deadweight losses and the greater the welfare benefit.

#### *Recommendation 1*

*That Australia pursues multilateral free trade negotiations through the WTO as its highest priority.*

While multilateral negotiations should be the highest priority of Australia's negotiation strategy, due to very slow progress in the Doha Round ASR has recognised the need to pursue plurilateral, regional and bilateral agreements.

The level of services commitments on the table in Doha, even if the round were completed, is so low that it would have almost no impact on world trade.

Goowitz and Mattoo have conducted a study of what is on the table for negotiation in the Doha Round against the existing regulatory and trade policies of 56 industrial and developing countries. They found that the best services offers would reduce protection by 13 per cent, but are 1.9 per cent more restrictive than current policies for these countries. (Gootiiz & Mattoo, 2009, p. 8) If Doha was completed with what is on the table, countries would be signing up to a commitment which is on

average 99 per cent more restrictive than their current policies. Goowitz and Mattoo sum up the value of this, when they state, “The bottomline: At this stage, Doha promises somewhat greater security of access to services markets but not one iota of liberalization.” (Gootiiz & Mattoo, 2009, p. 2)

## **1.2 A focus on Services Plurilateral**

ASR was one of the first to call for a services plurilateral to be negotiated through the WTO. Given the Doha Round has been stalled on negotiation of agriculture and manufacturing trade, and the low services commitments, ASR called for services plurilateral by raising the prospect of a services only agreement at APEC. Since then, Australia has taken an active lead in driving the negotiation of a services only agreement.

There is a compelling economic case for focusing on services in the Doha Round. Services account for 68 per cent of world gross domestic product (GDP), whereas agriculture accounts for less than 10 per cent. In developed countries the share is 75 per cent on average and 50 per cent for developing countries. (Lee-Makiyama, 2012, p. 6)

While quantifying the level of protection in services is difficult due to a lack of data and the complexity of the industry, estimates show that services are heavily protected. Lee-Makiyama (Lee-Makiyama, 2012) estimates that the barriers to services trade are often twice levels applied to goods and that while goods protection has fallen, trade barriers for services have “stood still”.

The combination of services’ large and growing share of world GDP and the sectors’ high levels of protection, means that services’ liberalisation is a necessary focus for economies to drive trade and economic growth.

### *Recommendation 2*

*Australia to continue to lead negotiation of the services plurilateral through the WTO.*

### 1.3 The Role for Regional FTAs

ASR is a strong supporter of Regional Trade Agreements (RTAs), in particular the Trans Pacific Partnership (TPP).

RTAs and bilateral FTAs have been much maligned by economists for leading to trade diversion rather than trade creation. Trade diversion occurs where a country imports a product from an RTA partner because preferential tariff rates make the good cheaper than importing from a more efficient third country not party to the agreement.

Trade creation cannot be overlooked as an important consideration for the value and impact of RTAs. If RTAs grow trade, then it follows that RTAs are good for economic growth. If the economic benefits of RTAs are as high, or higher than for multilateral negotiations when the costs of trade diversion are taken into account, the benefit of the WTO process is in doubt.

However, the WTO concludes that the evidence for trade creation is not strong with analysis of different RTAs producing different results. (World Trade Organisation, 2003, p. 59) Trade concentration can be used as a proxy for trade creation and diversion. Trade concentration calculates the ratio of the intra-regional trade share to that regions share of world trade. (Chen, 2012) Where there is no bias within a trade group, then the concentration ratio should be one. Whilst trade ratios are generally above one, indicating regions trade more with themselves this would be expected because of other factors such as location. Concentration ratios should increase over time if RTAs have a significant impact on trade. In the case of the EU, NAFTA and ASEAN they have remained fairly constant over time. (World Trade Organisation, 2012, p. 57)

For this reason, ASR continues to favour multilateral trade negotiations over regional and bilateral. However, given the lack of progress in multilateral negotiations, ASR has supported negotiation of RTAs as a second best measure.

In particular, ASR has taken a positive view of the TPP on the following basis:

1. The TPP has a strong focus on services and could be used as a template both for a services plurilateral through the WTO and for future bilateral FTAs in the region; and

2. The completion of the TPP could put pressure on the WTO to finalise the Doha Round or a services plurilateral.

## **1.4 Bilateral Free Trade Agreements**

Bilateral FTA's provide a method of liberalising trade that the Government should pursue as a second order to multilateral negotiations.

