
5 International trade in services — policy developments and issues

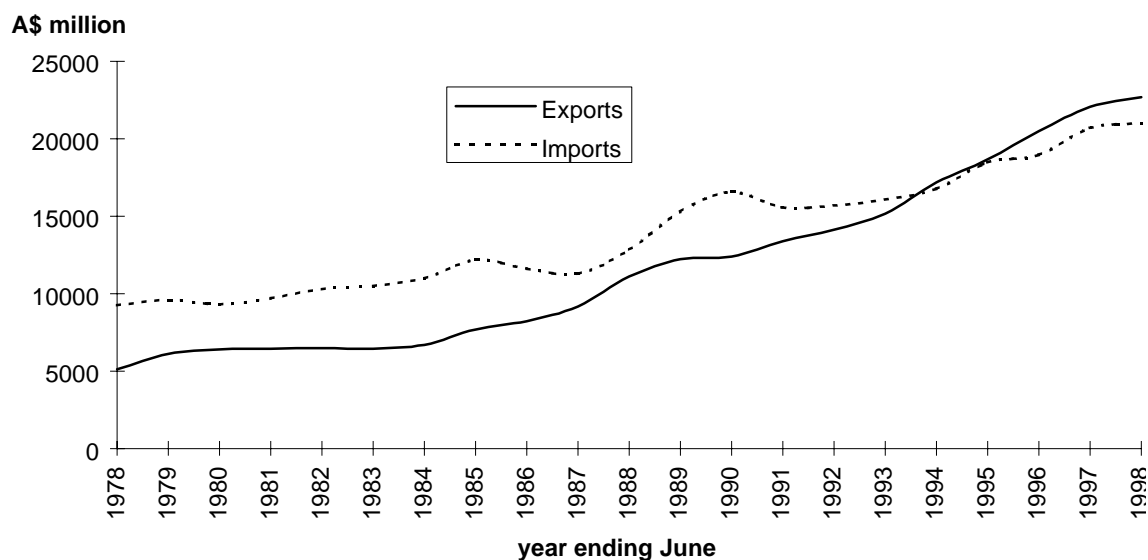
Trade in services is an important component of Australian and global trade. While services trade is growing rapidly — driven by growth in goods trade, policies to open markets to new service suppliers, and technological developments which are making a wider range of services tradeable — it is still subject to a wide range of restrictions that may protect existing suppliers at the expense of consumers. Over the past year, Australia has taken some steps, both unilaterally and multilaterally, to liberalise trade in services.

Legislation affecting trade in services is scheduled for review over the next few years. In addition, the next round of multilateral WTO services trade negotiations is scheduled for the year 2000, and governments are considering responses to matters such as the growth in electronic commerce. The policy setting for international trade in services could undergo some further major changes over the next few years.

5.1 Rapid growth and complex issues

Services account for a significant share of Australia's international trade. In 1997-98, they accounted for 20 per cent of Australia's total exports and 19 per cent of total imports. Over the past five years, exports of services have increased at an average annual rate of 9 per cent whereas imports of services have increased at a slower rate of 5 per cent. Australia has been a small net exporter of services over this period (figure 5.1).

Figure 5.1 Australia's exports and imports of services 1977-78 to 1997-98
constant 1989-90 prices



Data source: ABS Cat. no. 5302.0

International trade in services accounted for just over 20 per cent of the value of global trade in goods and services in 1996 (IMF 1997). The estimates for global and Australian trade understate the full significance of trade in services, as they include only the value of services traded across borders (as in international transport) or by the temporary movement of people (as in tourism or education). They do not include the value of services traded via a foreign supplier establishing a commercial presence in a market and supplying services directly to consumers — although royalties, license fees and repatriated profits would generally be included. The commercial presence mode of service trade is generally included in international (including WTO) definitions of trade in services. It has been estimated to be more important than cross-border trade, and its inclusion could more than double the value of international trade in services (OECD 1998).

The growth in international services trade partly reflects the growth in goods trade — as more goods are moved around the world, the demand for associated services such as transport, insurance and other financial services also increases. It also reflects a range of other developments, such as technological progress which has made trade in some services feasible via media such as the internet, as well as foreign investment and competition policy reforms which have allowed foreign suppliers to enter service markets which previously were tightly regulated.

In reviewing policy developments and issues for international trade in services it is necessary to take account of links with policies covering foreign direct investment,

competition, intellectual property and electronic commerce. Each of these raise some complex and interrelated issues. They have been identified by the WTO as key issues for future world trade liberalisation debate (WTO 1996 and 1997).

Services trade and foreign direct investment

Ongoing direct contact with consumers is important for services such as communications, financial, retailing and various business and professional services. This means that establishing a commercial presence via foreign direct investment (FDI) may be the best way for a foreign service supplier to enter the market. Restrictions on FDI can therefore have an impact on services trade. While many economies have liberalised their FDI regimes in recent years, most still apply some restrictions, particularly in key services industries such as communications, transport and financial services (Hardin and Holmes 1997).

Recognising the importance of FDI restrictions as a potential barrier to services trade, WTO Members have explicitly included establishment of commercial presence in the coverage of the General Agreement on Trade in Services (GATS). However, many Members have either not scheduled market access commitments for some key service industries or have indicated an intention to maintain FDI restrictions.

Services trade and competition policy

Attempts by foreign service suppliers to obtain direct access to markets can also be hindered by domestic competition policies. For example, exemptions or special treatment provided to local suppliers may place them in a favourable position relative to potential foreign (and other domestic) competitors. Failure to deal with anti-competitive practices may also limit the opportunities for foreign suppliers to enter service markets. For example, without an adequate regulatory framework for access to the ‘bottleneck’ parts of the telecommunications network, new suppliers — local or foreign — may not enter the market, thereby depriving domestic consumers of the potential benefits of wider choice and lower prices.

Several competition policy initiatives in the Australian economy over the past few years have significant implications for international trade in services — most notably reforms to the telecommunications and financial sectors. The regulatory arrangements for several service industries are also scheduled for review as part of the Commonwealth’s national competition policy commitments (see section 5.3).

