



**Australian Government**  
**Productivity Commission**

# Barriers to Growth in Service Exports

Productivity Commission  
Research Report

November 2015

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### **The Productivity Commission**

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website ([www.pc.gov.au](http://www.pc.gov.au)).

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# Foreword

The opportunities for Australian service providers to participate in international trade are greater than ever. Services make up a substantial part of Australian exports and demand for services globally continues to grow, driven in part by increasing incomes in Asia.

In this study the Commission was asked to examine domestic and international barriers to Australian service exports, with a focus on tourism, education, financial, professional, information technology and health services. The Commission found that Australian governments should take steps to reduce barriers to service exports, with priority given to domestic policy reform that promotes competition and provides incentives for firms to innovate and lift their productivity.

The study benefited from discussions and submissions from stakeholders in the government, non-government and business sectors. The Commission acknowledges the valuable contribution of all those who participated.

Angela MacRae  
Commissioner

November 2015

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# Terms of reference

## **PRODUCTIVITY COMMISSION STUDY INTO BARRIERS TO GROWTH IN AUSTRALIAN SERVICES EXPORTS**

I, Joe Hockey, Treasurer, pursuant to Parts 2 and 4 of the *Productivity Commission Act 1998*, hereby request that the Productivity Commission undertake a research study into barriers to growth in Australian services exports.

### **Background**

Service industries are a large and growing share of the Australian economy and world trade. While services account for approximately 70 per cent of the Australian economy, they represent only 20 per cent of Australia's total exports indicating there is scope for significant growth. Some service industries are subject to extensive regulation and barriers to entry. The Government considers there is scope to reduce these and other barriers to growth.

### **Scope of the research study**

In undertaking the study, the Commission should:

1. Consider recent trends in services exports by Australian suppliers, and draw on case studies and other material where relevant to look at drivers of Australian services exports. The study should focus on the education, financial services, health services, information technology, professional services, and tourism sectors.
2. Examine the domestic barriers to growth in Australian services exports, including any investment barriers, and consider appropriate policy remedies.
3. Examine barriers to growth in Australian services exports in economies with which Australia does not have free trade agreements/economic partnership agreements in force or substantially concluded and which are ranked in Australia's top forty trade partners.
4. Provide an assessment of the economic benefits of removing or reducing the barriers to Australian services exports in these markets.
5. Examine, where relevant, the experience of other international economies in developing policy approaches in this area.

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## **Process**

The Commission is to undertake an appropriate public consultation process and release both a draft and a final report.

Noting that the Commission has recently commenced research in the international education services and tourism sectors, in undertaking this study the Commission should avoid duplication of that work and draw on it as appropriate in its final report.

The final report should be released within nine months of receipt of these terms of reference.

J.B. HOCKEY

Treasurer

**[Received 4 March 2015]**



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# Abbreviations

ABS	Australian Bureau of Statistics
ACPET	Australian Council for Private Education and Training
AFMA	Australian Financial Markets Association
AIPE	Australian Institute of Professional Education
AL	Assessment level
ANZ	Australia and New Zealand Banking Group
APEC	Asia-Pacific Economic Cooperation
APRA	Australian Prudential Regulation Authority
ARFP	Asia Region Funds Passport
ASEAN	Association of Southeast Asian Nations
ASIC	Australian Securities and Investments Commission
ASQA	Australian Skills Quality Authority
ATO	Australian Taxation Office
CAMAC	Corporations and Markets Advisory Committee
COAG	Council of Australian Governments
CBPR	Cross-Border Privacy Rules
CGE	Computable general equilibrium
CIV	Collective investment vehicle
CRICOS	Commonwealth Register of Institutions and Courses for Overseas Students
DET	Department of Education and Training
DFAT	Department of Foreign Affairs and Trade
DIPB	Department of Immigration and Border Protection
ECA	Export Council of Australia
EFIC	Export Finance and Insurance Corporation
EMDG	Export Market Development Grants
ESOS	Education Services for Overseas Students

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ETF	Exchange-traded funds
FATA	<i>Foreign Acquisitions and Takeovers Act 1975 (Cwlth)</i>
FDI	Foreign direct investment
FISIM	Financial intermediation services indirectly measured
FSC	Financial Services Council
FSI	Financial System Inquiry
FTA	Free trade agreement
GATS	General Agreement on Trade in Services
GDP	Gross domestic product
GOS	APEC Group on Services
GSP	Gross state product
GTE	Genuine Temporary Entrant
IAIS	International Association of Insurance Supervisors
ICAC	Independent Commission Against Corruption NSW
ICP	Insurance Core Principle
ICT	Information and communications technology
IEAA	International Education Association of Australia
IMF	International Monetary Fund
IMR	Investment manager regime
IP	Intellectual property
ISO	International Organisation for Standardization
MFN	Most favoured nation
MIT	Managed investment trust
MRA	Mutual recognition agreement
OECD	Organisation for Economic Co-operation and Development
PC	Productivity Commission
PMC	Passenger Movement Charge
QILT	Quality Indicators for Learning and Teaching
RCEP	Regional comprehensive economic partnership agreement
RDNS	Royal District Nursing Service
SME	Small and medium-sized enterprise
SNA	System of National Accounts

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SSVF	Simplified international student visa framework
SVP	Streamlined visa processing
TAFE	Tertiary and Further Education
TEQSA	Tertiary Education Quality Standards Agency
TiSA	Trade in services agreement
TPP	Trans-Pacific Partnership
TRIPS	Trade-related aspects of intellectual property rights
TSA	Tourism Satellite Account
TTF	Tourism and Transport Forum Australia
TTMRA	Trans-Tasman mutual recognition arrangement
UCITS	Undertakings for collective investment in transferable securities
USTR	United States Trade Representative
VAGO	Victorian Auditor General's Office
VET	Vocational Education and Training
VFR	Visiting friends and relatives
WTO	World Trade Organization

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# OVERVIEW

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## Key points

- The total value of Australian service exports was \$62 billion in 2014-15 — about 20 per cent of the total value of exports. The six service sectors covered in this study — tourism, education, financial, professional, information technology and health services — accounted for around 85 per cent of the total value of service exports.
  - Rising household incomes in Asia have been an important driver of demand for service exports from Australia. Visitors from Asia accounted for much of the growth in Australian tourism and education exports over the past decade.
- The priority for Australian governments should be domestic policy reform that promotes competition and provides incentives for firms to innovate and lift their productivity.
  - Growing service exports is not an end in itself — domestic production is no more or less valuable to the community whether it is consumed in Australia or exported.
- Specific reforms to reduce domestic barriers to service exports that should be pursued by the Australian Government include:
  - implementing visa processing arrangements for short-term visitors and international students that are no more onerous than is necessary to meet a single policy objective of immigration integrity
  - liberalising air services arrangements for the major gateways of Brisbane, Melbourne and Perth and, following this, Sydney — unless a published assessment shows the costs of liberalising access to Sydney Airport would outweigh the benefits to the community
  - simplifying Australia's regime of withholding taxes through greater uniformity in the rate applied to different types of investment and reducing the range of exemptions
  - implementing consistent screening thresholds for Foreign Investment Review Board examination of foreign investment proposals across investors from different countries.
- International barriers to services trade can be costly:
  - Restrictions on setting up a commercial presence abroad are particularly high in key markets in Asia, notably China, India and Indonesia. These restrictions affect the education, health and professional service sectors, but are especially costly for financial services.
  - Licensing requirements and regulation are used to maintain standards of quality, consumer protection and safety but can impose unnecessary restrictions on services trade, particularly for professional services.
  - Service providers seeking to export rely on the ability to move data across borders, making data restrictions costly. The financial service sector can be especially affected by restrictions on data flows, as are exporters who rely on cloud computing services.
- Realising benefits from trade depends on governments committing to further reducing barriers *at and behind* the border. No one mechanism will be sufficient to address international barriers to services trade.
  - Trade agreements can be a precursor to market access, including establishing a commercial presence abroad, but realised benefits may be limited without supplementary measures, such as mutual recognition agreements. The Australian Government can help by putting in place a framework (that includes clear actions and timeframes and involves an adequately resourced implementation working group) to support the development of mutual recognition agreements through trade or other agreements.
  - The Australian Government is well-placed to help facilitate cross-border data flows through trade negotiations and other international forums, and as leader of a project on harmonising standards for the movement of data across APEC economies.

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# Overview

The opportunities for Australian service providers to participate in international trade are greater than ever. Global demand for services is increasing due to rising household incomes, particularly in some countries in Asia. Services are becoming increasingly important to global value chains, which themselves are becoming more complex. In addition to providing greater opportunities to earn export income, participation in global value chains enables Australian service providers to access less expensive or better quality intermediate inputs. The free flow of imports — which in itself improves the allocation of resources in the Australian economy — is increasingly important for Australia’s export success.

Barriers to service exports reduce the benefits from Australia’s involvement in international trade. Such barriers reduce the efficiency with which resources are allocated across the Australian economy, imposing costs on the community. A lower return is generated from Australia’s scarce resources, which can have flow-on effects for a range of other economic measures, including taxation revenues and wages. These costs provide a rationale for governments to seek to reduce or remove barriers — both in Australia and overseas — to service exports. Increasing service exports is not, however, an end in itself. Reducing barriers to service exports should only be pursued where it is expected to lead to net benefits for the community. Domestic production is no more or less valuable to the community whether it is consumed in Australia or exported.

The domestic policy reform effort should have the objective of enabling businesses to perform those activities they do best by promoting competition and providing incentives to innovate and lift their productivity. This will invariably lead to exports of some goods and services and imports of others.

## **What has the Commission been asked to do?**

The Australian Government has asked the Productivity Commission to conduct a study into barriers to growth in Australian service exports focusing on six service sectors (box 1). The terms of reference for the study ask the Commission to:

- consider recent trends in, and drivers of, service exports by Australian suppliers
- examine the domestic barriers to growth in Australian service exports, including any investment barriers, and consider appropriate policy responses
- examine barriers to growth in service exports in economies (ranked in Australia’s top 40 trading partners) with which Australia does not have a free trade agreement, and assess the economic benefits of reducing or removing barriers in these markets

- 
- examine the experience of other economies in developing policy approaches in this area.

### Box 1      **Service sectors**

The Commission has been asked to focus on six service sectors.

- *Tourism* — services and personal goods, such as transportation and food, consumed by short-term visitors to Australia. There is some overlap between tourism exports and exports from other service sectors. For example, expenditure in Australia by international students may be considered a tourism export or an education export.
- *Education* — services provided by universities, vocational education and training providers, schools and other education institutions. Education exports are provided to international students, either in Australia, or in other countries at foreign campuses or through online or distance education.
- *Financial* — services relating to financial intermediation, such as providing loans, insurance services, investment management, superannuation and pension services, stock brokerage and investment banking services.
- *Professional* — services provided by engineers, architects, accountants, lawyers, management consultants, advertisers, market researchers and other professionals.
- *Information technology* — services such as hardware and software consultancy, software licensing, data processing, database services, maintenance and repair of computers, and news services.
- *Health* — services relating to the diagnosis, treatment and prevention of disease, illness and injury, including hospital services and social services relating to health, such as aged care.

## What is a barrier to service exports?

The study focuses on identifying policy-relevant barriers that affect the export of services from Australia. A policy-relevant barrier is defined as anything that *unnecessarily* impedes the ability of businesses to export services by increasing the costs of exporting a service, restricting the supply of the service export, or inhibiting the demand for the service in an export market. This definition recognises that there may be a rationale for government involvement in markets to meet an equity objective or to address a market failure — sources of market failure that may warrant government involvement include externalities, public goods, information problems and a lack of effective competition. The challenge is distinguishing between measures that are the ‘least burdensome’ needed to achieve the equity or market failure objective and those that are unnecessarily restrictive.

## The Commission’s approach to this study

To identify the main barriers to service exports the Commission consulted extensively with study participants and drew on a range of other information sources such as case studies and quantitative research, including from other countries. Among other things, the Commission

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gathered information on how Australian service providers have been affected by (and responded to) trade barriers, and the costs and benefits of potential options for policy reform.

The Commission has used an economic framework to identify the domestic and international barriers to service exports that impose the greatest costs on the Australian community. The costs imposed by a barrier will depend on a number of factors including the height of the barrier — the extent to which the barrier has distorted market outcomes — and the size of the sector affected by the barrier in the importing countries. Identifying the barriers that impose the greatest costs on the community can help governments to focus their domestic policy reform and trade liberalisation efforts in areas where they are expected to deliver the greatest net benefits to the community.

## **Service exports have doubled over the past 20 years**

The total value of Australian service exports was \$62 billion in 2014-15 — about 20 per cent of the total value of exports (down from about 25 per cent of the total value of exports a decade prior). The contribution of services to Australian exports is generally undervalued, as standard trade statistics using gross measures of exports are poorly suited to capturing the contribution of services to goods exports (or global patterns of services trade) (box 2).

The decline of services as a proportion of total Australian exports in recent years is due to several factors, including an increase in goods exports driven by the mining boom, a decline in financial service exports during the global financial crisis, and a fall in education exports following the introduction of enhanced integrity measures for permanent visas in 2009.

The value of exports from all service sectors has grown at about the same average rate as services gross value added over the past two decades — both have roughly doubled (in real terms) since 1994-95. The six service sectors covered in the study accounted for about \$53 billion (around 85 per cent) of the total value of service exports from all sectors in 2014-15 (figure 1).

Education exports have grown at an average annual rate of 12 per cent over the past two decades and contributed around \$19 billion to the Australian economy in 2014-15. International tourism has also grown strongly over the past two decades — the value of tourism exports has grown by an average of 6 per cent per year over this period.

## Box 2 Global value chains and value-added measures of exports

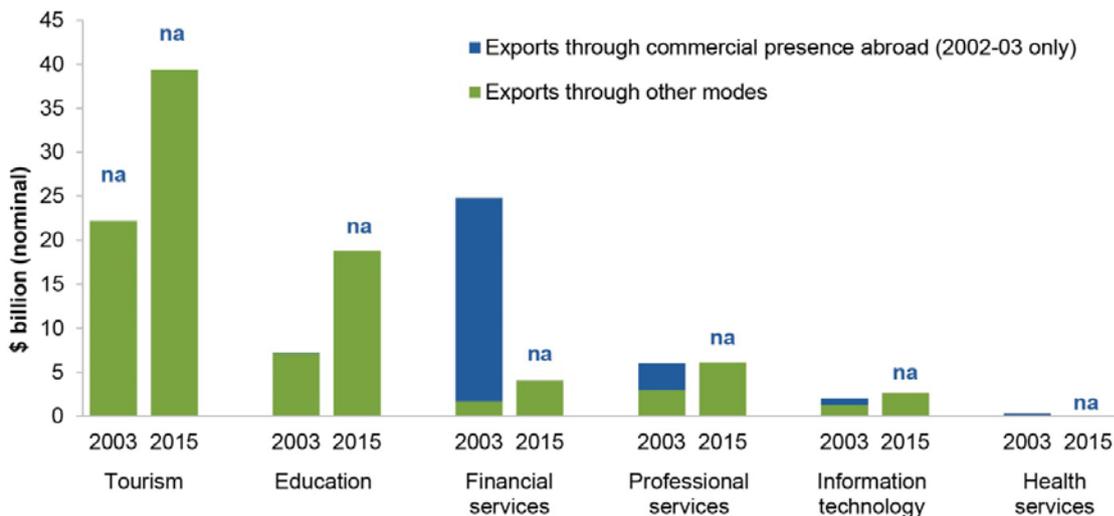
Over the past few decades the structure of international trade has changed with the emergence of global value chains — production networks that span multiple countries. The production of a single good, such as a mobile phone, typically now takes place across several countries, with each country contributing a part of the final product. Value-added measures of exports have been developed in response to these changes.

