

# **Australian Services Trade in the Global Economy**

**Excerpt: Financial Services**

## Executive summary

The ongoing structural transformation towards a services economy, across all countries and at all levels of development, has immense potential to improve the well-being of Australians. Technology has reduced trade and transaction costs for both goods and services, thereby facilitating more complex and services-intensive production networks. Telecommunications, audio-visual and computer services constitute a digital network at the heart of the world trading system. Transportation, courier, logistics and distribution services form the backbone of global supply chains. Legal, accounting, insurance and banking services are essential enablers of trade and finance. Architectural, engineering, mining and constructions services are a fundamental foundation of physical infrastructure. Health, education and tourism services are at the heart of better lives.

Yet impediments to services trade remain pervasive, while trade and regulatory policy in these individual services sectors are often made with limited regard for economy-wide impacts. This report aims to provide a better understanding of Australia's services performance in the global economy, to inform trade and regulatory policy makers of the likely effects of unilateral or concerted reforms and to help prioritise policy action. Taken together, the main findings seek to contribute to a national strategy by which Australia can fully capitalize on the strength of its services sectors and exporters to ensure that services trade works for all Australians.

## Main findings

### ***Services are Australia's gateway to global markets***

Australia's regional and global services trade and productivity performance is strong. Services exports, and services embedded in other exports such as food products, machinery and electronics, account for half of Australia's exported domestic value added. There is evidence, however, that Australian services suppliers face increasing competition. As such, a national services trade strategy can help sustain and strengthen Australia's comparative advantages.

### ***Australia's services regulatory environment is a source of strength***

Australians benefit from an open, efficient and generally pro-competitive regulatory environment that is favourable relative to many of its peers. Australia's domestic regulatory regime is more liberal than average in 21 of the 22 services sectors measured by OECD Services Trade Restrictiveness Indicators. There is scope for improvement in all sectors, however, and a targeted regulatory reform agenda can ensure that Australia's business environment remains a source of international competitiveness.

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***Global services sector growth is an opportunity for Australians***

Technical progress, urbanisation and fast-growing markets are driving a rising share of services in consumption across the globe, and Australian exporters are well positioned to capitalize on these trends. Rapid change and dynamic demand factors, however, require adaptation and new approaches to maintain existing strongholds and gain ground in new and diversified markets, especially in strategic sectors such as education, travel and tourism services.

***Ambitious services trade policy can transform bottlenecks into gateways***

Services trade restrictions and regulatory heterogeneity impose costs on services and manufacturing sectors, with a disproportionate burden falling on small and medium sized enterprises (SMEs). Enhanced commercial opportunities for Australian exporters can be secured by concerted efforts to encourage behind-the-border regulatory reforms in key markets (through fora such as the G20 and APEC), coupled with an ambitious trade negotiating agenda to secure new market access and bind applied regulatory regimes.

***Strategic national reforms can boost Australia's services trade competitiveness***

Services generate more than two-thirds of global gross domestic product (GDP), attract over three-quarters of foreign direct investment (FDI) in advanced economies, employ the most workers, and create most new jobs globally. The OECD recommends that countries adopt a whole-of-government approach to co-ordinated services trade policy and regulatory reforms as a driver of inclusive economic growth and employment, and encourages Australia to seize this opportunity. Horizontal and sector-specific policy conclusions are presented in the final chapter of this report.

## Whole-of-report policy conclusions

The analysis carried out in this report highlights the importance of services in the Australian economy. Evidence demonstrates the relative strength of Australia's services trade and productivity performance, and the opportunities arising from Australia's proximity to the world's most dynamic region. The report also highlights the challenges faced by Australian services exporting firms, including the risk of losing ground in stronghold sectors such as education and tourism. Furthermore, the empirical evidence included in the report highlights how services trade restrictions in foreign countries prevent Australia from exploiting its full export potential.

In this context, there is significant potential for services to sustain productivity and enhance the global competitiveness of Australian businesses. This section delineates key factors to be considered in response to the opportunities and challenges posed by a rising degree of globalisation and a growing tradability of services. On this basis, a strategic whole-of-government approach to the performance of Australian services in the global economy can help Australians fully capitalize on the strength of its services sectors and exporters to ensure that services trade works for all.