As global markets become more integrated, via both trade and investment flows, international competition policy issues are becoming more important and complex. International co-operation may be necessary to ensure effective and efficient control of anti-competitive behaviour by multinational firms. Some competition policy issues are dealt with in the WTO Agreement on Basic Telecommunications, which came into force in February 1998 (see section 5.2). However, many difficult issues still have to be resolved for this and other traded service industries, such as the professions, maritime transport and international air services.

Services trade and intellectual property rights

The nature and degree of protection of intellectual property rights can influence international trade in services, particularly for services such as publishing, broadcasting and film, sound recording, entertainment and business services. For example, restrictions on parallel imports of goods containing intellectual property (such as books, sound recordings and films), while having the stated intention of protecting intellectual property and providing incentives to publish and produce original work, will reduce competition and trade, and assist local suppliers in the same way as other restrictions on imports.

Balancing the interests of consumers, who may benefit from more competition in the supply of services containing intellectual property, and suppliers, who seek to obtain a return on the investment they make in intellectual property, is a challenge for policy makers. Growth in the sale and delivery of goods and services via the internet is intensifying the challenge. The recent Joint Committee of Public Accounts and Audit report on internet commerce noted concerns about whether the *Copyright Act 1968* could provide adequate protection and incentives (JCPAA 1998). The Government has proposed changes to the Act to address the concerns (see section 5.2).

Services trade and electronic commerce

The development of electronic commerce is creating a vast range of new opportunities for international trade in services. According to the Australian Bureau of Statistics around 85 per cent of Australian orders for, or purchases of, goods or services over the internet in the year to February 1998 were with overseas suppliers (ABS 1998b). A wide range of business, professional and retail trade services can be supplied via the internet. For example, a growing number of banks are supplying financial services via the internet, which provides a cost-effective alternative to more usual modes of service delivery. According to estimates for the United States,

the cost of an average payment transaction on the internet is as low as one US cent, compared with 27 cents for an automatic teller machine, 54 cents for a telephone banking service and US\$1.07 for a transaction conducted via a traditional bank branch (Kono et al 1997). Communication services also could be supplied more efficiently via the internet. The WTO estimates that sending a 42 page document from New York to Tokyo by air mail would cost US\$7.40, and take 5 days, compared with 10 cents and 2 minutes for sending it by internet email (Bacchetta et al 1998).

Policies affecting internet access and internet transactions will have an impact on the growth in the use of this important vehicle for international trade in goods and services. Progress in recent years in opening access to telecommunications networks should help to foster the development of electronic commerce, but many further issues are to be resolved (see section 5.3).

5.2 Policy developments in international trade in services

The complexity of the issues involved in identifying and assessing restrictions on trade in services is illustrated in this section. Some of the other services trade issues to be considered over the next few years are discussed in the final section and are likely to pose similar challenges for policy makers.

The major multilateral policy initiative affecting international trade in services in recent years was the signing of the WTO General Agreement on Trade in Services (GATS), which came into effect in January 1995. The structure of the GATS and the negotiations for two key sectors — basic telecommunications and financial services — were discussed in previous Commission reports (IC 1996b and 1997f).

Beyond the WTO forum, Australia has continued to participate actively in OECD and APEC initiatives designed to liberalise international trade in services or at least to make restrictions more transparent. Several important unilateral policies with implications for international services trade have also been introduced or proposed over the past year.

Financial services

A major international policy development over the past year was the completion of WTO negotiations on financial services in December 1997. These negotiations will form the basis for the financial services agreement when it comes into effect no later

than 1 March 1999. As a party to the agreement, Australia took the opportunity to amend its commitments to reflect some important financial services liberalisation undertaken as part of implementing the recommendations of the 1997 Financial System Inquiry. Australia has a relatively open financial services sector, but still applies several restrictions on trade in financial services.

At the completion of the 1997 negotiations, 102 WTO Members made commitments in financial services. The commitments contain significant improvements over those made at the end of the Uruguay Round. These improvements include relaxation of foreign ownership restrictions of domestic financial institutions, lifting limits on the juridical form of commercial presence and permitting the expansion of existing operations (WTO 1998a). These liberalising commitments were made despite the emerging Asian economic problems.

The GATS framework requires each Member to offer a schedule of commitments outlining how they intend to apply market access and national treatment disciplines. Where a Member intends to retain a restriction on market access or some measure which violates national treatment, it lists the measure in its schedule. Members also have the flexibility not to apply market access and national treatment disciplines to any service, by simply not including it in the schedule of commitments.

At the end of the 1997 negotiations, Australia added eight restrictions to its schedule covering market access and national treatment commitments, removed two restrictions and made minor amendments to five restrictions. Australia added Comcare's monopoly on the provision of workers' compensation insurance to Commonwealth Government employers, four restrictions on State and Territory central borrowing and investment operations, two restrictions on the operations of the Trust Bank of Tasmania, and a restriction on State and Territory guarantees to State-controlled banks.¹ Some of these are discussed further below.

Australia removed from its schedule of commitments a restriction on foreigners acquiring any of the four major banks. In 1997, the Government removed the blanket prohibition on the purchase of any of the four major banks. Any proposed foreign takeover or acquisition of a major bank will be assessed, like any other proposed foreign takeover or acquisition, on a case by case basis in accordance with the *Foreign Acquisition and Takeovers Act 1975*. However, a specific foreign investment policy condition continues to apply to the four major banks. In making assessments on acquisitions or takeovers, the Government will apply the principle

¹ Many Australian commitments contain more than one restriction and cover a number of Australian jurisdictions (Commonwealth, States and Territories).

that any large-scale transfer of Australian ownership of the financial system would be contrary to the national interest (Costello 1997a).

Australia also removed restrictions on ownership and transactions of authorised money market dealers. The arrangements applying to authorised money market dealers were abolished in 1996 as part of domestic monetary policy reform. This restriction could have been removed at an earlier time. The GATS requires Members to inform the Council for Trade in Services promptly and at least annually of any changes to existing measures which significantly affect trade in services covered by its specific commitments (WTO 1994, OECD 1994 and Low 1995).