The completion of bilateral FTAs with China, Japan and Korea are a positive outcome, in particular the inclusion of strong services chapters. The greater focus on services in bilateral FTAs in recent years and the strength of the outcomes are very positive developments. The outcomes Australia achieved in the China and Korean bilateral agreements in particular are world leading.

### **Gulf Cooperation Council**

The Gulf Cooperation Council (GCC) is not a major trading partner for Australia. However, the economies of the GCC are important existing and potential markets for services businesses in Australia. The GCC also provides an example of the importance of strong investment chapters in bilateral FTAs.

The United Arab Emirates and other GCC countries are important as current and future services export destinations. While the opportunity in these countries is great, there are significant barriers to exporting or establishing businesses in these countries.

Refer to Case Study 1: Architecture in the United Arab Emirates

### **Limitations of bilateral FTAs**

Although ASR welcomes the progress that has been made in the signing of bilateral FTAs, the benefits of FTAs with countries beyond those already completed or underway is not obvious. Following the conclusion of FTAs with China, Korea and Japan, Australia now has agreements with all of our top ten trading partners except the UK and Germany as well as some outside of our top ten.

Given the cost of negotiating bilateral agreements and the government's fiscal constraint, consideration should be given to focusing resources to the services

plurilateral and regional free trade agreements rather than beginning negotiations of bilateral agreements beyond those already underway.

*Recommendation 3*

*An acknowledgement by the review panel that Australia is facing diminishing returns to investing in negotiating bilateral FTAs.*

*Recommendation 4*

*Australia to continue to lead negotiation of the services plurilateral through the WTO including a reallocation of resources once existing bilateral FTAs are finalised.*

Refer to Case Study 2: Structure of Korean Industry and Financial Services

## **2. Australia's trade negotiation process**

### **2.1 Industry Consultation**

ASR acknowledges the ongoing and practical consultation with industry by the Department of Foreign Affairs. In particular the expertise of DFAT officials and their willingness to engage with industry and understand industry's issues and concerns is to be commended.

ASR has close relationships with services organisations and the services industry in other markets. Discussions with others have highlighted some options for closer and more fruitful collaboration between industry and government.

Industry would welcome and seeks closer involvement during trade negotiations and alongside this involvement, industry would welcome being privy to information, texts, papers, and progress reports during negotiations.

The United States model for industry engagement has been reviewed by Australian industry and delivers on the close engagement the Australian industry is seeking.

A more formal level of engagement by industry will also deliver support and an important value add to the process, providing much needed and robust industry intel and strategic advice.



For example, including Australian business leaders in trade committees will build capacity and interest in Australian businesses in free trade resulting in export opportunities.

*Recommendation 5:*

*A consideration of a revised trade negotiation framework modelled on the principles and structure of:*

- a. The open trade negotiation regime used by the United States; and*
- b. The trade committee system used in the United States.*

## **2.2 Post signing implementation**

Australian services firms have worked tirelessly alongside Government to include services within free trade agreements. Industry and Government recognise the economic benefits of FTAs which have a focus on services.

Industry is now seeking transparent and robust processes to maximise the benefit to industry once agreements are signed. Such a process will enable industry to build business processes and seek innovation and investment opportunities to drive optimal economic and growth potential. On a practical level, this could include formal notification upon signing to all industry stakeholders, and follow up in the form and substance of agreements. For example, ASR suggests that greater coordination between trade and investment portfolios and relevant industry specific departments would facilitate an improved awareness of the opportunities under FTAs and in so doing drive industry and government to maximise the potential for growth.

ASR suggests the following by way of example:

- formal notification when an agreement is signed
- industry briefings through issues papers and fact sheets, and roundtables, to facilitate the information and to enable industry to ask questions
- continual follow up and engagement by relevant departments with industry to drive closer integration of FTA benefits.

In addition, ASR would welcome briefing sessions about trade negotiations processes, who the players are, what's involved, Government's role and so on. Briefings on this nature will increase industry's engagement particularly by startups and SMEs. This will enable industry to influence the agenda of the trade negotiations but also to utilise the benefits following completion and signing.