Gross measures of exports attribute all export value to the final industry in the export production chain, whereas value-added measures of exports take account of intermediate inputs that are used in the production of exports. For example, if engineering services are used in the production of minerals, which are then exported, then a value-added measure of exports would count the engineering services embodied in the minerals as a service export. A gross measure of exports would count the entire value as an export of minerals.

Services used as inputs in the production of goods typically account for a significant proportion of the value of goods exports and, as a result, gross measures of exports understate the contribution of services to total exports. One study estimated that Australian service sectors accounted for about 40 per cent of exports in value-added terms in 2013, compared with 17 per cent in gross-value terms.

Value-added measures also show that patterns of trade are different when considered in terms of the final (rather than intermediate) destination of exports. Using value-added measures, more Australian exports of goods and services ultimately end up in Europe and the United States (and less in China, South Korea and Taiwan) than suggested by gross measures.

Figure 1 Australian exports by service sector<sup>a</sup>  
2002-03 and 2014-15



<sup>a</sup> Education-related travel (valued at \$18.2 billion in 2014-15) is counted as part of both education and tourism exports. The value of education exports through commercial presence abroad in 2002-03 and health service exports through modes other than commercial presence abroad in 2002-03 and 2014-15 are too small to be visible. The ABS Tourism Satellite Account uses an alternative approach to measuring tourism exports from Australia. Tourism Satellite Account data for 2014-15 are not currently available. **na** Not available (data on exports through commercial presence abroad for all sectors are not available after 2003).

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The four modes through which services are exported are shown in figure 2. Unlike exports through other modes, service exports through commercial presence abroad — the predominant mode for financial service exports — are not included in Australia’s balance of payments data. The lack of periodic data on Australian exports through commercial presence abroad makes it difficult to assess trends in service exports through this mode. Estimates that are available suggest that between 2003 and 2013 the value of service exports through commercial presence abroad increased at a faster rate than service exports through other modes.

An ABS review of its international accounts in 2015 identified that there was strong interest from a number of stakeholders in securing more up-to-date data on exports through commercial presence abroad. Assessment of Australia’s service exports would be much enhanced by more comprehensive statistics — particularly in relation to the commercial presence abroad of Australian service providers.

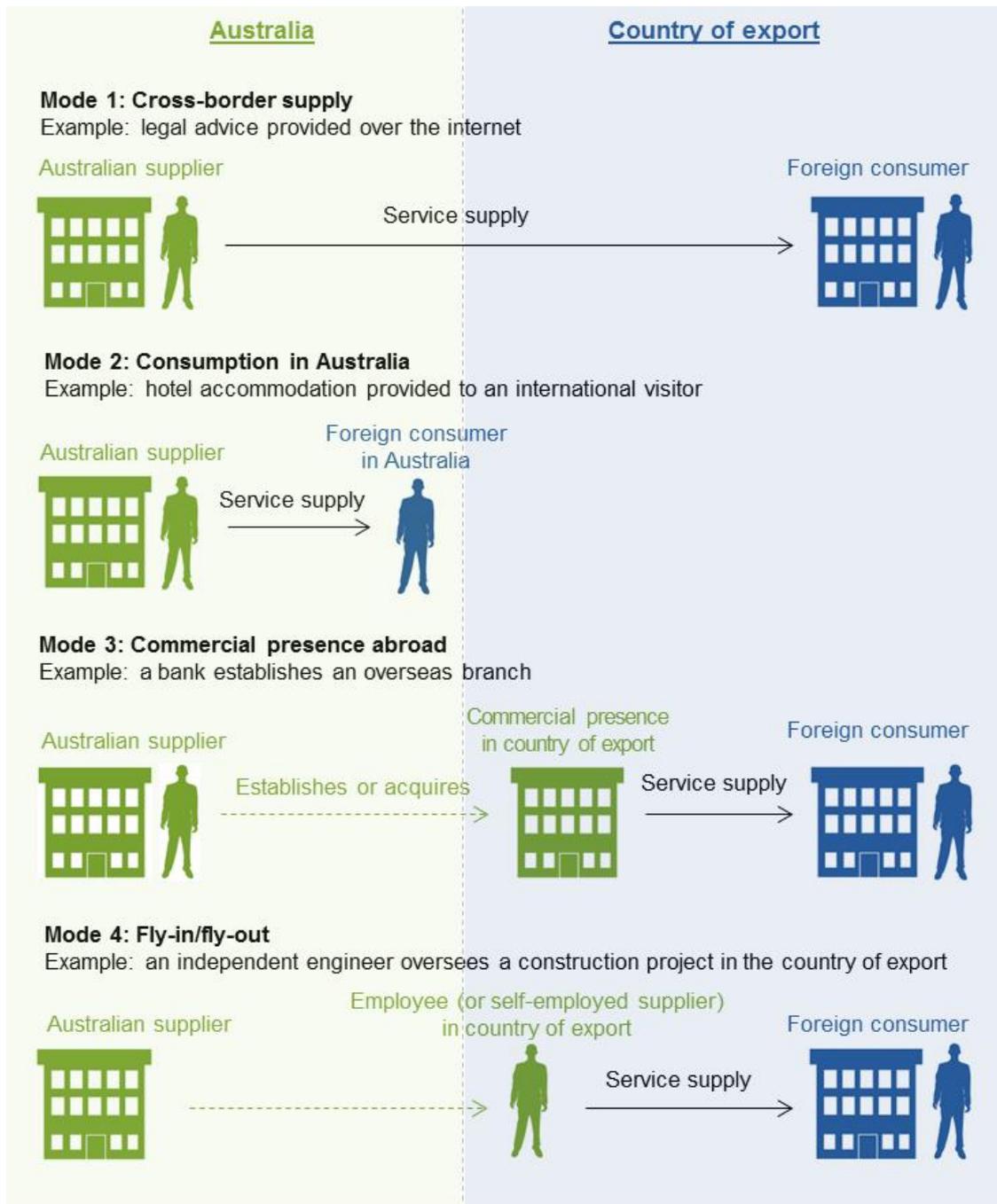
## **What are the drivers of service exports?**

Demand for Australian service exports is in part driven by global trends — from 2004 to 2014, the average annual growth rate of global service exports was 8 per cent. Over the past two decades, global service exports and Australian service exports have largely moved together (although growth in global service exports has outpaced Australian service exports since 2012). Increases in global incomes (as measured by global GDP), and particularly incomes in Asia, have been a key driver of global demand for service exports. The International Monetary Fund has forecast that global GDP will continue to grow and Asia is expected to continue to increase its share of global GDP, which is likely to drive future growth in demand for service exports within the Asian region.

Policy reforms in other countries have facilitated growth in services trade. China, for example, implemented a tourism strategy in 2013 that encourages employers to promote the use of paid leave days, which is expected to boost outbound (and domestic) tourism.

Movements in the value of the Australian dollar are one factor that affects Australian service providers’ ability to capture opportunities to meet rising global demand for services. In a 2013 survey of Australian exporters, commissioned by the Export Council of Australia, half of the respondents considered the high value of the Australian dollar the most important factor adversely affecting their international competitiveness. Since 2013, the value of the Australian dollar has fallen against the trade-weighted index.

Figure 2 Modes of exporting services



## Rising incomes in Asia are an important driver of demand for Australian services

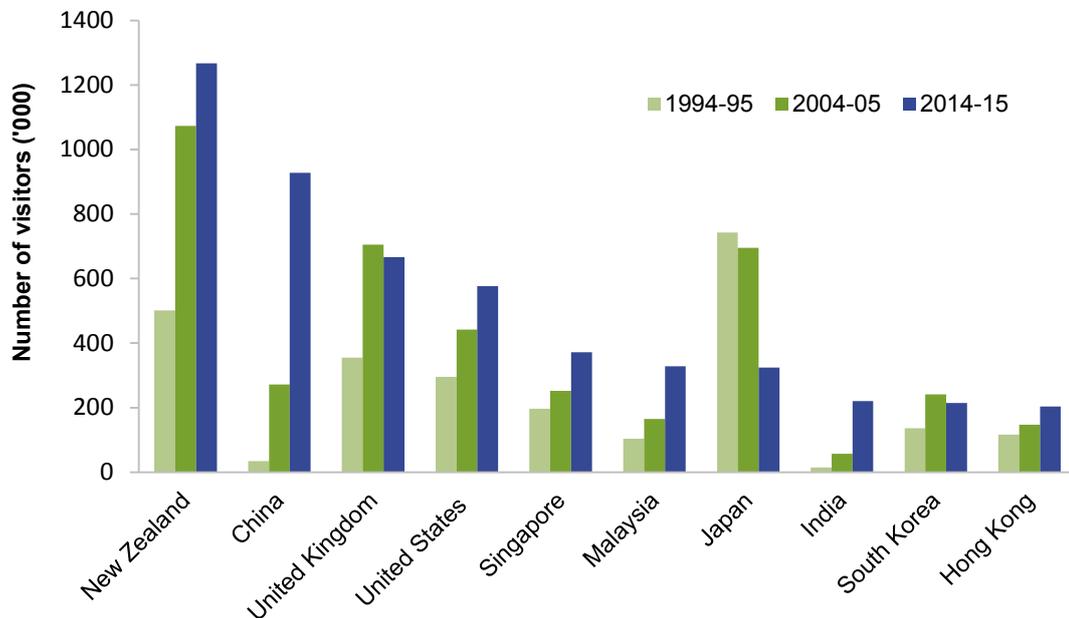
Recent decades have seen rapid economic growth and rising incomes, particularly in Asia. Real household incomes in China, for example, increased from about US\$470 per capita in 1980 to about US\$7500 per capita in 2014. Markets in Asia have been the fastest growing

for Australian service exports, particularly China, with average annual growth in the value of service exports from Australia to China of 12 per cent over the ten years to 2014. There has also been strong growth in the value of Australian service exports to India, Malaysia and Singapore.

### More visitors from Asia are travelling to Australia as tourists and as students

The tourism and education sectors, in particular, have benefited from rising household incomes in Asia. Over the past decade, the growth in the number of visitors to Australia has mostly come from developing countries in Asia (figure 3). China leads the world in total international tourism expenditure and is now the second-largest source of visitors to Australia after New Zealand. China is likely to continue to be a source of significant growth in visitor numbers as real incomes in China continue to rise. The proportion of international visitors who travel to Australia to visit their friends and relatives has increased from 21 per cent to 28 per cent between 2005-06 and 2014-15. Increased migration to Australia contributed to this growth, as friends and relatives of migrants may visit them in Australia.

**Figure 3 Short-term visitors to Australia<sup>a</sup>**  
Top ten source countries in 2014-15



<sup>a</sup> Arrivals of visitors that stay in Australia for less than one year. Includes visitors coming to Australia for any purpose — including tourism, visiting friends and relatives, business, education and health reasons.

Over the past decade, developing countries in Asia accounted for most of the growth in Australian education-related travel exports. Students from Asia accounted for about three quarters of all international student enrolments in Australia in 2014. In that year, students

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from China and India accounted for the largest proportion of enrolments — 26 per cent and 11 per cent respectively. While primary and secondary schools accounted for less than 5 per cent of international student enrolments in 2014, this still represents over 18 000 international student enrolments, with the main source countries being China, Vietnam and South Korea.

## **Tourism and international education are globally contested markets**

Tourism and education services are both globally contested markets and there is strong competition amongst countries to maintain or increase their share of visitors from key source markets, particularly China. Governments in competitor countries have initiatives focused on meeting this challenge.

Tourism agencies in many countries, including the United Kingdom and the United States, are running international destination marketing and other programs focused on attracting visitors from China. India, Thailand and the United Kingdom have implemented reforms to improve visa arrangements, particularly for visitors from emerging Asian markets, to facilitate growth in visitor numbers. The Australian Tourism Export Council noted in its submission that the number of travellers needing a traditional visa to visit an international destination fell from 77 per cent to 63 per cent over the past four years — the result of restrictions being lifted, an easing of requirements to get a visa on arrival and the waiving of visa requirements altogether.

Similarly, overseas governments and education providers are investing in onshore and offshore education services. Countries in Asia and the Middle East are investing heavily in higher education systems. China is also actively engaged in improving the range and quality of its domestic education services.

### **Visa settings for visitors and students influence demand for service exports**

Visa settings are important as they determine the ease with which short-term visitors and international students are able to enter Australia and, for students in particular, visas may open a pathway to permanent residency. Application costs and the time taken to process visa applications have been raised by tourism and education industry stakeholders as important considerations for visitors and students when deciding where to travel or where to study.

The potential for obtaining permanent residency in the host country is a key factor in the choice of study destination for many international students. The Department of Immigration and Border Protection identified that some of the rapid growth in the number of Australian student visas issued between 2007 and 2009 resulted from non-genuine students applying for student visas as a ‘back door’ to permanent residency. As of August 2015, just under one third of those with a student visa expiring between 1 July 2006 and 30 June 2011 had gone on to get a permanent or provisional visa. The Australian

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Government introduced enhanced integrity measures in 2009 and 2010, including tightening the list of occupations for the skilled migration program.

### Visitors to Australia are drawn by the quality of tourism amenities ...

Factors affecting visitor preferences for travel destinations include their country of origin, purpose of travel, demographics and sociocultural factors. Perceptions of a destination's tourism assets and amenities are important determinants of demand for Australian tourism exports. A 2014 survey found that 'world class beauty and natural environments' was rated as the most important factor by Chinese consumers, and as the second most important factor by Indian consumers, when selecting a holiday destination. High quality infrastructure in areas such as national parks is also important for attracting visitors to Australia.

### ... and students are seeking high quality education services

For international students, the quality and reputation of Australian education institutions are important drivers of demand for both onshore and offshore education services. The Commission has previously found that key factors influencing where students choose to study include the reputation of the provider (and the quality of the learning experience it offers) and the cost of studying in Australia. Study participants reiterated the importance of education quality as a factor in the choice of which institution to attend.

### Relative prices are also important in a globally competitive environment

The relative price of goods and services in Australia is also an important factor influencing visitors' decisions to choose Australia over competitor destinations. Some participants in the Commission's 2015 research paper into Australia's international tourism industry argued that Australia was a relatively high cost destination and that this had adversely affected Australia's tourism sector. Similarly, the cost of student accommodation was cited by participants in this study as a barrier to international students studying in Australia. Relative prices are particularly influential for highly mobile visitors who have discretion over their choice of destination. People travelling for education or a holiday have more discretion over whether and where they travel, and are likely to be more sensitive to differences in price than people travelling for business.