A most-favoured-nation (MFN) exemption on access to the Australian Stock Exchange was also removed.

Restriction on the provision of workers' compensation insurance

Australia scheduled a restriction on market access for the provision of workers' compensation insurance covering most Australian jurisdictions. Queensland and South Australian workers' compensation insurance is provided mainly by a public sector monopoly.² Comcare, a Commonwealth Government agency, has a monopoly over workers' compensation insurance provided to Commonwealth Government employers.³ In New South Wales, Tasmania, Victoria and Western Australia, insurance companies providing workers' compensation insurance must be licensed by the respective State governments. The Victorian arrangements are scheduled incorrectly as a monopoly — private insurers are able to enter and exit the market. The requirements to be a licensed workers' compensation insurer vary between jurisdictions but include being authorised under the *Insurance Act 1973* (Commonwealth), being financially viable and committing sufficient resources to providing workers' compensation insurance. In some jurisdictions, the type of services that licensed insurance companies can provide is limited — for example, insurers may not be permitted to provide underwriting services. Licensed insurers are supervised by the relevant jurisdiction's regulator.

As part of National Competition Policy reforms, States and Territories are reviewing legislation that restricts competition. Legislation must be reformed unless it can be

² In South Australia, claims managers (usually insurance companies) approved by the WorkCover Corporation of South Australia provide claims management services.

³ The Government has announced that there will be private sector competition in the delivery of Comcare's claims management services. Comcare is expected to be the sole manager of claims until 1 January 2000 (Reith 1998).

demonstrated that the benefits of the restriction to the community outweigh the costs and the objectives can only be achieved by restricting competition.

Workers' compensation insurance premiums are paid by employers to cover their employees against work accidents. Governments are involved in workers' compensation to put in place arrangements which embody safety incentives and are fair to those who suffer work-related injury or illness, but which do not at the same time impose an unreasonable burden on either firms or taxpayers (IC 1994). Regulation seeks to ensure that funds will be available to meet scheme costs by insisting that employers insure their liability and that insurers have the ability to cover risks. While such arrangements are necessary, there may be scope for greater private sector involvement, especially in those jurisdictions with monopoly arrangements or other competitive restrictions.

Certain other restrictions on the provision of workers' compensation insurance are not included in Australia's GATS schedule. These are Comcare's monopoly over the provision of workers' compensation insurance to Australian Capital Territory Government employers and the licensing requirements that apply in the Australian Capital Territory and the Northern Territory. The New South Wales Joint Coal Board also has a legislated monopoly over the provision of workers' compensation insurance for the New South Wales coal mining industry (IC 1998).

Restrictions on borrowing and investing for Australian governments

Australia scheduled a restriction on market access for borrowing and investment services provided to Australian governments by their central borrowing authorities.⁴ The commitment reflects the central borrowing authorities' monopoly over the provision of financial services to governments. Each Australian jurisdiction, with the exception of the Australian Capital Territory and the Commonwealth, is covered by this commitment.

Central borrowing authorities raise and manage debt for general government activities (such as building roads) and government trading enterprises (such as electricity utilities). They are also responsible for investing cash balances, providing financial advice and payment services. The liabilities of the central borrowing authorities are guaranteed by their respective governments.

Many debt raising and cash management services could be supplied by the private sector, provided that a government's cost of raising debt or the risk attached to

⁴ Australia's schedule also includes the Local Government Financing Authority in South Australia and the Queensland Government's fund manager, Queensland Investments Corporation.

government debt was not increased. In 1997-98, the Australian Capital Territory Government contracted part of its debt raising to the Commonwealth Bank, which arranged and managed a domestic retail bond issue (ACT Government 1998). Some of the Reserve Bank of Australia's (RBA) financial services — provision of bank accounts, payment and revenue collection processing, and financial information services — will also be open to competition. Commonwealth departments and agencies will be able to choose their provider of certain financial services from 1 July 1999 (Fahey 1998).

Licensing of banks

Australia scheduled a restriction on market access for the entry of banks and foreign bank branches. This restriction covers the requirement for a bank to be licensed as a locally incorporated subsidiary or as a foreign bank branch to provide banking services.

The practice of licensing deposit-taking services has changed recently with the implementation of recommendations from the 1997 Financial System Inquiry. A body corporate, including a non-operating holding company structure, seeking to accept deposits and carry on banking business is required to be an authorised deposit-taking institution (ADI).⁵ Foreign bank branches are required to be an ADI to carry on banking business within Australia, but are prevented from accepting deposits of less than \$250 000.⁶ A foreign bank branch is required to be incorporated and recognised under the laws of the home country, and to receive the support of the home supervisor in the supervision of the branch. The new Australian Prudential Regulation Authority (APRA) licenses ADIs or subsidiary banks and foreign bank branches. These new arrangements are not yet reflected in Australia's schedule.

Many WTO Members require their financial service providers to be licensed. Wallis et al (1997) noted that entry requirements contribute to financial system stability and are a justified restriction on competition. The GATS permits Members to license financial service providers, provided that such licensing is non-discriminatory and not excessive in restricting trade in financial services. The GATS

⁵ Deposit-taking institutions supervised by State and Territory governments, mainly building societies and credit unions, continue to be licensed by State and Territory financial regulators. The Commonwealth Government is negotiating with the States and Territories for their supervised deposit-taking institutions to be supervised in the same way as Commonwealth authorised deposit-taking institutions.

⁶ A previous Industry Commission report discussed the deposit-taking restriction on foreign bank branches (IC 1997f).

establishes safeguards against domestic regulations being operated for industry protection purposes. At the same time it recognises the right of domestic regulators to impose minimum standards and conditions, which relate to qualification requirements and procedures, technical standards, licensing and authorisation requirements (OECD 1994).

International telecommunications services

The WTO Agreement on Basic Telecommunications came into effect on 5 February 1998. It has been estimated that the trade and investment liberalisation initiatives embodied in the agreement — which covers services such as voice telephony, telex and facsimile — could assist in realising cost savings in the order of 80 per cent for international phone calls over the next few years, from US\$1 per minute on average to 20 cents per minute (OECD 1998).