### General key findings

- It is important to continue to promote regulatory reforms and the reduction of services trade restrictions in the applied regimes of priority markets abroad by, inter alia, advocating the potential of services reforms to drive inclusive economic growth and employment, ensuring the effective implementation of the APEC Services Competitiveness Roadmap and encouraging national and collective actions consistent with the G20 Strategy for Global Trade Growth.
- In addition to existing FTAs, it would be beneficial to continue pursuing bilateral, plurilateral, regional and multilateral trade agreements with ambitious market access, national treatment and domestic regulation provisions for services. Besides maximising the economic benefits accruing to Australians, this would also lock applied regimes and thereby secure a predictable and rules-based environment for services trade and investment. OECD empirical analysis confirms that the legal bindings found in services trade agreements tend to have a positive effect on services trade by reducing uncertainty.
- Continued investment in an efficient and effective visa system is desirable. The envisaged streamlining of the current visa system would be beneficial to international visitors, international students, and domestic as well as foreign businesses.
- Consideration could be given to the relationship between the Temporary Skill Shortage (TSS) visa and the cost of recruiting highly qualified foreign workers, and the ability of some international students to apply for jobs on the list of skilled occupations (with concomitant implications for the education sector).
- Australia ensures that data can flow freely across borders, while respecting privacy and security considerations. It is important to continue facilitating an environment that enables digital trade, through free trade agreements, harmonisation of standards and implementation of trade facilitation measures.
- Despite efforts to improve coordination of government initiatives promoting export capability, innovation and growth, there is still some work to do to increase transparency and to improve the dialogue between the different level

of government agencies and transparency. Firms find it difficult to navigate through the different programmes available to them. Also, there is a lack of co-operation between businesses and other actors, such as universities or research institutes. Hence, as recommended in the OECD *Economic Surveys: Australia 2017*, there is a need to develop a more integrated, “whole-of-government” approach to science, research and innovation and consolidate innovation support programmes. This approach could help to reduce the number of support schemes for innovative SMEs and exporters, facilitating the management and efficiency of the different schemes, allowing for more generous programmes while keeping total expenditure constant.

- A review of the R&D Tax Incentive, a program supporting business innovation, found that smaller firms face compliance costs of up to 23% of the of the program benefits. The Government continued efforts, through the recently announced reforms of the R&D TI, to improve the integrity of the program, continue assist smaller companies and refocus support for larger companies undertaking higher intensity R&D, are commendable. However, in line with other recommendations (Ferris et al., 2016), it would be desirable to improve also the administration of the R&D TI program by reducing compliance costs. This would increase companies’ accessibility and ensure a more inclusive participation.
- Application processes for government support schemes, such as the Export Market Development Grant (EMDG) are often time consuming and unnecessarily burdensome. Many firms turn to professional consultants for these processes. Application and reporting could be simplified so that firms could reap the full amount of the incentives available.
- The paucity of official statistical trade data, including the lack of Foreign Affiliate Trade Statistics (FATS), complicates the understanding of Australia’s strength and weaknesses in services. Improving the statistical base would allow for a more robust analysis of services trade and investment. While efforts in this direction are underway, the timely implementation of an annual survey to collect on a regular basis information on inwards, but also outwards, foreign affiliate sales and a harmonisation of the disaggregation level for the collection of trade statistics and business statistics are essential for an accurate investigation of the benefits of FTAs.

### ***Banking***

- Australia’s banking sector (especially retail banking) is dominated by four large banks, which are protected from takeovers among each other. Such high levels of concentration may potentially compromise competition and make Australia vulnerable to the risk of banks being “too big to fail”. Implicit guarantees for these banks represent competitive advantages over their competitors. Developing a loss absorbing and recapitalisation framework may reduce such implicit guarantees and lead to more equitable competition. The assessment of mergers and acquisitions among these banks should be made by an independent competition authority, considering the stability as well as the efficiency of the financial system.
- The efficiency of the banking system could also be enhanced by widening the scope for foreign offshore banks to actively engage with clients in Australia, which is currently not allowed.