### **Rising household incomes are fuelling demand for financial services**

Rapid income growth in Asia and greater individual wealth have increased demand for funds management services. Investing in offshore funds is a way for investors to diversify their portfolios. An increase in the number of 'ultra-high net worth individuals' —

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individuals with investable assets of US\$30 million or more — is a key driver of demand for exports of funds management services.

## **Wealthier and ageing populations drive demand for health care**

Global demand for health services is growing significantly. Economic development, higher household incomes and demographic change (particularly population ageing) are key drivers of demand for health services. Australian exporters are meeting the increasing demand for health services through commercial presence abroad, medical tourism and the provision of education and training services in health-related disciplines.

### **Australian health service providers operating abroad**

In 2002-03, commercial presence abroad was the dominant mode for Australian health service exports. In that year, the value of health service exports through commercial presence abroad was \$330 million. Although more recent data are not available, it is likely that this remains the dominant mode for Australian health service exports.

Ramsay Health Care — the largest operator of private hospitals in Australia — operates more than one hundred hospitals across France, Indonesia, Malaysia and the United Kingdom. Ramsay has identified opportunities for health service investment in China due to China's growing middle class, ageing population and liberalisation of policies for foreign investors, and is currently involved in a joint venture that plans to invest in hospitals in China.

Health services provided in Australia are typically more expensive than in key competitor destinations for medical-related travel such as India, Singapore and Thailand — partly as a result of high labour costs in Australia relative to these countries. This is not the case for health services provided through commercial presence abroad where labour is employed under market conditions in countries with lower wages than Australia.

In many Asian countries, including China, increases in life expectancy and the erosion of traditional family support networks (in which older people live with their families) are boosting demand for aged care services. Under the China-Australia trade agreement, Australian providers will be able to establish profit-making aged care institutions throughout China, and wholly own hospitals in some provinces.

### **Medical tourism: the quality and price of health care services matter**

The increasing cost of health care, or a lack of accessibility to services, in the home country means more people are seeking treatment elsewhere. Medical tourism is becoming an increasingly sophisticated market with countries specialising in types of care or procedures. For example, holidays and medical care are packaged together in Malaysia and

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Thailand, sometimes with the help of an agent to connect patients with health care providers.

Research has shown that the drivers of demand for medical tourism include the quality and price of health care. Australian health service providers offer high quality and specialist services that are unavailable in less-developed countries in our region.

Some less expensive destinations for medical tourism can provide acceptably high quality health care. For example, one study on medical tourism estimated the cost of heart bypass surgery in Australia at \$33 340, compared with \$10 000 to \$15 000 in countries such as India, Malaysia, Singapore and Thailand. Not only is the price of some medical procedures considerably higher than in competitor countries, residents of key source countries, such as China, can access high quality medical care closer to home.

### Provision of education and training services in health-related disciplines

Education in health-related disciplines is also an important Australian export (typically included in the definition of education exports). Health courses accounted for more than 7 per cent of total onshore and offshore enrolments (about 26 000 out of 360 000 international enrolments) in Australian higher education courses in 2014. Enrolment numbers may not capture all health-related education provision where courses are included in other fields (for example, a hospital administration course may be considered a management course), or where training is not provided through a vocational education and training provider or a university (such as training provided offshore by independent Australian doctors or nurses on a fly-in/fly-out basis).

### **Demand for service exports follows investment flows and goods trade**

The International Legal Services Advisory Council has found that investment flows are also an important driver of demand for exports of legal services. This is because key areas of legal service exports — such as mergers and acquisitions, and intellectual property — are closely linked to investment. Investment in infrastructure and other large-scale construction projects is a key driver of demand for professional service exports, such as architecture (box 3), engineering services and legal services. Australian exports of engineering and other construction services fell during the global financial crisis, due to fewer construction projects globally and increased competition for these projects.

The volume of goods and services trade is a key driver of financial service exports. Currency exchange and hedging products are necessary to facilitate trade between countries with different currencies. Banks can provide trade finance to foreign clients to assist with the import and export of products. Firms exporting through commercial presence abroad require banking services in multiple countries — some Australian banks, including ANZ and Westpac, have responded to growing demand by opening more branches and offering a broader range of financial services in the Asia–Pacific region.

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**Box 3 Investment drives demand for architecture exports**

Investment in the built environment in other countries (particularly in the Asia–Pacific and, to a lesser extent, the Middle East) drives demand for Australian exports of architectural services. Large, specialised projects such as sports stadiums and airports are particularly likely to attract international architecture firms. Such projects are often funded by government, so governments' investment priorities are a key driver of demand.

Cox Architecture is an Australian company that has exported its services (including designs for sports stadiums and exhibition centres) to Asia, Europe and the Middle East. As of 2015, the firm's most significant international markets were Malaysia, New Zealand, China and Singapore.

Architecture firms often provide a range of services. For example, Populous is a global architecture firm that designs major public infrastructure venues such as stadiums, arenas and convention centres, as well as providing planning services for major international events, such as Olympic games. While Populous has offices in six countries, including in three countries in Asia, it directs and manages all its work in the Asia–Pacific from its Australian base. As a result, investment in major events in the Asia–Pacific is the key demand driver for Populous' exports from Australia.

## **The cost of trading services is falling**

### **Exporters are benefiting from lower airfares**

Service providers that rely on face-to-face modes of delivery, such as some Australian engineers and lawyers, have benefited from the declining price of international air travel. The price of air travel has fallen by more than half (in real terms) over the past four decades. The commencement of new services over the past decade, particularly by carriers from Asia and the Middle East, has also benefited service exporters.

The tourism and education sectors, in particular, have benefited from lower price international air travel since about 99 per cent of international visitors travel to and from Australia by air. Airfares comprise a large part of the total cost of a short-term visit by an international visitor to Australia and a smaller, but still sizable, part of the total cost of a longer-term visit.

### **Technological innovations are changing the way service providers do business ...**

Technological advances in information and communications technology (ICT), including email, online video and audio calls, and online payment systems have greatly reduced the costs of delivering a range of services, and have allowed a wider range of service providers and consumers to come together. The internet allows trade in many types of services without the need for providers or consumers to be in the same physical location, avoiding travel costs. In a 2013 global survey of managers and business professionals, ICT infrastructure was considered among the most important drivers of competitiveness in all professional service sectors. Advances in ICT are also changing the way tourism services

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are delivered with more visitors researching and booking components of their trip on the internet, especially airfares and accommodation.

Technological change has lowered the cost of delivering financial services such as insurance, loans and brokerage, with these services now commonly provided online. In the education field, advances in technology mean that it is now possible to deliver a lecture once, and distribute it to any number of students over the internet — distribution is no longer restricted by the size of lecture halls, or distance between teacher and student. Education institutions that follow this online model can have large economies of scale, leading some of these institutions to deliver courses to large numbers of students.

... helping to overcome language barriers ...

Common language is more important for services trade than goods trade. In 2014, more than one third of Australian service exports were to countries where English is the first language. Advances in computer software and ICT have reduced the costs of trading services between parties that speak different languages. Over the past decade, the accuracy of text translation programs, such as Google Translate, has improved dramatically. In 2014, Skype — a provider of video-calling services — launched a program that translates speech in real time.

... and presenting export opportunities for Australian IT providers

Information technology (IT) consultancy services accounted for about two thirds of Australia's total IT service exports in 2014-15 (\$1.7 billion). Exports of software licenses were significant in that year too, valued at \$320 million. Technological advances, such as improvements in battery technology and computing power, have underpinned the creation of new electronic hardware and a boom in the development of software for smartphones and tablets.

Exports of consultancy services may be linked with software distribution. For example, Opmantek is an Australian company that develops network management software. The software is available to companies around the world at no charge and Opmantek generates revenue by providing customisation and support services to those using the software.

## **Capturing the opportunities for growth in service exports**

The Commission has identified three sectors where reforms would help to overcome material sector-specific barriers to exporting — tourism, education and financial services. IT, professional services and in some cases health services are predominantly (although not exclusively) affected by more general barriers that affect all sectors.

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## **Tourism and education exports would benefit from domestic policy reforms**

Policies to facilitate growth in tourism and education exports fall into four broad categories.

- Attracting international visitors and students to Australia in markets that are heavily contested.
- Facilitating the flow of international visitors and students to Australia through air services arrangements and visa and border processing arrangements.
- Delivering high quality international education services (including online).
- Facilitating infrastructure development (including accommodation for short-term visitors and students), and recreational, cultural and heritage attractions to support tourism activity.

### **Governments can have a role in attracting international visitors and students**

The Australian, state and territory governments market and promote export service sectors through:

- national brand and image marketing, such as the Building Brand Australia Program
- tourism promotion through destination marketing, such as the work of Tourism Australia and its state and territory equivalents, or the funding or provision of major events
- marketing and promotion of Australian education and training providers, such as that undertaken by state and territory government bodies (for example, Study Queensland and Study Melbourne), and nationally by Austrade.

The benefits arising from effective international marketing and promotion of Australian exports can be captured by many tourism-related businesses or education providers, but it is sometimes not feasible to exclude those in the sector who benefit from the campaign but who do not contribute to the costs. This free riding may mean that industry players do not face incentives to undertake the optimal level of international marketing and promotion from the community's perspective.

The failure of the market to generate an efficient outcome could result in less services being exported than would otherwise be the case — although this does not necessarily imply that government involvement would generate net benefits to the community. Whether governments are justified in undertaking international marketing and promotion campaigns can only be determined on a case-by-case basis through economic analysis prior to the activity proceeding. The analysis undertaken should be fit for purpose, and the scale and complexity of the analysis should be commensurate with the value of government funding to be provided to the activity.

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The Commission emphasises the importance of transparency in the evaluation of government provision of international marketing campaigns. Supporting economic analyses should be released publicly as soon as practicable. An ex post evaluation of the costs and benefits following the completion of the campaign, also released publicly, would provide further rigour and accountability on the use of taxpayer funds.

In general, the more highly concentrated a sector, the more likely it is that the larger businesses in that sector would conduct marketing and promotion in the absence of government provision (as they stand to capture the greatest proportion of the benefits), and there is less of a case for government involvement. For example, larger providers in the higher education sector have the incentive to promote their institution *and* the wider benefits of studying in Australia.

### Facilitating the flow of visitors — further liberalisation of Australia’s air services arrangements could lower travel costs

Under most of Australia’s air services arrangements, access (capacity) is restricted for international airlines flying to and from airports in the major gateways of Brisbane, Melbourne, Perth and Sydney, but is unrestricted to other Australian airports — a policy referred to as the regional package. Under the regional package, access is also restricted to secondary airports in the major gateways of Melbourne and Sydney (Avalon Airport and the proposed airport at Badgerys Creek, respectively) yet not to the secondary airports in Brisbane (Gold Coast and Sunshine Coast airports), which are treated as regional gateways.

The Department of Infrastructure and Regional Development is firmly of the view that the approach of restricting access to Australia’s major gateways has provided negotiating leverage to obtain improved rights for Australian airlines. The Department acknowledged that there are markets (Fiji, Hong Kong and Qatar) where foreign airlines are not currently able to add services to and from Australia’s major gateways. The Department stated that negotiations with these partner countries have been prioritised and are likely to be held in the coming months (subject to their agreement), but provided no indication as to when foreign airlines seeking additional access could expect to be able to gain such access.

Reducing restrictions on foreign airlines’ access to Australia’s major gateways would be expected to increase competition in aviation markets and put downward pressure on airfares. Passengers would benefit from any lowering of airfares, and from greater choice of airlines and air services to a wider range of destinations. While the tourism sector, in particular, would be expected to benefit, benefits would also accrue to other service export sectors where providers rely on face-to-face delivery of their service.

The Commission considers that, with perhaps the exception of Sydney Kingsford Smith Airport (Australia’s largest airport), the benefits to the Australian community from providing unrestricted access to any of the airports in Australia’s major gateways would

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outweigh the costs arising from any loss of negotiating leverage for the Australian Government.

The Commission proposes that access to Australia's major gateways be liberalised in a staged way. To begin with, the Australian Government should, as soon as practicable, provide (through negotiated amendments to its international air services arrangements) unrestricted access for foreign airlines flying to and from Brisbane, Melbourne and Perth airports, as well as secondary airports in all of the major gateways. Following this, the Australian Government should provide unrestricted access to Sydney Kingsford Smith Airport, unless a published assessment demonstrates that the costs of doing so would outweigh the benefits to the Australian community.

The Australian Government's policy objective for international aviation is to balance the interests of the Australian aviation industry and those of the broader community. Industry stakeholders, including Sydney Airport, have expressed a desire for greater transparency from Government as to how the national interest is determined when negotiating air services arrangements. An assessment of the relevant costs and benefits of more open international air services markets that is publicly released would boost the confidence of stakeholders that decisions are being made in the interests of the broader community. This assessment should include the benefits to the Australian community arising from lower airfares or gaining access to a wider range of outbound travel destinations, as well as any effects on Australian airlines.

### Simplifying visa arrangements to make it easier to travel to Australia

The policy objective of Australia's visitor visa program is to facilitate the entry of genuine visitors, while minimising non-return rates and breaches of visa conditions. Similarly, the objective of Australia's student visa program is to facilitate the movement of genuine international students wishing to study in Australia, while maintaining immigration integrity. Study participants raised a number of issues related to the entry of international short-term visitors and students to Australia, predominantly related to the process of obtaining visitor visas, particularly for visitors from China, and the streamlined visa processing (SVP) arrangements for international students.

Given they are important determinants of demand for tourism and education services, the requirements and restrictions attached to visa eligibility should be no more burdensome than is necessary to meet the policy objective. The Australian Government is implementing reforms to simplify visa processing, including streamlining documentary requirements for citizens of China. The Commission supports the steps and, once fully implemented, they appear likely to address many of the concerns raised by participants in relation to short-term visitor visas.

Participants in this study, including the National Tourism Alliance, raised the prospect of premium processing arrangements at the border, such as priority visa processing and off-terminal clearances, being offered to short-term visitors on a cost recovery or

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commercial basis. The Department of Immigration and Border Protection does not currently have a cost recovery framework in place for premium border processing, and these services are currently provided on an ad hoc basis. Charging for the services, in line with the Australian Government's guidelines on cost recovery, would enable premium services to be provided without undermining the ability of the Department of Immigration and Border Protection to undertake its standard visitor clearance processes.

### The case for reforming student visa arrangements

The Australian Government introduced SVP in March 2012 to facilitate simpler and faster visa processing for students enrolled at specific types of education providers. Arrangements for SVP have clearly benefited eligible education providers and students, who have mainly been from the higher education sector. An increase in the number of student visas granted in the higher education sector since 2012 is consistent with SVP having a positive effect on growth in that sector (although the size of this effect is difficult to disentangle from other factors, such as the value of the Australian dollar). Eligible students have enjoyed shorter visa processing times than applicants under the alternative assessment level framework.