From Australia's perspective, probably the main implication of the agreement is that it locks into a binding international commitment a range of domestic liberalisation and deregulation policies that have already been implemented. The agreement also restricts Australia's ability to introduce any new impediments to foreign suppliers entering the basic telecommunications market. New measures which limit market access or violate the national treatment principle in the GATS can be introduced only if there is compensation for all affected parties (IC 1997f).

The specific agreement covering basic telecommunications grew out of a recognition that the general GATS framework could not deal adequately with some of the impediments affecting telecommunications. For example, one of the most important constraints on access to telecommunications markets is a lack of effective regulation ensuring fair network interconnection. Recognising this, the agreement includes a reference paper on regulatory principles for telecommunications. Australia's regulation of anti-competitive behaviour and network access is compatible with the principles set out in the reference paper (IC 1997f).

While the agreement has addressed many issues affecting trade in telecommunications, there are still some further issues that require international co-operation. A key issue is international settlement rates — the rates charged by foreign network owners for completion services for international calls. These rates affect the price of outgoing international calls for Australians. In liberalised markets, settlement rates approach the underlying cost of the service. If that were not so, the Australian carrier could establish a presence in the foreign market (eg by leasing domestic capacity) and complete its own outgoing calls — a process known as 'bypass' (IC 1997b). However, in markets where bypass is not possible,

settlement rates tend to be higher. Liberalisation of these markets is the best option for reducing the settlement rates, but an alternative would be for negotiators to try to reform the settlement system directly. This is likely to be difficult, given the rents that accrue to some countries from the current system, where settlement rates are commonly set in bilateral arrangements and vary across trading partners depending on the characteristics of the markets involved.

Setting different settlement rates for different trading partners violates the MFN principle in the GATS and could therefore be subject to challenge in the WTO. However, parties to the Agreement on Basic Telecommunications reached an understanding not to challenge each other's accounting rate systems. They further agreed to review the understanding no later than the commencement of the next round of services negotiations in the year 2000 (Low and Mattoo 1998).

International maritime transport services

Maritime transport services, like financial services and basic telecommunications, were singled out for continuing specific negotiations at the end of the Uruguay Round. While agreements have been finalised for the other two industries, the maritime negotiations have been suspended, to be re-convened as part of the year 2000 GATS negotiations.

Only 36 of the 132 WTO Members made market access and national treatment commitments for maritime transport by the end of the Uruguay Round. Australia made commitments, but several major trading economies including the United States and the European Union did not. The MFN clause, one of the major disciplines of the GATS, has been suspended for those Members which have not made commitments (Ruggiero 1998).

The suspension of the MFN discipline was prompted in part by the reluctance of Members to relinquish their right to take unilateral retaliatory action against trading partners who are perceived to be restricting trade. If a country is concerned only with ensuring that imports enter its market at lowest cost, then the MFN discipline should not be a problem because it means that consumers are free to buy from the cheapest source. However, if a country is concerned also about gaining improved market access for its exporters, the opportunity for retaliation against trading partners that restrict this access may be difficult to resist (Mattoo 1997). The fact that many governments have a direct stake in their domestic shipping lines adds to the difficulties of reaching a maritime transport services agreement.

The desire of governments to maintain some strategic control over market access, rather than unilaterally allowing open access on a MFN basis, also influences policy

in other service industries such as international air transport, where bilateral agreements regulate market access, and telecommunications, where bilateral agreements still play a crucial role in the setting of international settlement rates.

Australia's GATS schedule includes market access and national treatment commitments for maritime transport. Australia lists one violation of national treatment. Under Part X of the *Trade Practices Act 1974*, Australian flag operators maintain the right to apply to have the Australian Competition and Consumer Commission (ACCC) examine whether liner shipping conference members or non-conference carriers are hindering Australian flag shipping — in particular, whether they prevent Australian shipping from engaging efficiently in the provision of outward liner cargo services. With respect to market access, Australia has listed its intention to maintain the requirement that shippers have a registered office in Australia.

Australia's GATS commitments do not cover other matters which may affect its international shipping services, such as restrictions on the participation of foreign flagged vessels in coastal shipping and the exemptions which liner shipping conferences receive from certain restrictive trade practices provisions in the *Trade Practices Act 1974*. However, these matters are to be reviewed as part of Australia's national competition policy and APEC commitments.

In its recent review of Australia's trade policies, the WTO noted that while major market opening had taken place in telecommunications and financial services markets and reforms have been implemented in air services and electricity and gas markets, other key service sectors such as maritime and port services are relatively untouched by the reform process (WTO 1998b).

Professional services

Recognising the potential for growth in trade in professional services and the widespread application of restrictions, both the WTO and OECD are continuing to work toward trade liberalisation for professional services. Major issues being addressed include mutual recognition of standards, restrictions on the movement of people, and the treatment of professions in national competition policies. While some progress has been made in addressing these issues — for example, the WTO has released guidelines on mutual recognition in the accounting profession — from Australia's perspective the main policy developments are at the national level. In 1996, Australia's competition laws were extended to the unincorporated sector, thus covering many of the professions for the first time. Over the next few years, several

pieces of Commonwealth and State legislation affecting competition in various professions and occupations are scheduled for review (see section 5.3).

The OECD's Multilateral Agreement on Investment

Since 1995, Australia and other OECD members have been negotiating a Multilateral Agreement on Investment (MAI). The MAI is intended to be a legally binding agreement covering all sectors and all forms of foreign investment, including FDI, portfolio investment, real estate investment and rights under contract. It covers laws, regulations and administrative practices at all levels of government (OECD 1997).

Over the past year, negotiations have continued and the deadline for completion of the agreement has been extended to allow further discussion and consultation. The Australian Government has indicated that it will not make a binding commitment to the proposed MAI treaty until it has been subjected to the treaty-making processes established in 1996 (Treasury 1998). As part of this process, a Parliamentary Committee tabled its interim report on the MAI in June 1998.