### *Insurance*

- The application process for insurance licenses could be enhanced by a maximum duration for the handling of license applications. Current ARPA Guidelines on Authorisation of General Insurers only state that “applications will be processed within a reasonable time”. Introducing an upper limit would reduce uncertainty in the process, sparking entry of young and innovative firms in the sector to the benefit of consumers and downstream businesses.
- While branches of foreign companies established in New Zealand, the United States, Japan, Korea and the People’s Republic of China (hereafter “China”) are authorised to offer life insurance services in Australia, Part 2b of the Life Insurance Regulations requires that insurance companies from all other countries establish a commercial presence in Australia. Carefully extending this possibility to life insurance companies from a wider range of countries could bring benefits to Australian consumers. In addition, the sector lacks an established process for the recognition of foreign qualifications as actuaries.

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## Global markets for Australian services

*Chapter 4 looks at the various factors that particularly influence the ability of Australian firms to compete internationally in key services markets. In Australia's main destination markets, various obstacles may inhibit the entry of new firms or restrict the expansion of Australian exporters already engaged there. This chapter presents the main trade barriers found in some of Australia's major trading partners for services exports emerging from an analysis of the OCED STRI database.*

Evidence from a recent survey of Australian business drew attention to the numerous challenges faced in their most important overseas markets, including interpreting and adapting to local regulation, discriminatory practices favouring local firms, and heterogeneity of licensing requirements and national standards.<sup>i</sup> This chapter examines the major obstacles influencing the ability of Australian firms to compete internationally in key services sectors.

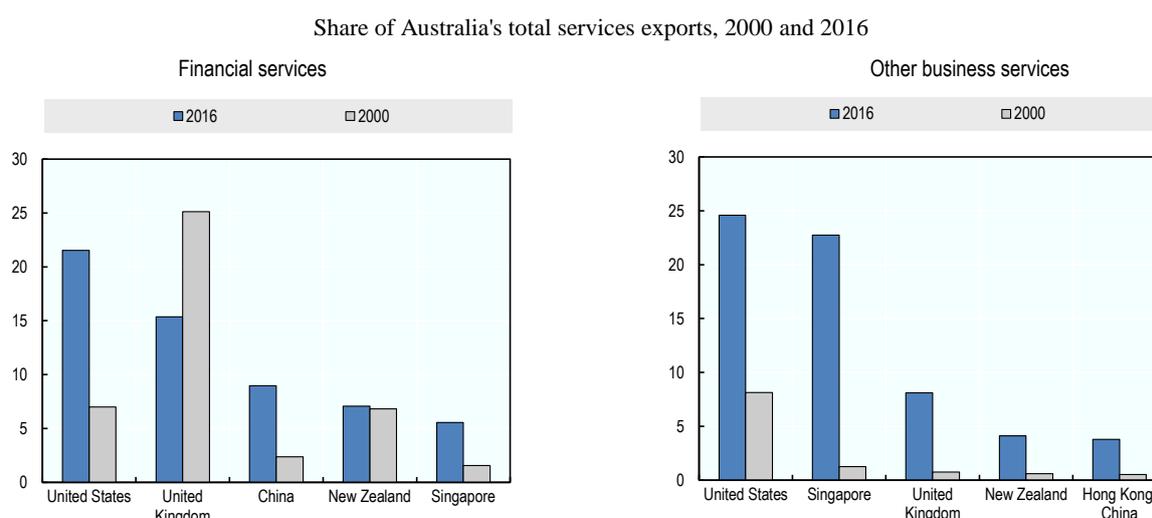
## The importance of financial services and professional services

*Financial services* and *Other business services* are among the largest contributors to Australia's total services exports after *Travel* and *Transport*, accounting for about 20% of Australia's total services exports in 2016.<sup>ii</sup> The total value of Australian *Financial services* exports was AUD 3.5 billion in 2016 (5% of total services exports), a three-fold increase since 2000. The United States has replaced the United Kingdom as Australia's main destination market for financial services exports (**Error! Reference source not found.**, left panel). Today, these two countries alone account for nearly 40% of Australia's total exports of financial services. In the Asia-Pacific region, the People's Republic of China's (hereafter "China") share increased in importance from a little over 2% in 2000 to nearly 9% in 2016. Other markets in the region have also seen an increase in their importing shares, some of which, most notably Singapore, have become almost as important as traditional destination markets like New Zealand.