While the SVP arrangements have provided benefits to some institutions, clear problems have emerged in relation to the effect of SVP on the education sector as a whole.

Concerns about SVP were raised by the Commission in its 2015 research paper on international education services and by participants in this study, including that it has created perverse incentives for some:

- international education agents to channel students to higher education providers or courses without regard for their career aspirations or aptitude
- students, once granted a visa, to 'course hop' to another provider offering an easier or less expensive course, potentially in breach of their visa conditions
- students to enrol with providers that have access to SVP on the false belief that SVP is a marker of education quality.

These perverse incentives reduce the likelihood that international students will have a quality learning experience in Australia and have the potential to adversely affect the reputation of Australian education institutions. Given that the reputation of Australian education institutions is a key driver of education exports, the unintended consequences of the SVP arrangements likely include some reduction in demand for Australian education services.

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The Australian Government departments responsible for immigration and education are undertaking reforms to address concerns with student visa processing, and to make more information on the quality of education providers accessible to international (and domestic) students. These measures include:

- implementing a single process for student visa applications that applies to prospective students across the international education sector in Australia, including schools and vocational education and training providers
- determining the immigration risk associated with each student visa application, and whether a student has access to streamlined evidentiary requirements, on the basis of the immigration risk of the student's source country and the immigration risk associated with their intended education provider
- supplementing published information sources through the Quality Indicators for Learning and Teaching online platform, which was launched in September 2015 and draws on surveys of student experience, graduate outcomes and employer satisfaction.

The reforms to student visa processing, scheduled to be implemented in mid-2016, will clearly assign the allocation of responsibility for assessing student visa applications to the Department of Immigration and Border Protection. Other government agencies will be responsible for addressing risks to education quality through other mechanisms.

The proposed student visa framework is a major improvement on current arrangements and should be progressed. The framework is more consistent with principles of good regulatory practice than the current SVP arrangements, and would address the perverse incentives outlined above that arise from providers having differential access to SVP. The Commission is also supportive of the Department of Immigration and Border Protection sharing data with education institutions, and consulting closely with education peak bodies and other key government agencies on the implementation of the proposed student visa processing framework, including through the Education Visa Consultative Committee working group.

### Online education — reducing impediments to innovation in service delivery

The Australian Government has indicated that it will consider reforms to increase the flexibility of providers to use online learning in courses offered to international students who are studying in Australia. The Department of Education and Training anticipates undertaking further consultation on a revised National Code of Practice for Providers of Education and Training to Overseas Students in late 2015, which will include consideration of amendments to allow a more flexible approach to delivering education services online.

Existing regulations that limit the use of online education by international students could adversely affect demand for international education services and impose costs on providers by limiting the ways in which they can deliver courses. The Australian Government should

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examine the relationship between the use of online education by international students studying in Australia and the risk of visa non-compliance, to enable an evaluation of options for more innovative and flexible approaches to course delivery that do not undermine immigration objectives.

### **Infrastructure — visitor attractions and places to stay**

Lack of appropriate infrastructure can act as a barrier to exporting services either by increasing the cost of delivering a service or by directly restricting the provision of a particular service. Tired and inadequate infrastructure, particularly relating to visitor accommodation, transport hubs including cruise ship terminals and airports, and national parks have been cited as a barrier to tourism exports. Similarly, student accommodation and facilities are important for attracting international students.

The cost and supply of services-related infrastructure reflect commercial realities but can also be influenced by regulatory barriers associated with planning and approval processes.

Government provision of services-related infrastructure could be improved by implementing good project selection processes that include the use of well-informed, high quality and consistently applied cost–benefit analysis. Key reforms to ensure private investment decisions are not unnecessarily impeded include that governments should ensure regulatory objectives are clear, consistent and coherent, avoid duplication of regulatory oversight across jurisdictions, undertake development approvals in a timely manner, and undertake risk-based assessments where feasible. Ensuring that planning and zoning systems are not overly prescriptive would better enable tourism-related businesses to innovate and adapt to changes in demand.

Greater user charging and more private investment would provide an additional source of funding and facilitate innovation in the provision of tourism-related infrastructure in national parks. A good example is Uluru-Kata Tjuta National Park Board of Management’s request in July 2015 for potential partners to submit expressions of interest for culturally appropriate and environmentally sensitive tourism within the Park.

### **Exports of financial services — an opportunity in waiting?**

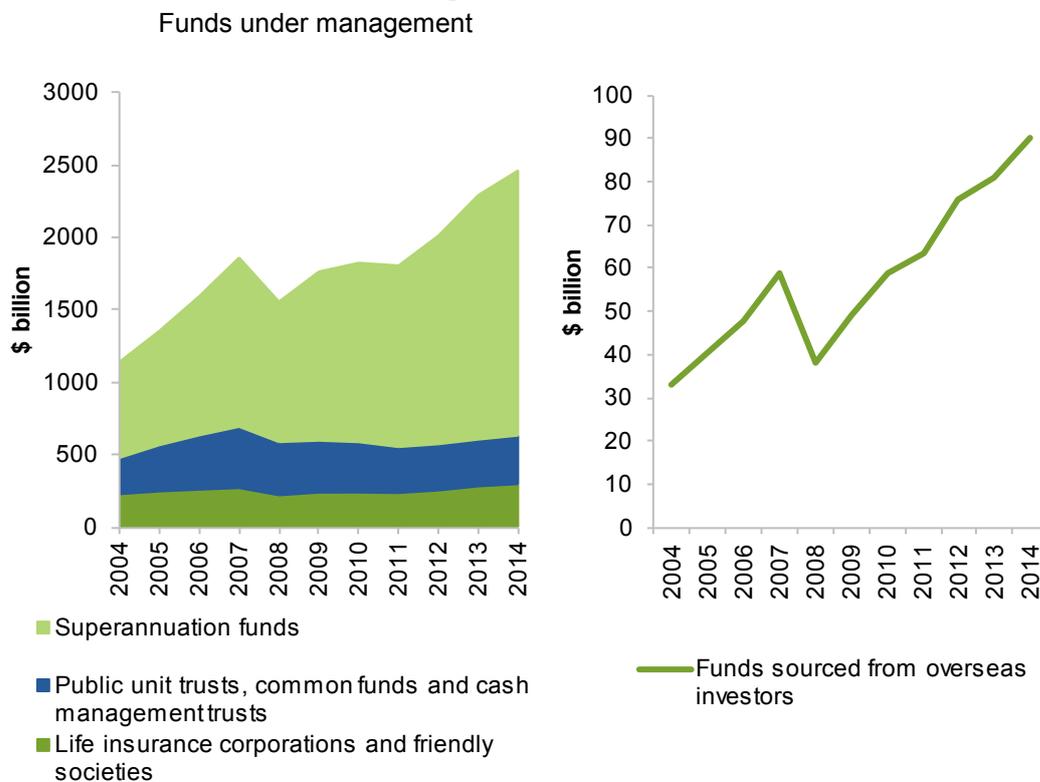
The provision of financial services is Australia’s largest service sector — contributing almost \$140 billion (gross value added) to the economy in 2014-15. The sector is also a substantial contributor to Australia’s service exports, predominantly through commercial presence abroad (for which data are limited, as noted above). Its large domestic footprint, coupled with the importance of commercial presence abroad, mean the financial services sector is heavily influenced by regulatory settings in Australia and in the jurisdictions where commercial operations are undertaken.

## Managed investment schemes present export opportunities

Managed investment schemes cover a variety of collective investments, including cash management schemes, equity schemes and property schemes. While the value of foreign funds under management in Australian managed funds (which include managed investment schemes, as well as superannuation funds and life insurance corporations) has almost tripled since 2004 (figure 4), industry stakeholders, such as the Financial Services Council, have noted that Australia has a small proportion of funds sourced from foreign investors relative to countries such as Hong Kong, Singapore and the United Kingdom. In 2014, foreign investors around the world held about \$1.4 trillion (72 per cent) of assets in Hong Kong's managed funds, relative to about \$90 billion (3.7 per cent) in managed funds domiciled in Australia.

The low proportion of foreign funds under management in Australia is not, of itself, a policy concern *unless* the Australian financial sector is unnecessarily impeded in its ability to play a larger role in exporting funds management services to overseas markets. Barriers to service exports in this sector will be particularly costly given the growing levels of wealth in Asia.

**Figure 4 The size of Australia's managed fund sector and funds sourced from foreign investors**



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To offer interests in a retail managed investment scheme in another country, schemes offered by Australian service providers must first meet the requirements to be registered in that country. To offer interests in a foreign managed investment scheme to a Singapore investor, for example, the scheme must meet the registration requirements of the Monetary Authority of Singapore, and meet other requirements such as being registered in a jurisdiction that offers investors protection at least equivalent to that in Singapore. If a country's registration requirements are not the least cost way of meeting its consumer protection objective, they can increase the costs of exporting financial services associated with managed investment schemes, or prevent Australian fund managers from offering their product in that jurisdiction.

### **The Asia Region Funds Passport will facilitate growth in exports of financial services but the playing field will not be even**

The Australian Government is negotiating the Asia Region Funds Passport (ARFP) with a group of countries — Japan, New Zealand, the Philippines, South Korea and Thailand have signed a statement of understanding to implement the ARFP (other countries may join). The Government intends to legislate to give effect to the ARFP in the second half of 2016. The ARFP will allow fund managers to market managed investment schemes in the other passport countries where they meet the passport rules (as determined by the regulator where the scheme is domiciled).

The magnitude of the potential benefits for Australian exports of services associated with managed investment schemes due to the ARFP will depend on the size of the market for managed investment schemes in ARFP countries, the extent to which the ARFP is able to reduce the regulatory requirements to export managed investment schemes, and the competitiveness of Australian providers. There are likely to be benefits for Australian investors resulting from greater competition in the Australian market and increased access to managed investment schemes domiciled overseas.

Australian financial service providers will be competing with ARFP jurisdictions that have more favourable tax arrangements, including those with lower rates of withholding tax for international investors. They will also face strong competition from providers of managed investment schemes domiciled in Europe (Luxembourg and Ireland in particular) using a long established regional passport that is heavily used in Asia.

### **Withholding tax: the case for simpler arrangements**

Like most other governments, the Australian Government imposes taxes on the income earned in Australia by foreign investors — this includes withholding taxes that apply to Australian payments of interest, dividends, royalties and payments from managed funds. Participants in this study from the financial sector have called for simpler and lower rates of withholding taxes. The Financial Services Council also called for a flat 5 per cent concessionary rate to be applied to all 'withholdable' income paid by managed investment

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trusts participating in the ARFP, with the intention of making Australian financial service providers more competitive with providers from other ARFP countries that have more favourable tax arrangements (particularly Singapore).

The rate of withholding tax applied in Australia varies across different investments and types of income, and is dependent on the conditions of tax treaties and legislated exemptions. The web of different rates creates distortions between groups of investors and between investment activities as investment decisions are altered to reflect the incidence of the taxes. Applying lower withholding tax rates to managed investment trusts participating in the ARFP, some of which already attract concessions, would only create further distortions in an already complex system. Lower rates are not justified on the basis that the current rates would be uncompetitive with other jurisdictions participating in the ARFP.

Although there may be a case for some variation in withholding tax rates on different types of investment based on the relative mobility of capital, unless it can be shown that variation is efficiency-enhancing, more uniform rates of withholding tax are likely to reduce the distortions associated with treating different types of investment differently for tax purposes. The Australian Government should simplify Australia's regime of withholding taxes through reforms that pursue greater uniformity in the rates applying to different types of investment, a reduction in the range of domestic exemptions available and the negotiation of more consistent withholding tax rates in tax treaties.

The case for lower withholding taxes is complex and requires detailed empirical consideration of the economywide effects — an analysis best undertaken during the Tax White Paper process.

### Improvements in arrangements for managed funds are underway

The Australian Government is advancing improvements to the arrangements for managed funds that are likely to reduce barriers to exporting faced by Australian financial service providers, including:

- the introduction of the Investment Manager Regime, which is designed to provide greater clarity on the level of taxation faced by foreign managed funds investing in Australia (or using Australian intermediaries) by introducing an income tax exemption for certain investments. The final element of this legislation was implemented in July 2015. The Regime should be reviewed no later than 2020, and at a minimum, the review should assess its effectiveness, its effect on tax revenues and any concerns related to inappropriate use
- the consideration of reforms that would allow a broader range of collective investment vehicles to be offered by Australian financial service providers. This reform is being considered as part of the Tax White Paper process and has the potential to provide significant benefits for the financial services sector, as the new vehicles increase the flexibility of fund managers to meet investor demands.

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The Tax White Paper provides an opportunity for the Australian Government to consider dividend imputation credits in a broader context than the promotion of service exports.

### **Restrictions on setting up a commercial presence abroad can be costly**

While commercial presence abroad is important to Australian service exports such as education, professional services and health services, restrictions on setting up overseas operations can be particularly costly for financial service providers, as the majority of financial services trade occurs via commercial presence. Barriers to international investment can take a number of forms — for example, limits on foreign equity, investment screening and approval processes, requirements for joint ventures or local incorporation, and the need to engage local directors — that can have a range of effects on service exports. Barriers to investment are particularly high in several developing countries in Asia, most notably in China, India and Indonesia. Examples raised by participants in this study underscore the significance of investment barriers in these countries across the education, financial and professional services sectors (box 4).

Investment barriers can either prevent firms from entering particular markets altogether, or impose costs through constraining how they operate. For example, limits on foreign equity can force banks to structure their operations differently, leading to costs through duplication of functions and systems, and additional capital requirements. Alternatively, insurance providers might offer services through cross-border supply in countries where regulations preclude them from establishing branches, which will limit the extent to which they can engage directly with their customers.

### **Trade agreements go some way to relaxing investment barriers**

Trade agreements can be used to address some investment barriers, such as foreign equity and ownership restrictions, and joint venture requirements. Under Australia's trade agreement with Malaysia, for example, majority Australian ownership of companies is permitted in a range of sectors supplying services in Malaysia, including insurance, accounting and education services. Further, to the extent that trade agreements are successful in opening up goods trade, including by eliminating or reducing tariffs, they can also facilitate further service exports.

Some participants considered that trade agreements are a necessary precursor to facilitating opportunities for service providers seeking to export. Other stakeholders noted that investment barriers that restrict market access at the border persist in countries where Australia has signed trade agreements — and there can also be behind-the-border barriers that are restricting market access. ANZ, for example, noted that limitations on the number of products approved, or the time taken to approve them, restrict the ability of a financial institution to access new or different sectors of a foreign market in a short timeframe.