The proposed MAI contains a set of principles or rules which signatories must adhere to, unless they specify exceptions (discussed below). The core principle in the MAI is non-discrimination. The non-discrimination principle is embodied in both the national treatment and most-favoured-nation rules. National treatment means that foreign investors and investments can be treated no less favourably than domestic investors and investments. The most-favoured-nation rule means that investors and investments from all countries must be accorded treatment equivalent to the most favoured.

Relevance to international trade in services

While the MAI covers all sectors, it is particularly relevant to trade in services. In Australia and other OECD and APEC economies, FDI restrictions apply mainly in the services sector, particularly in the communications (including broadcasting, telecommunications and postal services) and financial services industries (Hardin and Holmes 1997). In Australia, restrictions in addition to those set out in the *Foreign Acquisitions and Takeovers Act 1975* apply to certain sensitive sectors. With the exception of real estate, all of these are in the services sector — banking, civil aviation, shipping, broadcasting, newspapers and telecommunications.

Around half of all FDI in Australia and most other OECD economies is in the services sector. Over the past decade, services have accounted for a steady share of

around 55 per cent of the stock of Australia's inward FDI (ABS 1997), with finance and insurance services being around one third of this.

The MAI would not be the first binding multilateral agreement covering FDI in the services sector. As noted earlier, the GATS covers FDI as a mode of entry and its rules on market access, national treatment, MFN treatment and issues such as transparency apply to FDI regimes. However, by focussing on investment, rather than having it as one of several possible modes of service supply as the GATS does, the MAI is likely to intensify pressures on governments to make their measures more transparent. The positive list approach of the GATS, whereby commitments to market access and national treatment apply only to those service industries which each member chooses to schedule, has also undermined the effectiveness of the GATS in relation to FDI. The negative list approach of the MAI — with rules applying to all sectors unless exceptions are made — should make for a more transparent and effective system.

The role of exceptions

The mechanisms for making exceptions to the proposed MAI rules have important implications for the outcomes from the agreement. The MAI rules would not apply in cases addressed by general exceptions, temporary safeguards or country-specific exceptions (OECD 1997). The general exceptions allow countries to take measures necessary to protect national security or to ensure the stability of the financial system. Temporary safeguards measures may be taken to address balance of payments crises. The country-specific exceptions allow each country to maintain laws and regulations that do not conform to the MAI disciplines.

The nature and extent of exceptions will influence the potential benefits that may flow from the agreement. The exceptions also provide a mechanism for addressing concerns such as the impact of the agreement on national sovereignty.

APEC and trade in services

Australia's APEC commitments cover a range of matters relevant to trade in services. The Individual Action Plans (IAPs) submitted annually by members update commitments on trade. The IAPs include reports on services, investment, competition, deregulation and government procurement. While the scope of the commitments is broad, they are voluntary and non-binding, in contrast to the binding commitments in the GATS and in the proposed MAI. Further, while the process of presenting IAPs at the Economic Leaders' Meeting each year helps to improve the transparency of the trade and investment regimes in member

economies, it does not necessarily increase the pace of liberalisation. The IAPs largely contain statements on current restrictions, descriptions of recent or proposed changes, and commitments to review existing restrictions. In most cases these do not represent new policy initiatives, but those already undertaken unilaterally.

Australia's most recent IAP, released at the Economic Leaders' Meeting in November 1997, contains actions for 12 service industries. For seven of these (construction and related engineering; distribution; educational; environmental; health and social; tourism and travel; and recreational, cultural and sporting), the entry simply indicates that there are no restrictions. For the other five industries, the actions largely reflect decisions taken to review or change policies. For example, the listed actions for financial services are to remove the blanket prohibition on foreign takeovers of the four major Australian banks, to rationalise the regulatory framework and to introduce reforms to encourage new entry and more effective competition. For maritime transport the actions include a review of cabotage policy and the application of the *Trade Practices Act 1974* (Part X) which provides certain exemptions for shipping conferences. These have already been scheduled for review as part of the Commonwealth's national competition policy commitments.

In relation to foreign investment policy, Australia's listed action is to complete the review of foreign investment policy (also scheduled under national competition policy commitments), taking into account the timing and results of the OECD MAI negotiations. The intention to retain specified restrictions in 'sensitive' sectors is also noted, with those named — media, telecommunications and civil aviation — all in the services sector.

The listed actions in other services trade-relevant areas such as intellectual property rights policy and competition policy also largely involve broad statements of current domestic policy and proposed reviews.

Intellectual property rights and services trade

International co-operation has long been recognised as necessary for the effective protection and enforcement of intellectual property rights. Protection which only applies within national boundaries will not be effective in preventing copying or free riding in other countries. For over a century, multilateral agreements have covered matters such as copyright (the Berne Convention) and patents (the Paris Convention). An international body, now known as the World Intellectual Property Office (WIPO) was established in 1993 to monitor and co-ordinate compliance with the international agreements.

The Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement was one of the major outcomes from the Uruguay Round of multilateral trade negotiations. In signing on to the WTO in 1995, developed country Members agreed to comply with all the provisions of TRIPS by 1 January 1996. Developing countries have been allowed a phasing-in period of between 5 and 10 years. Australia agreed to abide by the provisions of TRIPS as from 1 July 1995.

The TRIPS encompasses most aspects of previous conventions, with the added features that more countries are now covered, monitoring of compliance has been tightened and new procedures have been established to resolve disputes. Implementation of the TRIPS is to be reviewed from the year 2000 (WTO 1997). The TRIPS specifies minimum standards of intellectual property protection which must be achieved by all Members.

Australia generally exceeds the minimum standards in the TRIPS. The major change that Australia has made to intellectual property laws to meet its TRIPS commitments has been the extension of patent life, from 16 to 20 years.

Over the past year, the Commonwealth Government has announced some further proposed changes to intellectual property laws which will affect services trade. Changes have been made to the *Copyright Act 1968* to permit 'parallel' imports of certain goods and further changes have been proposed to address concerns raised by the growth of electronic commerce. Further aspects of intellectual property law are to be reviewed over the next few years (see section 5.3).