The value of *Other business services* export in 2016 was AUD 9.8 billion (14% of total services exports), consisting mostly of exports of professional services like legal, accounting and auditing, architecture and engineering services. The total export of these professional services in 2016 was about AUD 5.7 billion, about 8% of Australia's total services exports. The top three destination markets for *Other business services* in 2016 were the United States, Singapore and the United Kingdom, absorbing more than half of Australia's total exports of such services (**Error! Reference source not found.**, right panel). A geographical breakdown of professional services exports is not available for Australia.

These estimates however do not reflect the full picture as they cover services provided by Modes 1, 2, and 4, but do not capture services delivered by Mode 3 (Australian branches or affiliates overseas). Information on Australia's Mode 3 services exports, typically found in Outward Foreign Affiliates Trade Statistics (FATS), is only available in the form of *ad hoc* surveys and specific studies. A one-off survey from the ABS in 2002-03 found that Mode 3 services exports were about twice the value of services exports through other Modes of supply.<sup>iii</sup> Most of Australian affiliates' services sales were realised in the United States, the United Kingdom and New Zealand, which jointly accounted for 74% of total affiliates' sales in the services sector. The same survey also estimated that the value of exports of professional services via commercial presence abroad was similar to the total value of exports through all other Modes.<sup>iv</sup>

A more recent ABS survey of 1 245 Australian finance and insurance affiliates abroad found that commercial presence abroad was the main supply Mode for Australian financial and insurance services in 2009-10.<sup>v</sup> This activity was valued at AUD 38.9 billion (covering both explicit and implicit financial services). Sales via commercial presence abroad accounted for nearly 96% of Australia's global export of financial and insurance services in 2009-10 (cross-border exports earned just AUD 1.4 billion). Nearly all sales of financial and insurance services by Australian affiliates were made to local residents in the host country, indicating that these affiliates were established primarily to serve the markets where they were domiciled. Over half of overseas affiliates' sales occurred in New Zealand, the United States and the United Kingdom.

**Figure 0.1. Australia's top five destination markets for selected services**

Source: Own calculations on OECD ITSS EBOPS 2010.

Nonetheless, the ability of Australian services providers to establish a presence in foreign markets is influenced by various factors, including policy-induced entry barriers and behind-the-border obstacles. Australia has tried to address barriers at the border by pursuing services trade liberalisation through multilateral, regional and bilateral trade agreements. The Australian Government has concluded free trade agreements to facilitate Australian services providers' access to some of the most important markets around the world.<sup>vi</sup> These agreements include commitments on the four Modes of supply of services covered by FTAs. Box 0.1 describes key commitments on foreign direct investment and the movement of people included in these agreements. FTAs also address aspects related to behind-the-border barriers by including specific chapters on investment and services (including financial services and telecommunications), competition policy, intellectual property rights and e-commerce. However, despite all past and ongoing efforts, barriers to services export and foreign investment in foreign markets are hard to weed out.

These barriers may prevent Australian firms, and especially smaller and newer businesses, from expanding via exporting, or they may raise operating costs for those firms that have already entered a foreign market but due to discriminatory practices or higher compliance costs, cannot trade as much as they would in more open and competitive markets. The OECD STRI regulatory database allows the assessment of barriers faced by Australian services exporters. The database records restrictions applying on a multilateral basis, in accordance with the most-favoured nation principle, although the discussion in this chapter also takes into account cases where preferential access is granted to Australian services suppliers through one of Australia's several FTAs.

**Box 0.1. Commercial presence and movement of people in Australia's bilateral FTAs**

**ChAFTA:** China allows a commercial presence to be set up for the delivery of services in certain sectors. These include health, aged care, education services, shipping, architecture and urban planning, legal and mining services, as well as financial services including banking, insurance and funds management. With respect to the movement of people, China guarantees access to Australian citizens and permanent residents as (1) intra-corporate transferees for an initial stay of up to three years (including executives, managers and specialists); (2) contractual service suppliers for an initial stay of up to one year, or longer if stipulated under the relevant contract; (3) installers and maintainers for up to 180 days; and (4) business visitors for up to 180 days.