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**Box 4      Examples of investment barriers faced by Australian service providers**

- Australian life insurance providers face caps on foreign equity participation (which also apply to funds management providers) and nationality requirements in Thailand, and foreign direct investment approvals in Japan. Insurance companies are not allowed to establish branches in several countries, including India, Indonesia and Russia.
- Foreign ownership of a domestic bank in China is limited to 20 per cent. Indonesia implemented a 40 per cent cap for ownership by a single foreign bank in 2012, unless the foreign bank is deemed to be 'fit and proper'. Banks in India must have a minimum of 50 per cent Indian nationals on the board of directors.
- Foreign higher education institutions in China must be established as a joint venture where the head of the institution holds Chinese citizenship and at least half of the members of the administrative council, board of directors or joint management committee must come from the Chinese parties. Foreign providers of vocational education and training have also faced quantitative limits on the number of joint venture campuses and the number of times the same course can be repeated across campuses. In Indonesia, foreign higher education institutions must operate in partnership with an approved Indonesian higher education institution.
- There is no scope for Australian law firms to establish a commercial presence in India and Australian lawyers are not able to enter into partnerships, joint ventures or other forms of commercial association with Indonesian law firms. Indonesia, Malaysia and Singapore are examples of countries that have restrictions on the number or percentage of foreign lawyers who may be employed by a local law firm or in special joint venture structures.

### Supplementary measures behind the border are usually needed to enable market access

Preferential trade agreements typically contain provisions that aim to address behind-the-border barriers to services trade. Some agreements include provisions that either mandate or encourage greater transparency of regulations affecting services. Commitments on regulatory cooperation in trade agreements are also aimed at encouraging regulatory reform and integration over time. For example, Australia's agreement with China includes a commitment for the Australian Prudential Regulation Authority and the China Banking Regulatory Commission to cooperate on a range of matters, including the development of prudential frameworks. The ASEAN–Australia–New Zealand agreement established a work program on economic development that included assistance for agencies in Cambodia, Laos and Myanmar to assess the effects of their laws and regulations affecting trade in services.

It is difficult to directly address all behind-the-border barriers to services trade through trade agreements given the range of rules and regulations that govern service provision. Trade agreements can, however, provide a framework to progress further liberalisation and to establish supplementary measures such as mutual recognition agreements (MRAs) or standards harmonisation, discussed below. Realising benefits from trade depends on

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governments committing to further reducing barriers *at and behind* the border. No one mechanism will be sufficient to address international barriers to services trade.

## **Reducing cross-cutting international barriers: scope to benefit a range of sectors**

The Commission has identified three cross-cutting international barriers to service exports — restrictions on cross-border data flows, licensing and standards, and violations of intellectual property rights — that affect most if not all sectors considered in the study.

### **Restrictions on cross-border data flows affect all sectors and all export modes**

Exporters in all Australian service sectors rely on the internet and the movement of data across borders. Many countries curb data flows through data localisation measures (including Australia through restrictions on the transfer of health records). Data localisation measures may be implemented to address data privacy and security concerns — although there may be other less burdensome remedies to address these issues, including legally binding contracts or legislation. Data localisation measures are also sometimes used by governments to address other objectives, such as industry protection, regional development or local employment objectives.

Restrictions on cross-border data flows are particularly costly for financial service providers that use a ‘hub’ strategy where data are stored centrally to improve efficiency, and users of cloud computing services (cloud computing is now common practice for service exporters). Where service providers are subject to restrictions on cross-border data flows and local data infrastructure is unsuitable, they face the costs of building their own infrastructure and any ongoing efficiency penalty. The cost of building infrastructure alone can be in the tens of millions of dollars.

### **The Australian Government can influence policies on cross-border data flows**

The Australian Government Treasury, with Standards Australia, is leading an Asia–Pacific Economic Cooperation (APEC) project to harmonise standards for the movement of data across APEC economies. The project is an opportunity for the Australian Government to help ensure that rules and regulations governing the flow of data (including those that apply in Australia) are developed in a consistent — and least restrictive — way. APEC economies are important destinations for Australian service exports, particularly financial services, so even small improvements could generate economic benefits.

The Australian Government has also participated in international efforts to develop guidelines for managing data confidentiality and sought the removal of data localisation measures in trade negotiations. The South Korea–Australia trade agreement led to the removal of rules in South Korea that required financial institutions to process data onshore

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unless clients provide written consent. The proposed Trans-Pacific Partnership Agreement includes a commitment by the parties to allow the transfer of data across borders. The Australian Government should continue to work through trade negotiations (including the Trade in Services Agreement) and international forums to encourage the removal of measures that unnecessarily restrict cross-border data flows.

### Regulatory cooperation can iron out unnecessary costs from licensing and standards regulations

Licensing and standards regulations used to address consumer protection, quality and safety concerns are commonly applied in service sectors. Where they are overly burdensome, licensing and standards regulations can impose a barrier to service exports, particularly for professional services — but determining whether they are overly burdensome is extremely difficult, particularly since governments will have different views on acceptable levels of risk. While it might be relatively easy to see that residency requirements are unlikely to influence the quality of a provider or the safety of a service, Australia's conservative approach to risk in its prudential regulation, considered overly burdensome by some stakeholders, was recognised by others as beneficial in maintaining the stability of Australia's financial system, including during the global financial crisis.

Regulatory cooperation through MRAs or harmonisation of standards can be used to address barriers arising from licensing and standards regulations, and benefit Australian service exporters through lower compliance costs. Westpac, for example, was supportive of MRAs between financial regulators in Australia and the other jurisdictions in which it operates and is of the view that these arrangements, and the application of consistent regulatory standards and requirements, can make a big difference to the bank's operations by allowing more streamlined global structures to better utilise these MRAs.

Trade agreements can play a role in facilitating MRAs but they do not guarantee an arrangement will be implemented or drawn on by service providers (box 5). Even though the Australia–United States trade agreement included provisions for MRAs, Engineers Australia has found it necessary to negotiate arrangements with individual states — to date, one agreement (with Texas in 2008) has been signed. MRAs have had mixed success in facilitating cross-border marketing of managed investment schemes. Cooperation on MRAs need not only occur under the umbrella of a trade agreement. It can also take place through other arrangements, for example through international forums such as APEC, as well as collaboration and cooperation between responsible agencies.

The responsibility for negotiating and managing MRAs often sits with professional bodies and government agencies, rather than being the direct responsibility of governments themselves. Professional bodies may not have an incentive to progress MRAs if they are not aware of the possibilities provided by MRAs or if they are insufficiently resourced. There could also be concerns within professional associations that the benefits of MRAs for member service providers may be outweighed by the potential costs of increased competition from foreign suppliers.

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**Box 5 Provisions for mutual recognition in trade agreements**

Some of Australia's preferential trade agreements including with China, Singapore, South Korea and the United States, include a framework for progressing MRAs for professional services. Although the agreements differ, they typically state that each party will encourage the bodies responsible for licensing and qualifications to explore possibilities for mutual recognition, including through the development of mutually acceptable standards and criteria for licensing or registration. Some of the agreements also establish a working group to report on progress and/or provide recommendations on mutual recognition to a committee that is responsible for reviewing implementation of services aspects of the relevant trade agreements.

A number of MRAs have been established for professional services as a result of Australia's trade agreements. Under Australia's trade agreement with South Korea, an MRA was signed between Engineers Australia and the South Korean Government. Under Australia's trade agreement with Singapore, an MRA was signed between CPA Australia and the Institute of Certified Accountants in Singapore.

The Australian Government can support the development of MRAs by establishing a framework for progressing MRAs when it negotiates trade or other agreements. The establishing framework should include clear actions and timeframes for an implementation working group to report on its progress to the committee responsible for overseeing implementation of the agreement. The framework should also include a process for consulting with industry stakeholders.

To help ensure commitment to the progression of MRAs that are in the interest of the Australian community, the implementation working group should be adequately resourced and involve representatives from the relevant regulators as well as the government agency responsible for policy matters in the specific service sector. For example, the responsible government agency would be the Australian Government Treasury in relation to financial services. The working group should engage closely with industry stakeholders to encourage the development of MRAs.

### Intellectual property rights will benefit some service providers ...

Violations of intellectual property (IP) rights in export markets affect some service providers, such as architects, engineers and software providers. The Commission has identified instances where service providers have incurred costs — in the form of foregone sales or the costs of diverging from their preferred mode of service delivery — as a result of IP violations. Cox Architecture, for example, cited occasions where its designs had been used in China and Malaysia without permission or payment.

### ... but using trade agreements to extend IP rights will be costly to Australia

While some Australian service providers would benefit if IP rights were recognised and enforced in overseas jurisdictions, this should not be considered justification for extending the coverage of IP in negotiations beyond that required under the Trade-Related Aspects of

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Intellectual Property Rights (TRIPS). Two of Australia's bilateral trade agreements (with Chile and the United States) involved an increase in protections for IP beyond the levels required by the TRIPS and other bilateral trade agreements. For example, the term of copyright protection under the Australia–United States trade agreement was extended to the life of the author plus 70 years and compares with life plus 50 years under TRIPS. As a net importer of IP, this extension is likely to have imposed net costs on Australia.

The Commission is currently undertaking a separate inquiry into Australia's IP arrangements. This inquiry will consider issues associated with enforcement of IP rights, as well as Australia's international arrangements, including Australia's IP obligations under bilateral, multilateral and regional trade agreements.

### **Sound domestic policy arrangements are vital**

Service exports, and trade flows more generally, are intrinsically linked to policy (including regulatory) settings in Australia. Domestic policy should be guided by whether it generates a net benefit to the Australian community overall, not its effects on a particular sector or on service exports alone. Sound policy settings that facilitate competition and promote a flexible and productive economy can enable all sectors of the economy, including service providers, to respond to market opportunities in Australia and in international markets.

Where reforms are expected to provide a net benefit to the Australian community, they should not be delayed on the basis that they may provide leverage in trade negotiations. Pursuing comprehensive domestic policy reforms on a unilateral basis is likely to deliver large gains to the community — as was the case when Australia reduced its trade barriers, and introduced national competition reforms, in the 1980s and 1990s.

### **There are opportunities to promote service exports through policy reform in Australia ...**

Some areas of reform would lead to benefits across the Australian economy, including for businesses that export services. Applying competition principles-based thinking to health and other social welfare service provision, to road reform and to urban planning has the potential to improve productivity across substantial parts of the Australian economy. Consistency in the thresholds that determine whether investment proposals are subject to examination by the Foreign Investment Review Board could help to promote foreign investment, potentially increasing service exporters' access to capital and foreign technology. Other important areas that require (and are receiving) further policy attention from the Australian Government are visa processing arrangements for short-term visitors and international students (discussed above), and the workplace relations framework.

There may be scope for some government agencies to strengthen efforts to recover the costs of providing information, advice and market research to service providers that are seeking to export. Cost recovery provides a signal to users about the costs of the additional

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resources involved and informs the government agency about which products are in demand and which are not. The level of cost recovery should be tailored to the nature of the information provided and the extent to which governments can identify and charge the beneficiaries.

The Commission found no evidence that market failures impede large firms from accessing financial services in its 2012 inquiry into export credit provided through the Export Finance and Insurance Corporation (EFIC). The Commission's recommendations in 2012 were focused on limiting EFIC's role to efficiently addressing the information-related market failures faced by newly exporting small and medium-sized enterprises. Refinements to EFIC's mandate since the Commission's review have stopped short of ensuring EFIC's activities are limited to this role — and of ensuring export assistance is directed to the areas of greatest benefit to the community as a whole.

Along with reiterating the need to confine the scope of EFIC's activities, the Commission remains of the view that, in addition to requirements under the *Public Governance, Performance and Accountability Act 2013* (Cwlth), EFIC should be required to develop a transparent performance management framework with indicators based on the objective of addressing the market failures affecting small and medium-sized enterprises.

... but policy settings should not favour specific industries or solely target export growth

Although exports can deliver benefits, policies with the goal of increasing exports will not necessarily result in a net benefit to the Australian community. Governments should only provide grants to businesses seeking to export where they address a market failure, or meet an equity objective, and the communitywide benefits of providing the grants would be expected to outweigh the costs.

Determining domestic policy on the basis of matching policies implemented in other countries (such as lowering tax rates or reducing prudential regulatory standards) may well benefit some service providers or industries, but is likely to have consequences far beyond services and could impose substantial costs.

Policy settings that give priority to specific industries disadvantage other, potentially more competitive activities. Participants in this study raised the priority given to specific industries under the Industry Skills Fund as an issue affecting service exports, as well as access by temporary immigrants to public services. Both of these issues are addressed in the Commission's recommendations.

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# Recommendations

## Domestic reform priorities

### RECOMMENDATION 4.1

Under Australia's Foreign Investment Policy, the Australian Government should make screening thresholds for examination of investment proposals by the Foreign Investment Review Board consistent across investors from different countries.

### RECOMMENDATION 4.2

The Australian, state and territory governments should facilitate service exports by pursuing sound policy settings that promote competition and a flexible and productive economy. Policy settings should be guided by expected net benefits to the Australian community overall rather than effects on service exports alone. This includes government actions to address concerns about infrastructure acting as a constraint to service exports.

Consistent with the Commission's conclusions in its Public Infrastructure inquiry report, the Australian, state and territory governments should:

- implement best practice selection processes for public infrastructure projects
- regularly review and reform development approval processes for public and private infrastructure projects to ensure they are risk-based (where feasible) and only as thorough as is necessary to ensure that regulatory objectives are met
- ensure that planning and zoning systems applying to public and private infrastructure are not overly prescriptive and do not unnecessarily impede service providers from innovating and adapting to changes in demand.

### RECOMMENDATION 4.3

The Industry Skills Fund seeks to address workforce capability issues by providing training assistance that prioritises five industries, chosen on the basis of their export growth potential. To improve the efficiency with which workforce capability improvements are achieved, the Australian Government should remove the priority afforded to specific industries under the Fund.

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#### RECOMMENDATION 4.4

In relation to temporary immigrants, the Australian, state and territory governments should not extend access to public health cover beyond the level provided through Reciprocal Health Care Agreements, or provide access to subsidised education, for the purpose of increasing service exports.

#### RECOMMENDATION 4.5

The New South Wales and Victorian governments should review the case for extending concessional access to public transport for international students to match that available to domestic students, as occurs in other states and territories. The assessment should take into consideration budgetary costs, any increase in peak usage of public transport, and any effect on international student numbers.

#### RECOMMENDATION 4.6

The Australian, state and territory governments should only provide grants to businesses seeking to export where they address a market failure, or meet an equity objective, and the communitywide benefits of providing the grants would be expected to outweigh the costs.

#### RECOMMENDATION 4.7

The Australian, state and territory governments should strengthen efforts to recover the costs of providing information, advice and market research to service providers that are seeking to export.

- Basic information, such as that collected to meet a government's own information and data requirements, should be funded from general taxation revenue.
- Incremental information, which involves additional collection, compilation or analysis of information by government beyond that required to provide basic information products, should be cost recovered.
- Commercial products, such as tailored advice, coaching or specialised market research reports are best left to the private sector, but where governments are involved, the products they provide should be priced according to competitive neutrality principles.

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#### RECOMMENDATION 4.8

The Australian Government should make amendments to the *Export Finance and Insurance Corporation Act 1991* (Cwlth) to confine the Export Finance and Insurance Corporation solely to meeting the objective of addressing market failures that affect newly exporting small and medium-sized enterprises. Small and medium-sized enterprises should be defined as entities, including any related entities, with fewer than 100 full-time equivalent employees or annual turnover of less than \$50 million.