Parallel imports

Restrictions on parallel imports have been used in Australia and several other economies. Parallel imports are neither prevented nor sanctioned under the TRIPS agreement. The *Copyright Act 1968* has allowed owners of Australian copyright to prevent imports of legitimate copies of the products covered by copyright. The restriction on parallel imports has given the Australian copyright holder a monopoly on distribution of the product in the Australian market. Thus, restrictions on parallel importing allow different prices to be set for the same product in different countries. Without the restriction on parallel imports, price discrimination is limited as legitimate copies of the product can be purchased in the lower price foreign market, then re-sold in the Australian market, undercutting the price set by the Australian copyright holder. It is argued that prevention of parallel imports enables the costs of investing in the product to be recovered.

While the protection of intellectual property rights and the control of free riding is important, finding the optimal level of protection is difficult. Restrictions on parallel

imports result in higher prices for consumers, as reported in the recent Senate inquiry into parallel import restrictions for sound recordings (SLCLC 1998), and the costs of this must be balanced against the potential benefits of allowing copyright holders to earn higher profits by segmenting markets. Furthermore, the restrictions on parallel imports provide protection in addition to that provided by the controls on illegitimate or pirated imports. While there is certainly a case for continued control of pirated copies, the case for permitting legitimate imports at world prices is strong.

In July 1998, the *Copyright Act 1968* was amended to allow parallel imports of sound recordings. This will remove some of the protection from imports that the Australian copyright holders, mainly large recording companies, have enjoyed. However, it will not remove their protection from pirated copies of recorded music, which will continue to be illegal. The amendment should also result in lower prices for Australian consumers of recorded music.

A further amendment to the *Copyright Act 1968*, also passed in July, relates to parallel imports of goods with packaging or labelling which is subject to copyright. The aim in removing the parallel import restriction is to prevent copyright in packaging from being used as a trade barrier. For example, prior to the amendment, an Australian holder of copyright over some packaging could effectively maintain a position as an exclusive supplier of the goods inside the packaging, such as liquor, cosmetics or luxury goods, by restricting imports of the packaging.

Further changes to the Copyright Act 1968

The Commonwealth Government has also announced its intention to draft amendments to the *Copyright Act 1968* to deal with the growth of electronic commerce (Williams and Alston 1998). Of particular relevance to trade in services is the decision to adopt many of the recommendations of the Copyright Law Review Committee (CLRC) on computer software protection. However, the recommendations of the CLRC on parallel imports of software are under separate ongoing consideration by the Government (Attorney-General's Department 1998). The Industry Commission in the past has recommended that restrictions on parallel importing of legal copies of software should be removed (IC 1995c).

5.3 Emerging issues for international trade in services

With several pieces of legislation affecting trade in services scheduled for review over the next few years and the next round of multilateral trade negotiations anticipated for the year 2000, and governments considering responses to matters

such as the growth in electronic commerce, the policy setting for international trade in services could undergo some major changes over the next few years.

Domestic competition policy and international services trade

As part of its commitment to a national competition policy, the Commonwealth has scheduled for review a range of legislation affecting competition in the Australian economy (Costello 1996). The review schedule covers several areas which are relevant to international trade in services. These include:

- international air service agreements (an Inquiry was recently completed by the Productivity Commission);
- Part X of the *Trade Practices Act 1974* (international liner shipping);
- foreign investment policy, including associated legislation;
- market-based reforms undertaken by the Spectrum Management Agency;
- the *Broadcasting Services Act 1992*; and
- intellectual property legislation, including the *Designs Act 1906*, *Patents Act 1990*, *Trade Marks Act 1995* and the *Copyright Act 1968*.

The guiding principle in the review process is that legislation should not restrict competition unless the public benefits of the restriction clearly outweigh the costs and the objectives of the legislation can only be achieved by restricting competition (Costello 1996).

As noted earlier in this report, reviews of several other pieces of legislation have already been completed. For trade in services, the most important is the comprehensive review of the Commonwealth regulatory framework for the financial system (Wallis et. al. 1997). In addition to the Commonwealth's review commitments, each State has scheduled many pieces of legislation for review, including some which are directly relevant for services trade, such as laws relating to certain professions and occupations.

Restrictions on trade in financial services

The GATS negotiations starting in 2000 provide an opportunity to enhance further the transparency of restrictions applying to financial services in Australia. Using the GATS framework, McGuire (1998) identifies and classifies restrictions on financial services in Australia. The study finds that a greater number of measures apply to financial services than those restrictions currently in Australia's GATS schedule

(box 5.1). There may be benefits in scheduling additional restrictions identified by McGuire covering superannuation, insurance and financial advice services.

Box 5.1 Australia's restrictions on trade in financial services

Using the GATS framework for classifying restrictions, McGuire (1998) identified 165 financial services measures for Australia compared with 38 restrictions listed in Australia's GATS schedule. Eight of the measures identified by McGuire discriminate against foreigners. The majority of measures identified and restrictions in the GATS schedule are imposed by State and Territory Governments.

The higher number of measures identified by McGuire, reflects the broader coverage — the inclusion of prudential measures and measures which are not scheduled voluntarily as part of the positive listing approach under the GATS. Measures are identified and scheduled in the same way as required under the GATS — against market access and national treatment for each mode of supply, for each Australian jurisdiction.

The GATS defines a measure as any regulation imposed by a government. It is difficult to make an assessment of whether a measure restricts trade in financial services. McGuire suggests that measures which deliberately restrict trade or are more excessive than necessary to maintain an efficient and stable financial sector are restrictions on trade in financial services.

Australia's trade in banking, insurance and securities is very liberal when measured against eight Asian economies — Hong Kong, India, Indonesia, Korea, Malaysia, Philippines, Singapore and Thailand. Using the index measure developed by Claessens and Glaessner (1998), McGuire shows that Australia ranks second behind Hong Kong in banking and securities services and third behind Singapore and Hong Kong for insurance services. Hong Kong has lower limits than Australia, or no limits, for establishment and ownership of banks, securities businesses and insurance companies. Singapore has only minor restrictions on the provision of insurance services.