**JAIPA:** Japan improves opportunities and protection for Australian investors in Japan with provisions to ensure non-discrimination. Japan provides access for (1) intra-corporate transferees for up to three years (including executives, managers and specialists); (2) investors for up to three years; (3) professional and contractual service providers for up to three years; and (4) business visitors for up to 90 days.

**KAFTA:** Korea improves protection and access for Australian service suppliers through the reduction of market access barriers in sectors such as telecommunication, legal services, as well as accounting and tax agency services. Moreover, Korea provides access for (1) intra-corporate transferees for an initial stay of up to three years (including executives, managers and specialists); (2) traders and investors for up to two years; (3) contractual service suppliers, in certain sectors, for up to one year; and (4) business visitors for up to 90 days.

**MAFTA:** It guarantees Australian investors the right to majority ownership in companies in a wide range of sectors, including higher education services (100%), investment banking and direct insurance services (70%), telecommunications (70%), and accounting (100%). MAFTA also extends the scope of commitments on business visitor to include goods sellers and investors, permitting them to stay in Malaysia for a period of 90 days.

**ACIFTA:** It improves opportunities and protection for Australian investors in Chile, securing market access in many sectors of the economy. Chile commits to provide temporary visas with unlimited opportunities for renewal and with the right to obtain an identity card for business visitors (three months or twelve months for service sellers), contractual service suppliers (initial period of up to one year, with possibility of further stay), and intra-corporate transferees (initial period of up to four years (managers or executives), or two years (specialists), with the possibility of further stay).

**AUSFTA:** The Agreement contains commitments ensuring a liberal services trade environment beyond those at the WTO in a wide range of sectors, including educational, financial and professional services.

**TAFTA:** Thailand allows majority Australian ownership in various sectors, including mining operations (60%), distribution services in relation to goods manufacturing (100%), certain construction services (100% with minimum paid-up registered capital of THB 1 000 million), management consulting services provided through regional operating headquarters (100%), major restaurants or hotels (60%), tertiary education institutions outside of Bangkok specialising in science and technology (up to 60%) and supporting services for maritime transport, excluding cargo handling (60%). Moreover, Thailand grants access to (1) intra-corporate transferees for an initial period of one year, extended annually for a total of five years (with a limit of ten foreign persons per firm); (2) contractual services suppliers for an initial period of one year, extended on a yearly basis for a total of three years (with a limit of ten foreign persons per firm); (3) business visitors for up to 15 days and up to 90 days if APEC Travel Card Holders.

**SAFTA:** Recent updates to SAFTA (from 1 December 2017) strengthen non-discrimination requirements with respect to services supplied through a commercial presence. Moreover, Singapore allows Australian independent executives and contractual service suppliers an

initial temporary stay of up to two years; three years (up to 15 years) for Australian intra-corporate transferees and up to three months for Australian installers and services providers.

**ANZCERTA:** The Australia-New Zealand Closer Economic Relations Trade Agreement allows most services to be traded free of restriction. Mutual recognition of occupations removed impediments to the movement of skilled personnel between jurisdictions without the need for complete harmonisation of professional qualifications. Investors in each country benefits from lower compliance costs, higher screening thresholds and greater legal certainty.

The rest of the chapter describes the regulation of financial services and professional services in the key markets of China, New Zealand, the United States and the United Kingdom. India is also included given its potential to become an even more important trading partner in the near future, including through a possible India-Australia FTA.<sup>vii</sup> This comparative analysis aims to highlight the benefits of a liberal regulatory regime for cross-border trade in services, while also revealing the potential for further liberalisation in the future.

## 1. Financial services

Trade in financial services occurs via all four Modes of services trade. An example via Mode 1 is when a client uses a foreign bank account. Withdrawing cash from an ATM in a foreign country is an example of consumption of financial services abroad (Mode 2). Trade via mode 3 occurs when consumers buy an insurance policy from a foreign-owned insurance company in their country. Finally, mode 4 of trade in financial services includes insurance intermediators travelling abroad in order to advise their clients.