In addition, the harmonisation of domestic regulation following the signing agreements, is often cited as an area for improvement. For example, the capacity for greater harmonisation between Australian financial services licencing and capital requirements appear to exist within several Australian bilateral FTAs, yet few if any Australian firms have been able to take advantage of these clauses.

*Recommendation 6:*

*Development of an execution plan to highlight opportunities in bilateral FTAs for industry*

*Recommendation 7:*

*Consideration by Australian regulatory agencies to:*

- o review and implement key concepts from FTA with a view to implement the harmonisation of domestic regulation such as licensing arrangements; and*
- o identify opportunities to harmonise regulation independently of FTA negotiations both bilaterally and at a regional level.*

### **3. Domestic regulatory barriers**

#### **3.1 FDI/ licencing**

Australian services businesses report restrictions to foreign direct investment as a significant restriction on the ability to establish business for many countries. Many countries including India, Indonesia and the UAE require joint ventures or have minimum domestic investment thresholds for Australian firms to operate in country.

Australia's own stance on foreign direct investment also has negative implications for Australian services companies seeking to operate overseas. Media coverage of Australian government decisions to reject significant foreign direct investment in Australia has an impact on their ability to invest in other countries.

### 3.2 Payment/ currency issues

Several services firms interviewed have noted currency restrictions, limitations of payment systems in some countries and concerns about getting paid generally as significant barriers to trade in certain countries. Examples are China and the United Arab Emirates.

Specific concerns are:

- Restrictions on convertibility of currency, though recent changes for AUD/ Yuan convertibility have assisted;
- Fixed exchange rates;
- Strict foreign exchange controls;
- A lack of payment providers such as PayPal; and
- Simple non-payment of fees.

For businesses that operate entirely online and act as market places for trading goods, services or skills, effective payment systems are essential in doing business. For these businesses, well-regulated payments markets and harmonisation across countries would assist in their business of bringing buyers and sellers together online.

#### *Recommendation 8*

*Seek to remove currency restrictions and harmonise payment systems when negotiating bilateral or regional FTA's.*

#### *Recommendation 9:*

*Discuss regulation of payment systems at a regional forum with a view to harmonisation.*

### (b) Cross-border data flows

Services businesses rely heavily on the transfer of data. The export of services is often just the transfer of data across borders. For online businesses, this is more so the case.

Restrictions on the movement of data across borders has an impact on the ability of services businesses to export.

A recent development in the region has been the restrictions on cross border data flows by some countries. This acts as a form of protection for data storage specifically and services

businesses generally. Restrictions come in the form of requirements to house data on-shore. This adds to the cost of doing businesses for some services. It also prevents services businesses from breaking down the value chain so as to produce various components of a service or product in different countries.

## **4. Domestic Barriers**

### **4.1 Government Portfolio and Department structure**

The structure of the Australian Public Service and other institutions could be improved to better reflect the current structure of the Australian economy. The services industry does not have unique home or champion within the Australian Government. In the same way that DFAT has a services focussed sub-department, so too, should the bureaucracy have a dedicated services department. Such a department or sub-department would also then, take on a championing role for industry in the implementation of FTAs. Some departments for the services industry, such as education, have such a championing focus and view their role as promoting exports of the relevant service.

The traditional focus of the Department of Industry on manufacturing for example, may well result in FTA opportunities for services being overlooked or missed.

#### *Recommendation 10*

*Consider reviewing the Department of Industry to ensure it has a capability and mandate to understand and represent the Australian Services Industry.*

### **4.2 Implementation issues**

#### **(a) Financial Services**

Australia has significant potential as an exporter of financial services. However, Australia has a relatively low proportion of foreign sourced funds under management compared to other leading financial centres. Only around 3.5 per cent of funds under management in Australia are sourced offshore. This compares to 80 per cent in Singapore and 65 per cent in Hong Kong.