#### RECOMMENDATION 4.9

The Minister should amend the Statement of Expectations to require the Export Finance and Insurance Corporation (EFIC) Board to establish a performance management framework directed at achieving the objective for EFIC set out in recommendation 4.8.

The framework should be developed in consultation with other Australian Government agencies, be consistent with requirements under the *Public Governance, Performance and Accountability Act 2013* (Cwlth), and use relevant performance benchmarks and indicators for EFIC's business units, including treasury operations.

EFIC should publicly report its performance against this framework in its annual report and corporate plan.

## Opportunities for growth in financial service exports

#### RECOMMENDATION 6.1

The Australian Government should continue to progress the Asia Region Funds Passport and, through work in international forums, encourage other jurisdictions to participate in the Passport.

#### RECOMMENDATION 6.2

The Australian Government should simplify Australia's regime of withholding taxes through reforms that pursue greater uniformity in the rates applying to different types of investment, a reduction in the range of domestic exemptions available and the negotiation of more consistent withholding tax rates in tax treaties.

The Australian Government should not introduce additional concessional withholding tax rates for the Asia Region Funds Passport as future changes to the withholding tax regime should seek to introduce greater — rather than lesser — uniformity.

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#### RECOMMENDATION 6.3

During the course of the Tax White Paper process the Australian Government should make a determination on the optimal rate for withholding taxes in Australia having regard to:

- the effect of withholding taxes on domestic and international investment, and on the supply of services by Australian providers
- the prevalence of location-specific economic rents
- the secondary effects of withholding tax on land rents and wages
- interactions with other taxes
- any relevant international developments.

#### RECOMMENDATION 6.4

The Australian Government should not make changes to the dividend imputation system solely to increase service exports. The Australian Government should instead consider changes to dividend imputation as part of the Tax White Paper process, incorporating analysis of the effects on:

- domestic and international investment, and the supply of services by Australian providers
- domestic taxation, including the balance of taxes between different investment activities and the broader balance of taxation between investment, saving and consumption, and between debt and equity
- the integrity of the taxation system
- taxation revenue
- the efficiency of international capital markets.

#### RECOMMENDATION 6.5

The Board of Taxation should review the Investment Manager Regime no later than 2020. This review should, at a minimum:

- assess the effectiveness of the Regime in attracting additional investment and the effect on tax revenue
- address any concerns related to inappropriate use of the Regime
- publicly consult to ensure that administrative and compliance costs associated with the Regime are minimised.

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RECOMMENDATION 6.6

A range of collective investment vehicles is important for facilitating the export of financial services and the Australian Government should continue to advance their development as part of the Tax White Paper process.

## Enhancing export capacity in education

RECOMMENDATION 7.1

The Australian Government should ensure that the following principles guide the further development and implementation of the simplified international student visa framework, announced in June 2015.

- Clear assignment of responsibility for managing risks to the party best placed to do so.
- The student visa program should address a single policy objective of maintaining immigration integrity.
- Regulatory requirements for visa applications should be proportionate to the immigration risk posed by different types of student visa applicants.

RECOMMENDATION 7.2

The Department of Education and Training should review the effectiveness of the Quality Indicators for Learning and Teaching online platform in meeting its proposed objective — providing adequate information for international and domestic students to make informed choices about where, and what, to study in Australia. The review should occur no later than 2018.

RECOMMENDATION 7.3

The Australian Government should examine the relationship between the use of online education by international students studying in Australia and student visa non-compliance to inform options for relaxing restrictions on online education set out in the National Code of Practice for Registration Authorities and Providers of Education and Training to Overseas Students 2007.

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## Removing impediments to tourism exports

### RECOMMENDATION 8.1

The Australian, state and territory governments should:

- undertake a transparent analysis of the costs and benefits to Australia of government provision or funding of destination marketing or major events, both prior to funding or providing a destination marketing campaign or major event and following the activity's completion. The analysis should be fit for purpose, and the scale and complexity of this analysis should be commensurate with the value of government funding being provided to the activity
- publicly release the analyses of these costs and benefits as soon as practicable
- not provide or fund a destination marketing campaign or major event unless an analysis of the costs and benefits of the activity demonstrates that government funding is expected to provide net benefits to the Australian community.

### RECOMMENDATION 8.2

The Department of Immigration and Border Protection should establish a framework to charge users of premium border processing services, in line with the Australian Government's guidelines for cost recovery.

### RECOMMENDATION 8.3

As soon as practicable, the Australian Government should provide (through negotiated amendments to its international air services arrangements) unrestricted access for foreign airlines flying to and from Brisbane, Melbourne and Perth airports as well as all secondary airports in Australia's major gateways. Following this, the Australian Government should provide unrestricted access to Sydney Kingsford Smith Airport unless a published assessment demonstrates that the costs of unrestricted access would outweigh the benefits to the Australian community.

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#### RECOMMENDATION 8.4

When negotiating an air services agreement, the Australian Government should undertake an assessment of all relevant costs and benefits of more open international air services markets, including benefits to the Australian community arising from lower airfares or access to a wider range of outbound travel destinations, as well as any effects on Australian airlines. The Australian Government should publicly release its assessment of the costs and benefits of the negotiated outcome as soon as practicable.

## Reducing international barriers to service exports

#### RECOMMENDATION 9.1

The Australian Government should put in place a framework to support the development of mutual recognition agreements as part of, or following, the inclusion of mutual recognition provisions in trade or other agreements. The framework should include clear actions and timeframes for an implementation working group (that is adequately resourced and involves relevant regulators and government bodies) to report on its progress to the committee responsible for overseeing implementation of the agreement. The framework should also include a process for consulting with industry stakeholders.

#### RECOMMENDATION 9.2

The Australian Government should work through trade negotiations and international forums to ensure that:

- standards and regulations for the movement of data across borders are internationally consistent
- any government measures relating to cross-border data flows are the least restrictive necessary to address privacy or security objectives.

The Australian Government should also work through relevant international forums to ensure that restrictions on cross-border data flows are only applied where other remedies (such as contracts or laws to ensure data stored offshore meets data protection standards) could not achieve the same objective at a lower net cost.

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# 1 Introduction

The export of services comprises a diverse range of activities — the preparation of a restaurant meal for an international visitor, the teaching of an English language course (either in Australia or overseas) to an international student, and the provision of a range of financial and professional services to consumers overseas, such as insurance, engineering and legal services. The value of Australia’s service exports was \$62 billion in 2014-15 — about 20 per cent of total exports. The value of service exports from all sectors has roughly doubled (in real terms) over the past two decades. Growth in education exports and professional service exports has been particularly strong — these sectors have grown at an average annual rate of 12 per cent and 10 per cent respectively since the mid-1990s (chapter 3).

Rising incomes, particularly in emerging economies in Asia, have increased demand for many of Australia’s services, especially education and tourism. Advances in information and telecommunications technologies have facilitated new ways of exporting services and led to an expansion in the range of services that can be traded across borders, such as electronic banking and distance education.

Services are used extensively as inputs in the production of many goods exports — for example, engineering services are embodied in the production of mineral exports, and electricity, transport and communication services are embodied in the production of manufactured goods exports. Services are also embedded within many exported goods at the point of sale, such as technical advice accompanying the sale of medical technology. When the contribution of services to the production of goods is taken into account, service exports account for a much larger proportion of Australian exports (estimated to be about 40 per cent in 2013) (chapter 3).

The contribution of services to the Australian economy, both directly and as a facilitator of the production of goods, underlines the need to address barriers to the efficient production and supply of services, including services destined for export markets.

## 1.1 What has the Commission been asked to do?

In the terms of reference for this study (reproduced at the front of this report), the Australian Government has asked the Productivity Commission to conduct a study into barriers to growth in Australian service exports. In particular, the Commission has been asked to:

- consider recent trends in, and drivers of, service exports by Australian suppliers

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- examine the domestic barriers to growth in Australian service exports, including any investment barriers, and consider appropriate policy responses
  - examine barriers to growth in service exports in economies (ranked in Australia's top 40 trade partners) with which Australia does not have a free trade agreement, and assess the economic benefits of reducing or removing barriers in these markets
  - examine the experience of other economies in developing policy approaches in this area.

The terms of reference note that the Commission has undertaken research into the international education and tourism sectors, and that in undertaking this study the Commission should avoid duplication of that work and draw on it as appropriate in the final report.

The Commission has been asked to focus on six service sectors.

- *Tourism* — services and personal goods, such as transportation and food, consumed by short-term visitors to Australia. There is some overlap between tourism exports and exports from other service sectors. For example, expenditure in Australia by international students may be considered a tourism export or an education export.
- *Education* — services provided by universities, vocational education and training providers, schools and other education institutions. Education exports are provided to international students, either in Australia, or in other countries at foreign campuses or through online or distance education.
- *Financial* — services relating to financial intermediation, such as providing loans, insurance services, investment management, superannuation and pension services, stock brokerage and investment banking services.
- *Professional* — services provided by engineers, architects, accountants, lawyers, management consultants, advertisers, market researchers and other professionals.
- *Information technology* — services such as hardware and software consultancy, software licensing, data processing, database services, maintenance and repair of computers, and news services.
- *Health* — services relating to the diagnosis, treatment and prevention of disease, illness and injury, including hospital services and social services relating to health, such as aged care.

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## 1.2 Understanding service exports

### What is a service?

Some definitions of services focus on the features of services that distinguish them from goods and other types of economic activities. Distinguishing features of services are their intangible and non-transferable nature, requiring simultaneous production and consumption (ASR 2006; Mattoo, Stern and Zanini 2008; McLachlan, Clark and Monday 2002). Nonetheless, some services produce tangible outputs, such as restaurant meals, engineering and architectural drawings, photographs and published reports of lawyers and accountants. Many service outputs can be stored or transferred either electronically or physically, including water and electricity. Further, there have been advances in technology and innovations in the way services are provided. Examples include the electronic transfer of architectural designs produced in Australia or the provision of financial advice via videoconferencing.

An economic definition of services that is based on how services change the conditions of consuming units (goods, people, or other services) is set out in the internationally agreed statistical framework of the System of National Accounts (box 1.1). This definition takes into account the heterogeneous nature of services and the different ways they are supplied and consumed. The Commission has adopted this definition for the purpose of this study.

### How are services exported?

There are four modes by which services are traded, based on how service providers and consumers interact (figure 1.1). Cross-border supply (mode 1) closely resembles goods trade in that it involves geographical separation between the service supplier and the consumer (which could be an individual or a business) — only the service crosses national borders. Technological developments have facilitated growth in cross-border supply of services and eliminated distance as a barrier to trade in some services. Numerous services are now delivered to international consumers electronically, including entertainment services and financial services.

In some instances, services can only be supplied if the consumer or service supplier travels abroad. One of the key differences between services trade and goods trade is that much services trade must take place via the movement of factors of production — labour (through the temporary movement of people) or capital (through direct foreign investment) (Copeland and Mattoo 2008). It may be necessary for service exporters to travel to, or establish a commercial presence in, another country (modes 3 and 4) where close contact with consumers is required. Many construction services, for example, require the service supplier to travel to the country of the consumer. Similarly, Australian tourism and some health services can only be provided where the consumer travels to Australia (mode 2).

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Where services are traded via the movement of labour or capital, the service transaction typically occurs ‘behind the border’ (Dee 2005a).

### Box 1.1      **Definition of a service**

An internationally accepted definition of services is set out in the System of National Accounts (SNA). The SNA defines services as ‘the result of a production activity that changes the conditions of the consuming units, or facilitates the exchange of products or financial assets’ (EC et al. 2009, p. 96).

The types of services described in the SNA are *change-effecting services* and *margin services*.

Change-effecting services apply to goods or to people in a variety of forms, such as changes in the condition of goods (through transportation, cleaning, or some other transformation) or changes to the physical or mental condition of persons, such as through the provision of accommodation or medical services, education or advice.

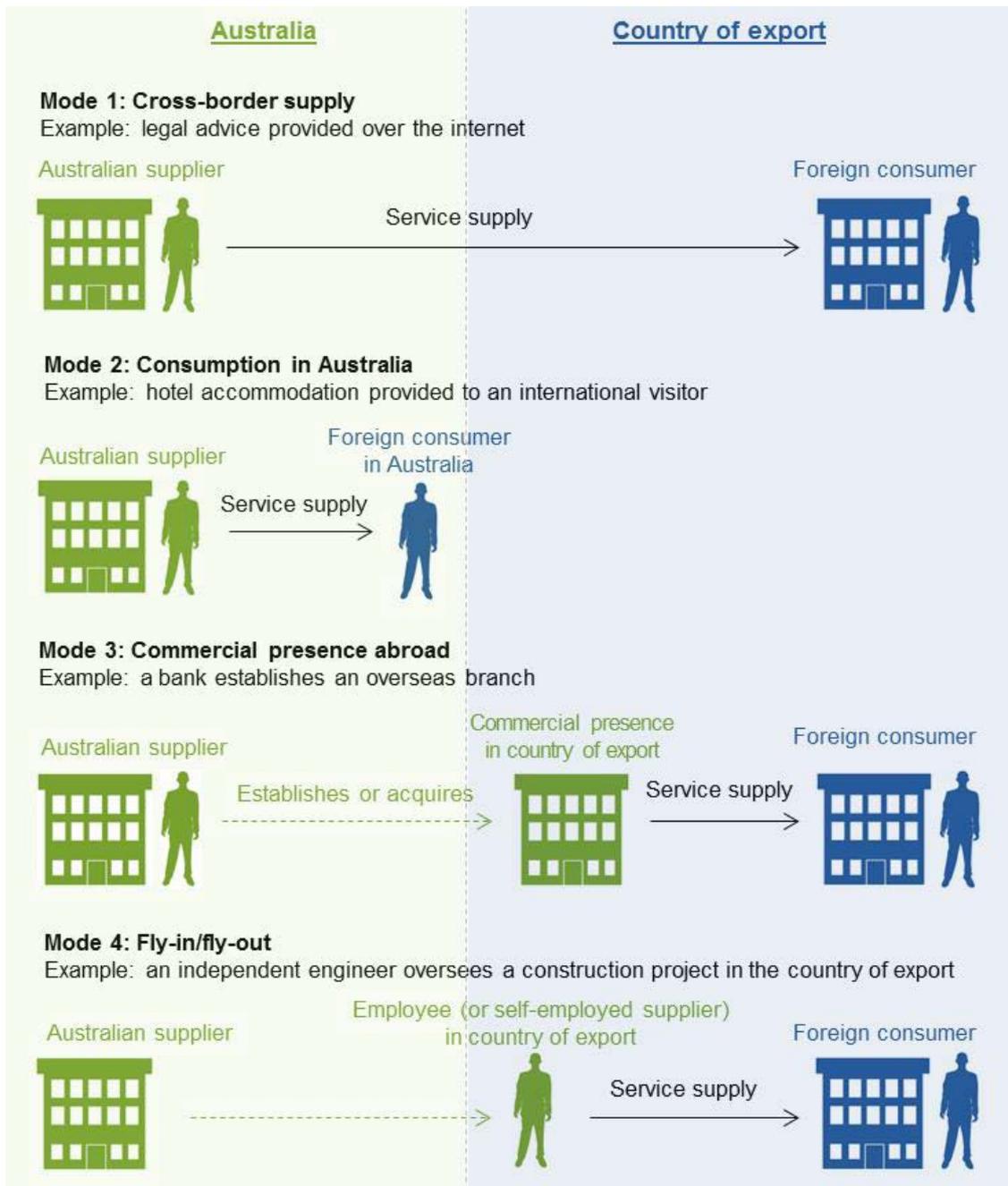
Margin services apply to goods or services and result when one institutional unit facilitates the change of ownership of goods, knowledge-capturing products, services or financial assets between two other institutional units. Margin services are provided by wholesalers, retailers and financial institutions. Change-effecting and margin services are not separate entities over which ownership can be established — they cannot be traded separately from their production. They must have been provided to the consumer by the time their production is complete.