Source: McGuire (1998)

In the superannuation industry, government agencies have monopolies over the administration of superannuation schemes — essentially collection and recording of contributions and determination and payment of benefits. In certain jurisdictions, governments are involved also in the investment management of public sector superannuation funds.⁷ In the insurance sector, general and life insurance

⁷ Commonwealth legislation will be introduced to provide employees with choice over which fund receives compulsory employer superannuation contributions made on their behalf (Costello 1997b).

companies are required to be licensed to provide insurance services. Life insurance services can only be provided by Australian companies or through locally incorporated subsidiaries of foreign companies.⁸ For financial advisory services, dealers and advisers are required to be licensed. These licensing requirements may be subject to the new licensing arrangements proposed as part of implementing the recommendations from the Financial System Inquiry. A single licence — a financial intermediary licence — will be introduced for financial market dealers and advisers (Treasury 1997a).

International air services

International air services have been almost immune so far to multilateral liberalisation. Restrictions on competition and trade have turned the international airline industry into one of the most regulated in the world. In contrast to trade in goods, which is generally allowed unless specifically restricted, trade in international air services is prohibited unless specifically allowed. Most aspects of production and trade are regulated in bilateral air service agreements, which specify the terms and conditions under which the airlines of two countries can fly to, from, between and beyond each country. Bilateral agreements covering market access are also used widely in some other service industries, such as international postal and telecommunications services.

The regulations in the bilateral agreements restrict the efficient operation of air services in many ways and therefore impose costs on airlines, users and the economy. In its draft report on International Air Services (PC 1998a), the Commission estimated that liberalising markets and allowing more open competition could result in significant gains. Greater competition on a number of Asian routes following the entry of Ansett International has resulted in lower fares, increased traffic and a net economic gain for Australia, with gains to airline users more than offsetting any falls in airline profits.

The Commission has argued in the draft report that the presence of an entrenched system of bilateral agreements (over 3000 worldwide and 51 involving Australia) has important implications for the best path to liberalisation for Australia. As long as the rest of the world remains committed to the bilateral system, a policy of unilateral open skies is unlikely to enhance welfare, and may even leave Australians worse off than under the current system.

⁸ A limited explanation of this restriction is included in Australia's schedule. Branches of foreign incorporated life insurers operating prior to the introduction of the *Life Insurance Act 1995* are allowed to continue to operate.

The Commission recommended in its draft report that Australia should negotiate reciprocal bilateral 'open skies' arrangements with like-minded countries and invite those countries to discuss the formation of an open club of nations committed to liberalising international aviation through a common plurilateral 'open skies' agreement. This could open up opportunities for airlines to operate more efficiently and provide more diverse and competitive services. An open club could enhance the economic welfare of its member nations.

While recognising the difficulties with multilateral liberalisation, as reflected in the exclusion of most aspects of international air services from the GATS, the Commission in its draft report also recommended that Australia should promote discussion within the WTO membership to determine a process for including all air services in the GATS.

International shipping services

Around 78 per cent of Australia's exports and 70 per cent of imports (by value) are transported by sea. For many commodities, particularly those which are heavy and bulky or not valuable enough to make air transport economic, there are no viable alternatives to shipping as a transport mode. Policies or practices which restrict competition and inflate the costs of shipping services or reduce the quality of service can therefore have a significant impact on the Australian economy.

The international shipping legislation that is scheduled for review in 1998-99 relates to international liner shipping services, which are services on scheduled voyages, most commonly in container vessels. They differ from contract services in bulk vessels, which are used for some high volume commodities such as coal and iron ore. Liner services are provided often by liner conferences, which are groups of liner shipping operators who collude to co-ordinate schedules and capacity, and also to set common freight rates. In Australia, conferences account for around 66 per cent of the value of liner imports and 58 per cent of the value of liner exports. The conference market share is considerably higher for some routes and some valuable commodities.

Part X of the *Trade Practices Act 1974* provides these liner shipping conferences with exemptions from the restrictive trade practices provisions in the Act which otherwise would make the collusion and price setting illegal. The rationale is that such coordination can minimise unused capacity and lower the total costs of the shipping network. Similar liner shipping exemptions are applied by most of our trading partners. Part X also contains explicit protection for Australian flagged vessels.

In return for the exemptions, some obligations are imposed on conferences — most notably the obligation to negotiate with peak shipper bodies. There is no monitoring or regulation of the negotiated freight rates and, in contrast to the approach taken with most other exemptions in the *Trade Practices Act 1974*, no public interest test applies.

Part X was last reviewed in 1993 (Brazil et al 1993). The Review Panel recommended that Part X be retained, with a few amendments designed to expand the coverage to inward liner trade, strengthen protection of shippers, and provide a commercially oriented procedure for dealing with problems. The Review Panel did not address explicitly the issue of whether the exemptions are in the public interest. In support of its recommendations, the Review Panel argued that the contestability of the liner shipping market and the countervailing market power of exporters provide an effective constraint on the market power of shipping conferences. The Review Panel emphasised that Australia should not try to take unilateral action to remove the exemptions. Unilateral removal of exemptions has also been rejected in some other economies. This then raises the issues of whether and how some multilateral reform should be pursued. One possible forum is the WTO's GATS negotiations (discussed below).

In the pending review of Part X, under the auspices of national competition policy, the Review Panel's findings will need to be re-examined and it will be necessary to establish whether the legislation results in a net community benefit. To do this, account will need to be taken of changes in market conditions since 1993 and some of the arguments which the Review Panel offered in support of its recommendations will need to be reassessed. A number of questions will need to be addressed. For example, is there an effective competitive fringe of independent carriers limiting the market power of conferences on all inward and outward routes and for all commodities? Are outcomes negotiated by single conferences and single peak shipper bodies necessarily in the best interests of the consumers and producers of shipped commodities and the wider economy? Should the shipping-specific exemptions be retained, amended, or replaced by the general competition rules, with scope for exemptions (via authorisations) where the public interest warrants.

Professional services

Restrictions on market entry and operations for certain occupations and professions can assist the suppliers of those services and impose costs on consumers. The ACCC (and its predecessor, the Trade Practices Commission) have examined a range of anti-competitive restrictions in certain occupations and professions, including detailed studies of the accountancy, architectural and legal professions

(TPC 1992a, 1992b, 1994). The Industry Commission has shown that restrictions can result in higher prices for these and other services, such as some specialist medical services (IC 1995a).