The Asia Region Funds Passport (the “Passport”) provides a regulatory framework for the mutual recognition of fund operators and investment funds between

participating jurisdictions. Australia's participation in a mutual recognition framework within the Asian region was recommended by the Johnson Review as a part of a package of reforms aimed at leveraging Australia's significant funds management expertise. While progress on the Passport has been significant, a number of related recommendations have not yet been progressed by the Government. Five critical recommendations of the Johnson Review are:

1. Implementation of an Investment Manager Regime;
2. Broadening the range of allowable Collective Investment Vehicles;
3. Ensuring ongoing competitiveness of the Offshore Banking Unit regime;
4. Removing tax uncertainty; and
5. Competitive tax settings.

One of the most important recommendations of the Johnson Report was a reduction of the Managed Investment Trust withholding tax rate which was then 30 per cent. While the rate was reduced to 7.5 per cent per cent under the former government, it was subsequently increased to 15 per cent from 1 July 2012.

This rate is inconsistent with interest withholding tax rate of 10 per cent and is encouraging investment to be structured as debt instead of equity. It is also not competitive with other financial services centres in the region. As a result, Singapore and Hong Kong are at a significant advantage as funds management centres in the region.

**(a) Education**

The Department of Education has a clear focus on education exports. However, in ASR's view, the full export potential has not been fully realised.

The impact of the change in visa requirements for example, had a significant impact on education exports. Improved coordination between the Department of immigration and the Department of Education may have assisted here. In addition, improved coordination between State departments may have avoided reputational problems in relation to safety of international students.

Refer to Case Study 3: Crowd Source Equity Funding

*Recommendation 11*

*Incorporate within departments, such as Treasury Health, Education and Communications, the mission statement of enabling industry to increase exports.*

### **4.3 Australia's State and Federal Governments**

The operation of Australia's Federation is cited by many services businesses as an issue that impacts on their competitiveness in international markets. A lack of harmonisation of legislation and licencing across states and territories increases the cost of doing business in Australia and places the business at a price disadvantage when it comes to competing in international markets.

State transaction taxes also impose regulatory burdens and have often been cited as inefficient. Modelling conducted for the Henry Review showed that state taxes are six of the ten taxes that have the highest marginal cost on society.

These taxes are inefficient in an economic sense, in that they distort economic decisions reducing the competitiveness of the economy more generally and increase the cost of Australian businesses.

For services businesses, however, a more significant issue is the different rates and legislative treatment of insurance taxes across states and territories. Businesses in the general insurance and life insurance sectors both state that the lack of harmonisation is increasing the costs of businesses and reducing the ability to grow exports.

Refer to Case Study 4: Life Insurance.

*Recommendation 12*

*Review, complete and release the Federation White Paper as a matter of priority.*

## **Case Studies**

### **Case study 1 : Architecture in United Arab Emirates**

The UAE represents a significant potential market for Australian architecture, engineering and other professional services firms. However, a number of factors make exporting to the UAE from Australia difficult.

An Australian architecture firm establishing in the UAE raised the following as barriers they have encountered:

- To operate in the UAE, they are required to have a multidisciplinary team, including engineers which is not the structure of Australian architecture firms;
- Sponsorship from a domestic partner is required;
- There are a number of different licences that are required to establish a practice; and
- Different licencing structures apply across various jurisdictions in the UAE.

Each of these adds cost to establishing an architecture practice in the UAE. The lack of equivalent barriers to trading in Australia by foreign architectural firms was also noted, with the exception of licensing/registration and state first government procurement policies in Australia.

### **Case Study 2 : Structure of Korean Industry and Financial Services**

The difficulties Australian financial services companies faces in Korea are an example of the limitations of bilateral FTAs. KAFTA includes a financial services chapter which provides greater access for Australian firms. However, the structure of Korean industry and action (or lack of action) by the Korean Government are significant barriers to trade.

Korea has a large sovereign wealth fund, the Korean Investment Corporation and a large Government operated pension fund, the National Pension Service. Collectively, these two funds manage around \$A400 billion. These funds will continue to grow with Korea's growing incomes and ageing population.

For Australian fund managers this is a significant opportunity to provide funds management services. However, little (possibly zero) of these funds is invested through Australian fund managers. One reason is that there is a lack of depth in currency hedging between the two countries. The lack of

depth of currency markets reflects the low level of investment by these two funds in Australia. There appears to be a market failure in terms of information asymmetry which can be addressed.