*Source:* EC et al. (2009).

Some services can be supplied via multiple modes and hence modes of supply can be substitutes or complements. For example, an accountant or lawyer can provide their services via phone or the internet (mode 1), by temporarily travelling to the location of the consumer (mode 4), or by establishing a commercial presence abroad (mode 3) and providing services face-to-face.

Cernat and Kutlina-Dimitrova (2014) have argued that the existing four modes of supply do not adequately cover the export of services embodied in goods exports. They have suggested that an additional mode (‘mode 5’) could be introduced to take account of this type of indirect trade in services. Quantification of this type of trade has been made possible by new value-added trade measures, discussed in chapter 3.

Figure 1.1 Modes of exporting services



Source: Adapted from DESA (2010).

## Measuring service exports

Measurement of service exports is inherently difficult given the intangibility of many services and the various ways services are exported. Of the four modes of service delivery described in figure 1.1, three are captured in Australia's balance of payment statistics —

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commercial presence abroad (mode 3) is not captured. This has implications for measuring the economic contribution of service sectors, particularly financial services, which undertake a significant proportion of their trade through a commercial presence abroad.

Measuring the value of Australian service exports is further complicated by limited data on the contribution of services in the production of goods exports (the ‘value added’ of services). This data limitation is significant as service activities are embodied within the production of many goods, particularly in manufacturing and mining (discussed further in chapter 3).

These data gaps hamper analysis of trends in service exports by Australian suppliers as well as the quantification of the costs and benefits of reducing barriers to service exports.

### **1.3 What is a barrier to service exports?**

Many factors affect the ability of businesses to export services. These factors include exchange rates, costs of production (such as labour and transport), access to finance, government policy (both in Australia and overseas), and cultural and language differences.

The focus of this study is on identifying policy-relevant barriers that affect the export of services from Australia. For the purposes of this study, a barrier is defined to be any policy (including legislative and regulatory requirements or other measures imposed by governments) that *unnecessarily* impedes the ability of businesses to export services — by increasing the costs of exporting a service, restricting the supply of the service export, or inhibiting the demand for the service in an export market.

Barriers to service exports can be either:

- domestic barriers — those that can be addressed by changes in government policy within Australia
- international barriers — those that can only be addressed by overseas governments making changes to their policies. Many international barriers to service exports are implicit barriers implemented through domestic regulations within the destination country. These types of barriers are often referred to as non-tariff barriers (Mattoo, Stern and Zanini 2008).

The above definition of a barrier recognises that there may be a legitimate economic or social objective for some measures — where regulation is required to address a market failure or to meet an equity objective. This includes, for example, regulations to protect the health and safety of consumers, or to ensure the quality of services.

Even where there is a legitimate policy rationale for a measure, a barrier could arise where existing policies are not the ‘least burdensome’ required to achieve their objective. There may also be instances where measures that are justified on policy grounds are designed in a way that protects local service providers. An important challenge for this study is

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distinguishing between measures that are the least burdensome needed to achieve the equity or market failure objective and those that are unnecessarily restrictive.

## **1.4 The structure of this report**

### **An analytical framework for identifying and assessing barriers to service exports**

The nature of service exports and the range of sectors being considered in this report means that barriers could exist in a number of policy areas and hence a range of issues, institutions and policy objectives are relevant to the analysis. To assist with the broad nature of the Commission's task, chapter 2 establishes an analytical framework for assessing the benefits of reducing barriers to Australian service exports. This framework underpins more specific analysis of the costs and benefits of reducing barriers to service exports in the remainder of the report.

### **Examining trends in, and drivers of, Australian service exports**

An understanding of the trends in, and drivers of, Australian service exports (the focus of chapter 3) is important for targeting policies to areas where the existence of barriers may be imposing the largest costs on the Australian community, and hence where the gains from reform are likely to be the greatest.

### **Identifying barriers to service exports and policy remedies**

Policy issues within Australia affect the productivity and efficiency of Australian service exporters. Domestic barriers to service exports that apply across service sectors, and policy remedies for addressing these barriers, are discussed in chapter 4. (Domestic barriers that influence the ability of businesses to supply services to the *domestic* market are not within the scope of this study.) These barriers relate to policy arrangements underpinning investments required to support service exports, labour market issues and visa issues. An examination of the range of export support measures provided by the Australian and state and territory governments is also provided in chapter 4.

International barriers that apply across service sectors are discussed in chapter 5 — these barriers relate to cross-border data flows, protection of intellectual property rights, barriers to service providers establishing a commercial presence abroad (investment barriers), and licensing and standards regulations.

Some domestic and international barriers are specific to certain service sectors and have been considered in separate chapters of this report. Barriers to financial service exports,

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including taxation issues, are considered in chapter 6 and barriers to the export of education and health services are considered in chapter 7. Barriers in the international tourism, professional services and information technology sectors are considered in chapter 8.

## **Addressing international barriers to service exports**

A key challenge in reducing international barriers to service exports is that many barriers relate to domestic policy frameworks in the export (destination) country. Removal of these barriers requires commitments and action from other countries. Chapter 9 discusses how the gains to Australia from the removal of international barriers to service exports can be realised, and what role the Australian Government can take to facilitate reform, for example through trade agreements, mutual recognition arrangements or technical assistance that serves to strengthen domestic policies and regulations relating to services in other countries.

## **1.5 How the Commission conducted the study**

The Commission received the terms of reference for this study on 4 March 2015. In preparing this report, the Commission consulted widely, including via:

- discussions with representatives from Australian, state and territory government departments and agencies, academics, service industry peak bodies, and Australian service exporters in each of the service sectors covered in this study
- a questionnaire and face-to-face interviews with selected Australian service exporters — 29 responses to the questionnaire were received, of which 14 are public and are contained in appendix B
- submissions — the Commission received 32 submissions prior to this report and an additional 20 submissions in response to the draft report.

The details of the consultation process are contained in appendix A.

The Commission is grateful to all study participants for meeting with Commission staff, making written submissions and providing other information to the Commission.

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## 2 The analytical approach

### Key points

- Policy barriers to service exports unnecessarily impede the ability of businesses to export services. Barriers can be categorised according to how they impede exports.
  - Some barriers impede the supply of Australian-produced services in export markets — either by increasing the upfront or ongoing costs of export operations, or through measures that directly restrict the provision of service exports.
  - Barriers can impede service exports by reducing the demand for Australian-produced services in export markets.
- Reducing barriers to service exports provides opportunities for Australian service providers to supply a larger and more diverse set of markets. A larger and more diverse set of markets offers service providers greater opportunities and incentives to specialise in areas of production, including by increasing production to exploit economies of scale. Specialisation improves the efficiency with which labour, land and capital are allocated across the economy, providing the Australian community with greater value from its scarce resources.
- The potential benefits from reducing a barrier to service exports will be influenced by a number of factors, including the extent to which the barrier has distorted market outcomes (the ‘height’ of the barrier), and the size of the sector affected by the barrier in the importing country.
  - The Commission’s approach to assessing the potential benefits is qualitative in nature. To gauge the net benefits of reducing a barrier, the Commission also considered the economic costs associated with particular reform options.
- The role for Australian governments once barriers to service exports have been reduced is to help ensure that domestic policy arrangements do not unnecessarily hinder Australian service providers from responding to market opportunities and capturing the benefits from reduced barriers to trade in services.
  - The international competitiveness of Australian service providers will influence how well placed they are to capture these benefits. International competitiveness of service providers depends on a range of factors including the efficiency of domestic regulation, the quality of information and communications technology, and access to human capital.

Analysing barriers to service exports within an economic framework can help to identify the barriers that impose the greatest costs on the Australian community. This can help governments to focus their domestic policy reform and trade liberalisation efforts in areas where they are expected to deliver the greatest net benefits to the community. This chapter establishes an economic framework for assessing the benefits from reducing barriers to Australian service exports.

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## 2.1 Barriers to service exports

### The economic effects of barriers to service exports

International trade enables producers and consumers in Australia to participate in a larger and more diverse set of markets than otherwise. Supplying a larger and more diverse set of markets offers producers greater opportunities and incentives to specialise in areas of production, including by increasing production to exploit economies of scale (box 2.1). Specialisation in production improves the efficiency with which labour, land and capital are allocated across the economy, providing the Australian community with greater value from its scarce resources. Efficiency further improves over time as both the opportunities to serve a larger number of consumers and the competitive pressures exerted by producers in other countries increases the incentives for Australian producers to develop new products and more efficient production methods. Trade also provides consumers (both individuals and businesses) with access to greater consumption choices, which may include less expensive and better quality goods and services.

#### Box 2.1 Forces driving specialisation and trade

Countries can specialise and trade on the basis of *comparative advantage*. A country has a comparative advantage in producing a service if its economic costs of producing the service (including the opportunity costs from not using available resources to produce alternative goods or services) are lower than other countries' economic costs of producing the service. Differences in technology and factor endowments provide the basis for comparative advantage, and lead to countries specialising in areas of production. Differences in factor endowments reflect differences in labour, land and capital across countries. Technology differences can be measured by applying the theory of multifactor productivity across different sectors and countries (productivity changes among service sectors in Australia are discussed in chapter 3).

Where different countries have access to similar technology and factor endowments, patterns of specialisation and trade can still emerge on the basis of internal and external *economies of scale*. Internal economies of scale — where average costs decline as output increases — provide an incentive for specialisation in areas of production. External economies of scale can arise from businesses locating near one another in cities and industrial clusters. As total output in an industrial cluster increases, fixed costs can be shared across a greater number of businesses. There are also benefits if clustering leads to the easier diffusion of information and technology.

*Sources:* Harrigan (1997); Heckscher (1919); Krugman (1991); Melitz (2003); Ohlin (1933); Ricardo (1817); Smith (1776).

Barriers to service exports reduce the benefits from international trade. By reducing the number and diversity of markets that Australian service providers can participate in, barriers to service exports decrease service providers' ability to capitalise on the opportunities from specialising in areas of production, and to earn export income. Barriers can also reduce the scope for Australian service providers to participate in global value

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chains<sup>1</sup> which, in addition to providing opportunities to earn export income, increase the competitiveness of Australian service providers by enabling them to access less expensive or better quality intermediate inputs. Seen in this context, a country's export success is increasingly reliant on the free flow of imports.

For importing countries, barriers to service exports can decrease competition in local service markets. Diminished competition can put upward pressure on prices for consumers and weaken incentives for local service providers to increase their productivity and innovate. Barriers to imported services may also increase the real resource costs of producing services in the importing country. For example, requirements for foreign service professionals to undertake unnecessary assessments of their capability in the importing country would increase the resources used to provide those services.

Barriers to service exports reduce the efficiency with which resources are allocated across the Australian economy imposing costs on the Australian community as a whole. A lower return is generated from Australia's scarce resources, which can have flow-on effects for a range of other economic measures, including taxation revenues and wages. These costs provide a rationale for governments to seek to reduce barriers — both in Australia and overseas — to service exports, where doing so would provide a net benefit to the Australian community.

## **The nature of barriers to service exports**

For the purposes of this study, a policy-relevant barrier is defined to be anything that *unnecessarily* impedes the ability of businesses to export services (chapter 1). This definition recognises that there may be a legitimate economic or social rationale for some policy measures — where regulation is required to address a market failure or to meet an equity objective.

Sources of market failure that may warrant government involvement include externalities, public goods, information problems and a lack of effective competition. Externalities can weaken incentives to invest in research and development and to innovate, decreasing knowledge development and diffusion. Information problems can, for example, reduce consumers' trust in the quality or safety of a service, lowering their willingness to pay and ultimately lead to underprovision of the service. Even where there is a market failure or equity rationale for government involvement, it is not necessarily the case that the benefits of government intervention would exceed the costs to the community. Governments should only introduce policies, including policies designed to facilitate service exports (chapter 4), where doing so would be expected to provide net benefits to the community as a whole.

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<sup>1</sup> Products are increasingly assembled with inputs — many of which are services — from multiple countries (Lamy 2013). Global value chains take place both between companies and within large multinational companies. For example, a motor vehicle manufacturer's assembly plants and design centres can be spread across multiple countries.

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Barriers to service exports can arise due to policies in Australia, or in other countries. Barriers to service exports in other countries can be either discriminatory or non-discriminatory. Discriminatory barriers impede foreign businesses from supplying an export market, while non-discriminatory barriers apply to foreign businesses seeking to export as well as local businesses. Barriers may also vary according to whether they are applied consistently using rules or on an ad hoc case-by-case basis. All else equal, policies that involve administrative discretion on a case-by-case basis are likely to provide greater uncertainty for service providers than clearly specified and transparent rules that are consistently applied.

Reflecting their diversity, barriers to service exports can be categorised in a number of ways. One approach is to categorise these barriers according to how they impede service exports (figure 2.1).

- Barriers can impede service exports on the supply side — either by increasing the upfront or ongoing costs of export operations, or through measures that directly restrict the provision of service exports.
- Barriers can also impede service exports by reducing the demand for services in export markets.

### Barriers that impede the supply of service exports

In some cases, barriers that impede the supply of service exports through a particular mode of supply may prompt exporters to substitute to another, less efficient, mode of supply. For example, some financial services firms may be supplying their services through commercial presence abroad to circumvent barriers associated with cross-border supply (AFMA, sub. 14). In these cases exports are not prevented entirely but the costs of supply are increased.