In 1996, the Commonwealth and State governments took a major step toward controlling restrictive trade practices in the professions by enacting legislation to extend competition laws to all businesses in Australia. Prior to this reform, government businesses and unincorporated businesses, such as lawyers, doctors, architects and engineers, were exempt from the competition laws which may make certain restrictive trade practices such as price-fixing agreements illegal.

While certain restrictive trade practices in the professions are now subject to legal action by the ACCC or private individuals or companies, there are still many potentially anti-competitive practices which are supported by legislation, particularly at the State level. A range of regulations governing professions and occupations are listed for review over the next few years as part of the national competition policy. Some of the professions and occupations covered include architects, legal practitioners, licensed surveyors, electrical contractors, plumbers and gasfitters, building practitioners and certifiers, employment agents, travel agents, auctioneers and real estate agents (Samuel 1998).

The legislative review process should examine closely the rationale for the rules which restrict competition. Some forms of regulation, such as accreditation standards, may be in the public interest. They may restrict competition for the licensed suppliers, but the costs of this — higher prices and less incentive to innovate — may be more than offset by the benefits to consumers of being able to make more informed decisions. However, it is not clear that other types of restrictions, such as restrictions on advertising or ownership structures, are in the public interest (Fels 1997). In the legislative review process, the onus will be on those sheltered by the laws to establish that the laws result in a net benefit for the community.

Electronic commerce, intellectual property and services trade

Electronic commerce can increase competitive pressures on domestic service suppliers in many ways. For example, where goods such as books or magazines are ordered from a foreign supplier and delivered electronically, foreign suppliers are competing with domestic publishers and also domestic suppliers of distribution services such as postal or courier services. Where the goods are only ordered over the internet but delivered by traditional means, the foreign supplier is still competing with domestic publishers.

The major products purchased over the internet by Australians in 1997 — non-educational software, books, music, and magazines — were all service-related. Books have been the fastest growing market (JCPAA 1998). Services such as travel bookings are also increasingly being supplied electronically. There is also potential for some professional services, such as medical services, to be delivered via the internet. This could provide competition for existing suppliers and also make services available in areas which may otherwise not be served, such as remote areas.

Given that many of the products currently traded over the internet involve intellectual property (in software, books and magazines and music), intellectual property rights policies are particularly important. As noted in the recent parliamentary report on electronic commerce:

... while the internet provides a major distribution tool, sellers must be confident that their intellectual property is protected. At the same time, consumers must be confident that they are receiving authentic goods and services (JCPAA 1998, p. 169).

Some of the issues have been addressed in the Digital Agenda report (Attorney-General's and Department of Communications and the Arts 1997), and the Government has announced its intention to amend the *Copyright Act 1968* in response. A new broad-based technology-neutral right of communication to the public will apply to works made available on the internet and other on-line services, as well as works transmitted or broadcast to the public (Williams and Alston 1998).

The issues extend beyond national borders. As outlined in a recent WTO report on electronic commerce, the 'borderless' nature of the internet and the difficulties in determining the applicable laws in certain situations mean that international co-operation and the effective implementation of the TRIPS agreement are vital (Bacchetta et al. 1998). The implementation of the TRIPS is to be reviewed from the year 2000 (WTO 1997).

The JCPAA also noted that the regulatory framework will shape the development of internet commerce. It recommended that the Productivity Commission conduct an inquiry into the development and growth issues and regulatory issues arising from the growth of internet commerce (JCPAA 1998).

In its submission to the JCPAA inquiry, the Commission focussed on one of the many issues affecting the development of internet commerce — the pricing of access to the internet.

In Australia, competition among internet access and service providers has lowered the price of internet access substantially. However, a number of factors continue to distort the cost of providing internet access and have an impact on the price, quality

and take-up of internet commerce. Two existing cost distortions are those associated with:

- the cost of access to the domestic telecommunications network; and
- the cost of international internet capacity between Australia and the United States.

Also important are potential cost imposts which may result from the introduction of new regulations governing use of the internet, including any new taxes. The Commission has recommended that a proper regulatory cost-benefit analysis, including a Regulatory Impact Statement, be undertaken before the introduction of any taxation measures which could affect internet commerce (IC 1997c).

The next round of GATS negotiations

While no definite agenda has been set for the next round of GATS negotiations in 2000, a wide range of matters could be addressed — some relating to particular sectors, others to the structure and scope of the agreement. From Australia's perspective, the negotiations provide an opportunity to amend commitments, locking in to a binding multilateral agreement reforms which have been implemented in recent years. Some of the potential sectoral negotiations also should be of particular interest for Australia. For example, as a trade-oriented and geographically relatively isolated economy, Australia could gain from multilateral agreements to liberalise international transport services. Australia will need to develop its negotiating position on matters such as market access for foreign airlines and shipping lines.

The next round of GATS negotiations could focus particularly on areas where trade in services can be liberalised significantly. One such area is services sectors with few commitments and where negotiations have been difficult — for example, maritime transport, air services and professional services. Sector-specific agreements may be required to cover complex issues in these sectors. While individual agreements can facilitate negotiations by allowing more detailed consideration of difficult issues, they can also weaken liberalisation efforts by discouraging cross-sectoral trade-offs.

With this in mind, there might be benefits in proceeding with transport negotiations on a multimodal basis (Mattoo 1997). This could recognise the importance of links between transport modes, as more than one mode is used in providing door-to-door services for consumers. It also could create opportunities for those Members with particular interests in one transport industry to put pressure on those in another to liberalise, and thereby generate net benefits for the users of the transport sector as a whole.

The shortcomings in the structure and scope of the GATS are well documented (Hoekman 1995; IC 1995d). The next round of negotiations might be an opportunity to consider the adoption of a 'negative list' approach to scheduling services sectors and commitments, clarification of the definitions of market access and national treatment disciplines, and expansion and strengthening of generally applicable rules. As one of the signatories which has made relatively strong commitments under the GATS, Australia could also support moves which result in greater transparency and commitment to liberalisation among other WTO Members.