*Cross-border trade* in financial services (Mode 1) often is severely restricted, although some countries give preferential treatment. For example, the Protocol on Trade in Services to ANZCERTA allows cross-border trade for all types of services.<sup>viii</sup> However, New Zealand, China, India, the United States and the United Kingdom all apply a multilateral policy requiring foreign banks to establish a commercial presence in the country before offering deposit taking and payment services. Of the five, only the United States allows lending services on a cross-border basis without commercial establishment in the country. In the insurance sector, New Zealand has multilaterally liberalised its cross-border regime so that all types of insurance product can be supplied without a commercial presence. In China, this is only possible for reinsurance services, while in the United States reinsurance as well as maritime, aviation and transport (MAT) insurance can be traded without commercial establishment.

The requirement to establish a *commercial presence* (Mode 3) in order to provide cross-border services may severely limit the ability of Australian financial services companies to reach foreign markets. While commercial establishment is possible in all major economies, it often comes with many conditions. In India, there is a foreign equity limit of 74% of the shares of existing local banks. Screening of such investment applies if the share of foreign equity goes above 49%; also the screening does not explicitly consider economic interests. Insurance companies must be Indian majority-owned but no screening is being applied.

In China, a maximum of 50% foreign equity is possible for life insurance companies, while fully owned subsidiaries are allowed in the other segments of the insurance markets.<sup>ix</sup> China also allows fully owned foreign banks, while foreign participation in domestically funded banks is capped at 49% according to the ChAFTA of 2015.<sup>x</sup> Moreover, China screens foreign investments to permit only those that promote economic development and confer clear economic benefits to the country. New Zealand, the United States and the United Kingdom, all allow fully owned foreign subsidiaries in

financial services and they apply a screening procedure for which economic interests are not explicitly mentioned.

Licensing procedures may also restrict the commercial presence of foreign financial services companies. Licensing is meant to ensure the financial stability of new banks and insurance companies, and should not be abused to protect incumbents or to discriminate against foreign-owned firms. Nevertheless, in China, India and the United States, quotas or economic needs tests are applied when allocating licences for commercial banks. In the insurance sector, economic needs tests are applied in China and India. While the damage of such regulation depends on each country's characteristics, it can lower efficiency and competition within the banking sector. In addition, in China, India, and (less so) in the United States, licensing criteria are more stringent for foreign banks and insurance companies than for domestic companies. The same is true for reinsurance companies in India, precluding foreign-owned firms from competing on a level playing field with domestic firms. In the United States, applicants for insurance licences need not be told why a licence has been denied. Moreover, only China and the United Kingdom have a time limit for application decisions.

Once having entered a country, banks may struggle with regulations that inhibit their geographical expansion and growth of business activities. For example, in India a bank must open at least 25% of its branches in unbanked rural centres with a population of less than 10 000 inhabitants.<sup>xi</sup> In China and India, growth of foreign-owned banks is complicated by restrictions on raising capital domestically in the host economy. In both countries, issuing domestic securities is not possible for foreign-owned banks.

In several countries, financial services firms are not free in their choice of board members. In India, a majority of board members of banks must be Indian nationals. In New Zealand, the Reserve Bank requires some board members of banks and insurance companies to be New Zealand residents (the required number of residents depends on the size of the board, usually less than half). In the United States, all directors of commercial banks regulated by the National Code on Banks and Banking must be US citizens and at least a majority of the directors must reside in the State where the company is located.<sup>xii</sup>

Competition policy can be a major obstacle to entry for foreign-owned financial services providers, affecting commercial presence as well as cross-border supply. Weak enforcement of competition rules benefits established suppliers, which are usually domestic companies. Regulation of rates or fees and excessively complicated regulatory procedures may prevent more productive foreign suppliers from competing on price with domestic firms. For example, insurance companies in China and India need prior approval from the supervision authority to adopt new products or services, and to introduce new rates or fees. Approval for new products is also compulsory in the United States. For commercial banking services, prior approval for rates and fees as well as for new products is required only in China.