The Korean Government has established investment offices in the United States and the UK. These offices act to reduce the gap in information available to Korean investors directly through the two governments operated funds. There is no equivalent Korean investment office in Australia. As a result, EU and US fund managers have an advantage over Australian fund managers and investment is flowing to these countries instead of Australia.

The establishment of a similar office in Australia would have a substantial benefit in providing for direct relationships between the two Korean Government operated funds and Australian fund managers and in turn facilitate the development of deeper currency hedging services.

The structure of Korean industry more generally can also make opening new business relationships in Korea difficult. The Chaebol structure of large conglomerate businesses favours services provided by other subsidiary companies of the large Chaebol group.

For Australian financial services companies already active in Korea, this has meant they have had no choice but to partner with companies that are part of a Chaebol group to compete for contracts. This issue is not one that can be dealt with easily through a free trade agreement. While the free trade agreement formalises non-discrimination against Australian companies in a legal sense, opening access requires a change in business culture.

### **Case Study 3: Crowd Source Equity Funding**

The recent experience of crowd source equity funding in Australia shows the impact that a lack of focus and drive by Australian government agencies to assist exporting services can have. Australia lags behind the world in developing legislation to allow crowd source equity funding.

Crowd source equity funding refers to a form of corporate fundraising that envisages start-up or other smaller companies (issuers) obtaining seed or other capital through small equity investments from relatively large numbers of investors, with online portals (intermediaries) publicising and facilitating these equity offers to online users (the crowd).



The United Kingdom, the United States and New Zealand all have passed legislation to allow equity crowd source funding. The Corporations Advisory and Markets Committee (CAMAC) in Australia released a report “Crowd Source Equity Funding in May 2014”. However, as yet, legislation enabling crowd source equity funding has not yet been tabled in Australia.

A Fintech accelerator in Sydney, AWI Ventures provided seed funding for a crowd source equity funding platform, Equitise, in October 2014. The lack of enabling legislation in Australia resulted in Equitise incorporating in New Zealand and beginning operations there. Equitise has crowd funded two businesses in New Zealand since launching. Due to mutual recognition arrangements in the Australia New Zealand Closer Economic relationship Agreement, Equitise is able to raise funds from Australians.

While this is just one example, it is one that illustrates the impact that a lack of focus on regulatory issues affecting services businesses and digital businesses can have on export opportunities. In short Australian entrepreneurs started a services business, discovered it was not legal in Australia so moved to New Zealand to establish there. While this is a small example, given the push for Sydney to be a Fintech Hub, such an example is telling.

#### **Case Study 4: State Taxes - Life Insurance**

In addition to the general inefficiencies caused by the different treatment of stamp duty on life insurance in each state and territory, there have also been recent developments which have further complicated matters for the life insurance industry. One such example relates to the recent changes to stamp duty in Victoria.

The 2014-15 Victorian State Budget stated that stamp duty would be abolished on life insurance policies, saving \$4 million annually. However, while the *Building a Better Victoria (State Tax and Other Legislation) Act 2014* (the Amending Act), which received Royal Assent on 17 June 2014, did abolish stamp duty payable on life insurance policies from 1 July 2014, the Amending Act also inserted new section 196A which defines what is considered “*life insurance*” for the purposes of the Duties Act – namely any insurance in respect of:

- a life or lives; or
- any event or contingency relating to or depending on a life or lives, of any person living in Victoria at the time the insurance policy is issued.

Essentially, this means that:

- If a life insurance policy offers a payment of benefits on events that do not relate to or depend on life (such as disability or trauma), then these benefits are considered to be “*additional insurance*” (that is, a rider to a life insurance policy), which is taken to be general insurance and not life insurance; and
- Insurance duty – calculated as 10% of the amount of the premium – applies to the *additional insurance* offered by *life insurance policy riders*.

Communications issued by the Victorian State Revenue Office (SRO) and statements in the Duties Act Bulletin of June 14 D1/14 (the Bulletin) issued by that office make it clear that only death cover is seen as qualifying as life insurance. Disablement cover is treated as *additional insurance* and subject to stamp duty.

As a result of this interpretation, TPD cover is classified as general insurance, and hence subject to stamp duty, even though it is classified as life insurance under the *Life Insurance Act 1995* (Cth).

The changes will have the cost impact on insurers, and the people who ultimately bear the cost of these changes will be Victorian members of the public.