China and India both heavily regulate the prices of financial services. Premiums and fees of insurance contracts are regulated by the *Insurance Law* of China. The Tariff Advisory Committee of India's Insurance Regulatory and Development Authority (IRDA) may control and regulate the rates offered by insurers in the non-life segment. Commercial banks in India face an interest rate ceiling for deposits by non-residents in foreign currency, while in China there is a lower limit on deposit interest rates. In addition, both countries apply directed credit schemes, obliging commercial banks to allocate a certain share of their total credit volume to sectors or regions of particular priority for the government.

Where banks hold strong bargaining power relative to consumers, regulation must be in place to ensure the fair pricing of services. However, conditions and fees for early repayment of loans are not regulated in China and India. This shortcoming severely

affects consumers' ability to restructure their debts. Regulation in the United Kingdom does not explicitly include product tying in the list of unfair contract terms. Nevertheless, the prohibition of unfair commercial practices has been interpreted in some competition cases as covering tying and bundling. The enforcement of fair competition also requires independence of the supervisory authority from direct or indirect interference of the government. Nevertheless, the China Banking Regulatory Commission, China Insurance Regulatory Commission and China Securities Regulatory Commission are under direct authority of the State Council, which can overrule the decisions of the supervisor. In addition, the supervisory agency's funding is under discretionary control by the government in both China and India.

Many countries have adopted the International Financial Reporting Standards (IFRS) for the reporting of large or publicly listed local companies.<sup>xiii</sup> In China, companies must comply with the Chinese Accounting Standards for Business Enterprises, issued in February 2006. The national standards, however, substantially converge with IFRS. The 2015 Indian Accounting Standards Rules (Ind AS) are also largely in line with IFRS Standards. However, section 5 of the Ind AS Rules explicitly excludes banks and insurance companies from applying these standards. Instead, they must follow standards prescribed by the Reserve Bank of India (RBI). In 2016, the Ministry of Corporate Affairs announced that banks and insurance companies will have to implement Ind AS rules from 1 April 2018 onwards (Government of India, 2016).

The Basel Capital Accords, issued by the Basel Committee on Banking Supervision (BCBS), are important risk-weighting procedures for international harmonisation, and have been adopted by many countries. New Zealand has only adopted the main elements of the Basel Capital Accords, sometimes taking a more conservative approach to bank capital policy (Reserve Bank of New Zealand, 2015).

The movement of natural persons (Mode 4) is impacted by a country's general visa policy but also by sector-specific recognition of qualifications and requirements on professional education. In all five economies, professionals need a licence to offer broking and agency services. In China, India, New Zealand and the United Kingdom, licences are also required by professional actuaries. However, most countries have no law or regulation establishing a process for recognising qualifications gained abroad in these professions, the only exceptions being India and New Zealand with respect to professional actuaries. Moreover, in India, appointed actuaries must be resident and members of the Actuarial Society of India.

This review shows that trade in financial services is still relatively restrictive. A local commercial presence is often required in order to offer services. Fully owned foreign subsidiaries are not always allowed. Regulation of prices and burdensome approval procedures still operate in some developing countries. Several countries have no established process for recognising foreign qualifications as insurance brokers or actuaries.

Digitalisation of the financial services sector offers tremendous opportunities for Australian banks and insurance companies, provided it is supported by adequate broadband connectivity. Many services businesses rely on access to high-speed internet, not least services exporters.<sup>xiv</sup> On the one hand, digitalisation allows exporting firms to move away from physical distribution through foreign branches to online distribution, which can substantially facilitate foreign market entry. However, it requires that regulatory barriers with respect to cross-border trade in financial services, such as requirements to establish a commercial presence in order to offer deposit-taking, lending, or insurance services, are abolished. On the other hand, even though financial services are already among the most digitised sectors in Australia, digitalisation still has enormous cost-saving potential. It is estimated that retail banking will be able to save between 20% and 33% of the operating cost base, while savings on risk costs are likely to be between 10% and 30%. Savings in personal lines insurance can be between 12% and 25% of operating costs and between 2% and 8% of claims costs due to fraud reduction and telematics (McKinsey, 2017).

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- i. Differences in business culture, difficulties with payments and protection of intellectual property rights were also important hurdles for Australian exporters (ECA, 2015). Recent findings show how the lack of clear information on market compliance and risks, external support, and on local customs and border procedures, as well as on the general regulatory environment of a foreign market, militate against Australian businesses entering and thriving in overseas markets (ECA, 2016).
  - ii. Under the Extended Balance of Payment Services (EBOPS 2010) classification, the item *Other business services* includes R&D services, professional, management and consulting services, and other technical, trade-related and other business services. In EBOPS the item *Financial services* refers only to financial intermediary and auxiliary services between residents and non-residents, but does not include *Insurance services*, counted as a separate item. The statistics reported above do not include the category *Insurance services*, but for the purpose of this assessment, the use of the term *Financial services* hereafter should be interpreted to include both services categories to match the OECD STRI definition of Financial services.
  - iii. Source: ABS, *Australian Outward Foreign Affiliates Trade, 2002-03*, catalogue no. 5495.0.
  - iv. A more focused and recent study by the Law Council of Australia found that Australia's provision of legal services from law firms established abroad was valued at AUD 141 million in 2010-11, which is a small fraction (around 18%) of Australia's total exports of legal services, even smaller than the one estimated for all professional services by the ABS survey in 2002-03.
  - v. Source: ABS, *Australian Outward Finance and Insurance Foreign Affiliate Trade, 2009-10*, catalogue no. 5485.0.
  - vi. The Trade in Services Protocol was added to the Australia – New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) in January 1989. In addition, Australia has FTAs in force with ASEAN and New Zealand (AANZFTA), Chile, China, Japan, Korea, Malaysia, Singapore, Thailand and the United States. FTAs concluded, but not yet in force, include with Peru, the Pacific Agreement on Closer Economic Relations Plus (PACER Plus) and the Trans-Pacific Partnership (TPP). Many of Australia's FTAs include commitments to review the chapters on services (e.g. a review of the China-Australia FTA chapter on trade in services commenced in 2017). Australia is also negotiating a number of FTAs including with Indonesia, the Pacific Alliance and parties involved in the Regional Comprehensive Economic Partnership (RCEP).
  - vii. Exports of *financial services* and *other business services* to India were AUD 51 million and AUD 33 million in 2016. Negotiations for the India-Australia Comprehensive Economic Cooperation Agreement (IA-CECA) began in 2011, with the last round held in September 2015. Recently, there has been renewed interest in intensifying economic ties between the two countries. In April 2017, the Australian Government commissioned an independent India Economic Strategy to chart a course for this economic partnership.
  - viii. Other free trade agreements liberalising cross-border trade in financial services for Australian providers include JAEPA with Japan, liberalising wholesale securities transactions, investment advice and portfolio management and KAFTA with Korea, liberalising investment advice and

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portfolio management services for investment funds, as well as a range of insurance and insurance-related services on a cross-border basis.

- <sup>ix</sup>. In November 2017, China announced plans to raise the foreign equity threshold to 51% by 2020 after three years and remove the cap on foreign equity after five years.
- x. China's multilateral policy is even more restrictive, currently only allowing joint ventures with a maximum of 25% foreign equity while investment for each single foreign financial firm is limited to 20%. In November 2017, it was announced that these limitations should be dropped, without a timeline for this reform.
- <sup>xi</sup>. This requirement can be particularly detrimental to foreign-owned banks with a customer base consisting mostly of multinational companies and foreign nationals.
- <sup>xii</sup>. Some commercial banks may be regulated by state laws. In the state of New York (representative state for the STRI database), the New York Banking Law requires half the directors to be US citizens. The New York Insurance Law stipulates that a majority of directors in insurance companies be citizens and residents of the United States. Requirements on board members may be different in other states.
- <sup>xiii</sup>. International standards are an important facilitator of trade in financial services and may help to prevent accounting irregularities and to make an economy more resilient to economic turmoil. In turn, deviations from these standards can be used in order to protect domestic firms from foreign competition.
- <sup>xiv</sup>. Mobile banking is pervasive in many countries; machine learning has been transforming professional services in particular law with digital tools such as eDiscover which assists lawyers in searching for evidence, as well as routine tasks in accounting and other professional services (CEDA, 2017).