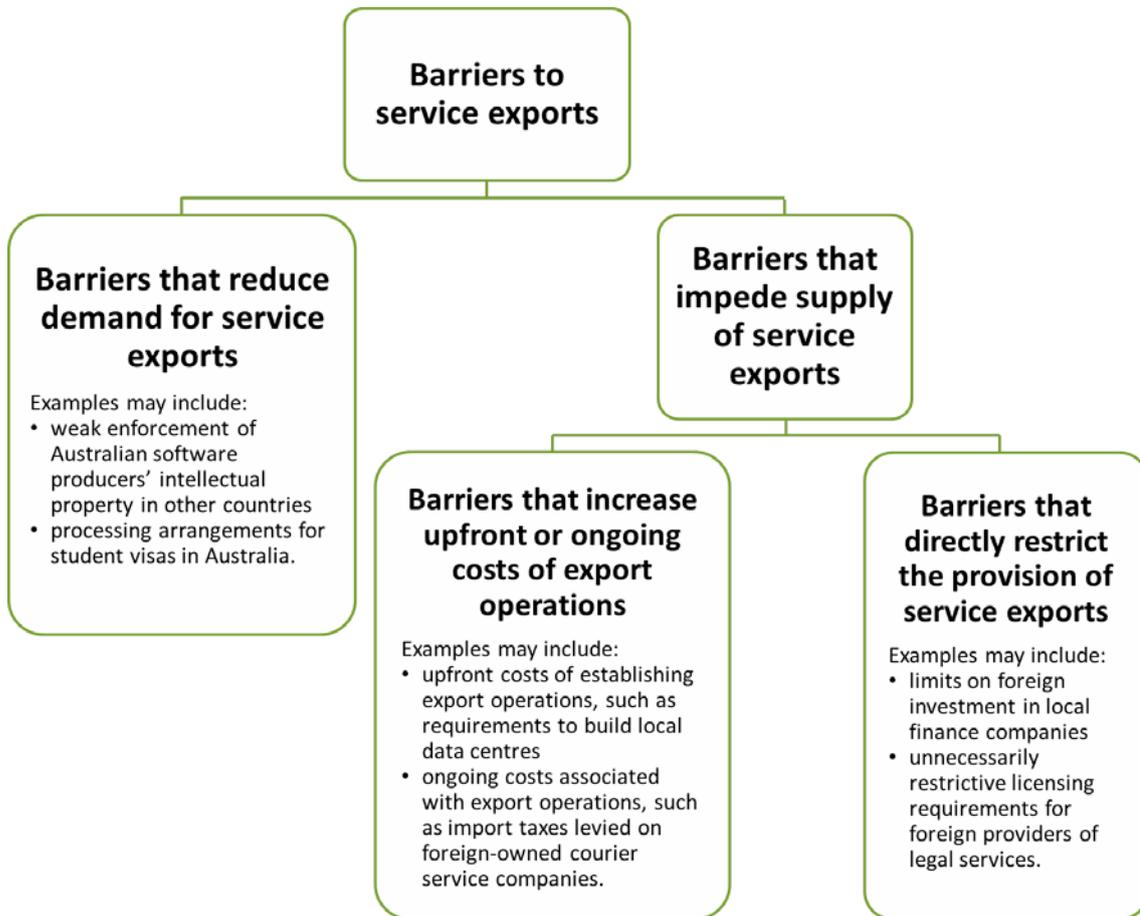
#### *Barriers that increase the costs of export operations*

Policy arrangements can increase the upfront or ongoing costs of export operations (or both). These scenarios are depicted in figure 2.2 (panels (a) and (b) respectively) for a service provider operating in an export market that includes multiple competitors offering differentiated services.<sup>2</sup>

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<sup>2</sup> Most service markets consist of multiple competitors offering differentiated services. Each service provider faces its own demand curve meaning it has some ability to set its own prices. This pricing power will be limited by the price of substitute services.

Figure 2.1 **Barriers to service exports<sup>a</sup>**



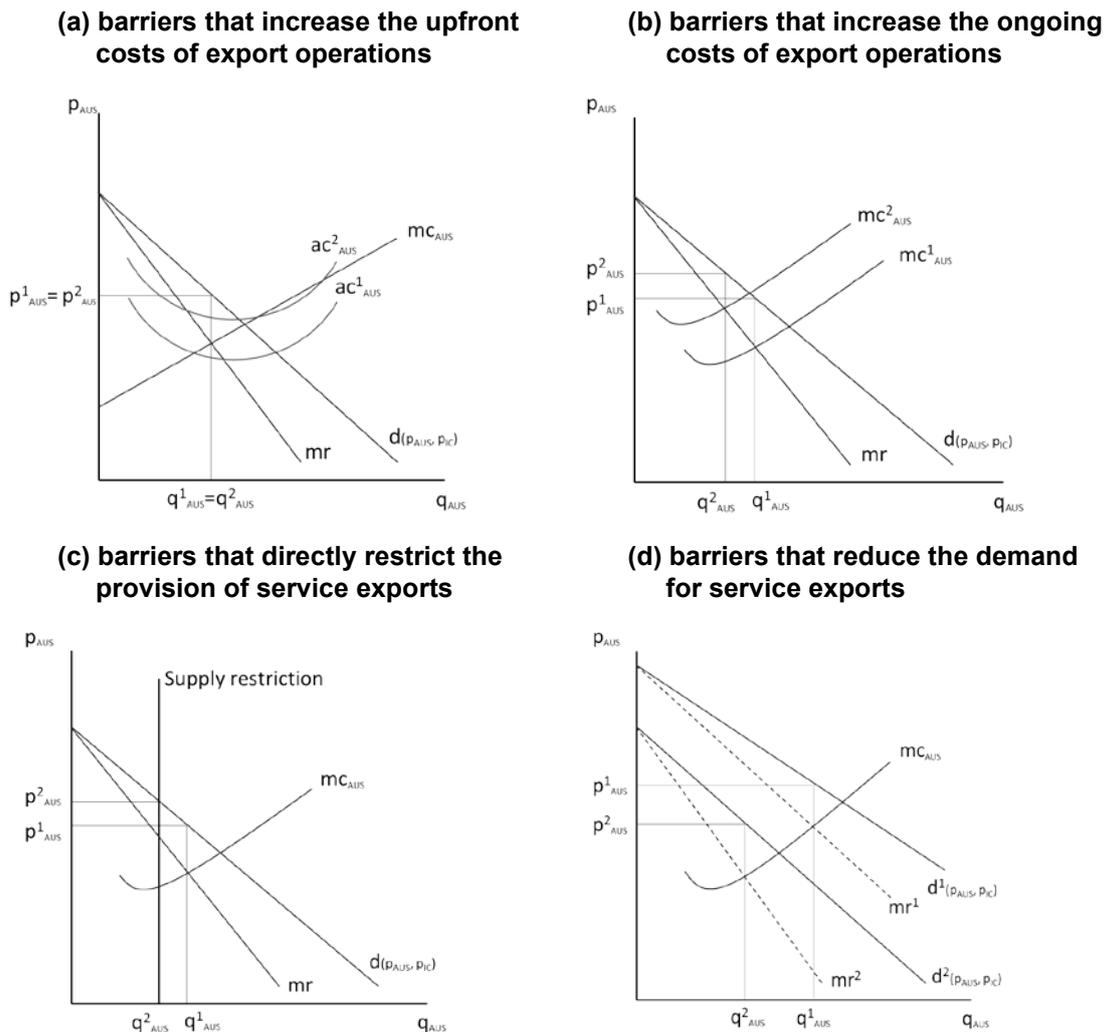
<sup>a</sup> Exporters may be able to circumvent an impediment to their preferred mode by substituting to another mode but this will decrease the efficiency of export operations.

Barriers that increase the upfront costs of establishing export operations increase the average costs of supplying service exports, and decrease the overall expected returns to the Australian service provider from supplying the export market. Barriers that increase upfront costs could distort investment decisions, including whether to enter an export market or not. In some cases the increase in average costs may be too small to influence the service provider's decision about whether to supply the market (as depicted in figure 2.2, panel (a)). Examples of barriers that increase upfront costs include overly burdensome screening of foreign investments and requirements to invest in infrastructure in the local market.

Barriers that can increase the ongoing costs of export operations include requirements to store data in local data servers (which can increase the costs of managing customers' data). Weak enforcement of intellectual property could increase ongoing costs by forcing businesses to change their business operations to protect their intellectual property. In some cases these sorts of barriers could increase the marginal costs of supply — that is, the costs from supplying an additional unit of the service. With higher marginal costs the

quantity of the service supplied would be expected to be lower than what it would have otherwise been (as depicted in figure 2.2, panel (b)). If the increase in costs of ongoing export operations is large enough there may be no supply to the export market at all.

**Figure 2.2 How different types of barriers impede service exports<sup>a,b</sup>**  
Market for a differentiated service



<sup>a</sup> **mc** marginal cost; **ac** average cost; **p<sub>AUS</sub>** price of the service produced by Australian provider, **p<sub>IC</sub>** price of the service produced by provider in the importing country; **d** demand for the service produced by Australian provider; **mr** marginal revenue; **q** quantity. <sup>b</sup> The figure shows the demand for and supply of a service produced by an Australian service provider in an export market. Demand depends on both the price of the service produced by the Australian service provider and the price of a substitutable service produced by service providers in the importing country. It is assumed there are no competing service providers in other countries. The market for the service produced by service providers in the importing country is not shown. Prices correspond to the point on the demand curve where marginal revenue equals marginal cost.

### Barriers that directly restrict the provision of service exports

Some barriers fully or partially restrict the provision of Australian service exports (figure 2.2, panel (c)). A full restriction on supply would prevent any amount of the service being

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supplied in the export market through a given supply mode. An example is a measure that prevents individuals from gaining a visa or a license to provide a professional service in an export market. A partial limit on supply would enable supply only up to a certain level ( $q^2_{AUS}$  in figure 2.2, panel (c)). An example of a partial limit on supply may include restrictions on the number of branches that a foreign bank can open in the importing country.

### Barriers that reduce the demand for service exports

Some barriers reduce the quantity of services that other countries' citizens or businesses demand from Australian service providers (figure 2.2, panel (d)). There are a number of policy arrangements that could reduce the demand for service exports.

- *Weak enforcement of intellectual property in other countries.* For example, demand for licensed copies of a patented software service — such as a method for settling financial transactions — would be lower in countries where consumers can illegally acquire unlicensed copies.
- *Local content or government procurement rules in other countries.* For example, a government policy that requires large projects to use information technology services provided by locally owned companies would reduce the demand for similar services provided by Australian service providers.
- *Restrictions on the use of the internet in other countries.* For example, if the access points of the internet into a country are blocked it is less likely that consumers in the importing country will be aware of services offered by Australian service providers.

## 2.2 Assessing the potential benefits of reduced barriers to service exports

Increasing service exports is not an end in itself. Domestic production is no more or less valuable to the community whether it is exported or consumed in Australia. Implementing policy for the purpose of increasing service exports may have costs that include foregone opportunities to use resources in more valuable activities. Accordingly, policies designed to increase service exports will not necessarily result in a net benefit to the Australian community.

The benefits to the Australian community from reduced barriers to service exports will vary across the sectors and countries where barriers are reduced. A broad understanding of the nature and magnitude of the benefits from reducing different barriers to service exports is necessary to inform the prioritisation of domestic policy reform and government efforts to reduce barriers in other countries.

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## Empirical approaches to estimating the benefits

Much of the literature that empirically analyses barriers to trade in services estimates the benefits from liberalisation of service trade in general, rather than focusing on the specific benefits from reducing barriers faced by an exporting country. Where the literature does analyse outcomes for particular countries, the focus is most often on the benefits to importing countries from greater imports. This may reflect the finding in the literature that most of the benefits from liberalising service trade arise from reducing barriers to imports (Dee 2013).

Broadly, three steps are undertaken to empirically estimate the benefits from liberalisation of service trade (Dee and Diop 2014). First, qualitative information about barriers to service exports are converted into a quantitative index. This is usually done at the sectoral level. Second, econometric methods are used to convert these indexes into either a ‘tax equivalent’ or ‘productivity equivalent’ measure. Third, tax or productivity equivalents are used in an economic modelling framework to estimate the effect of liberalised service trade on market outcomes relative to a counterfactual scenario.

### Constructing a quantitative index

A common approach to constructing quantitative measures of barriers to service exports combines details about different trade barriers in the relevant service sector with information about the restrictiveness of those regulations, such as how many countries the barrier applies to. This information is combined into a single measure using weightings that reflect the relative importance of each type of barrier. An index of barriers to service trade for a particular sector can then be formed to provide a common measure of barriers to service trade across sectors and countries. Researchers at the World Bank and OECD have taken this approach to measuring barriers to trade in services (box 2.2). The Commission has previously collaborated with the Australian National University to develop service trade restrictiveness indexes using this approach (PC 2000).

Barriers to trade in services are notoriously difficult to identify and measure, which makes constructing a robust index of a country’s trade barriers challenging. Many barriers to service trade are a result of regulations in the importing country (that is, ‘behind the border’ measures) and how restrictive they are depends on how regulation is implemented. For example, a country’s licensing procedures may appear to be efficient but, when used by international service providers, procedures may be slow and opaque. How a country’s institutions enforce different laws (such as intellectual property laws) can also affect trade in some services (chapter 5). It can also be difficult to separately identify barriers to service exports from policies or regulations that have a legitimate rationale (such as prudential regulation to maintain financial system stability). Given these difficulties, countries that have more observable barriers will appear to have more restrictions than countries with more unobservable barriers.

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## Box 2.2 Quantitative measurements of barriers to trade in services

The World Bank and the OECD have each developed indexes on barriers to trade in services.

- The *OECD Services Trade Restrictiveness Index* is calculated for 18 service subsectors for 40 countries as of the end of 2013. Service subsectors included in the index that are covered by the Commission's terms of reference are legal, accounting, architecture, engineering, insurance, banking and computer services. The policy measures covered include restrictions on foreign entry and movement of people, barriers to competition and regulatory transparency. The Index does not include measures that apply exclusively to cross-border supply or consumption in the exporting country.
- The *World Bank Services Trade Restrictions Index* is constructed for 19 service subsectors in 103 countries, with most of the information collected in 2008. Service subsectors included in the index that are covered by the Commission's terms of reference are legal, accounting, insurance and banking services. The index only accounts for policies or regulations that affect foreign businesses, and does not include services consumed in the exporting country.

The OECD and World Bank indexes enable analysis of differences in barriers to international trade in services across a range of economies, including Australia. The OECD database is based on more recent information, and covers more of the service sectors covered by the Commission's terms of reference. The Commission has drawn on the OECD's index in its analysis of international barriers to service exports (in chapters 5, 6 and 8).

The World Bank and OECD have other databases that can help to measure barriers to trade in services.

- The *OECD Indicators of Product Market Regulation* covers policies, regulations, and administrative and procedural requirements affecting foreign and local businesses at the sectoral level for OECD countries.
- The *World Bank Doing Business* initiative ranks 189 economies according to how conducive their regulatory environments are for business operations in a number of sectors. The index accounts for business regulations and the protection of property rights for both foreign and local businesses.
- The *World Bank Investing Across Borders* initiative compares countries' regulations of foreign direct investment. The index accounts for a range of laws (including investment and company laws) affecting foreign businesses.

Sources: Borchert et al. (2012); Grosso et al. (2015).

## Converting indexes to a tax or productivity equivalent

In the second step, quantitative indexes are converted to a tax or productivity equivalent. These equivalent measures summarise the relationship between the barrier to service exports and market outcomes, such as the price of the service or the quantity sold. A tax equivalent provides an estimate of the tax increase that would have an equivalent effect on market outcomes as the barrier to service trade, and is relevant in cases where a barrier raises prices in the importing market (because competition is lower or supply is restricted). A productivity equivalent provides an estimate of the decrease in productivity that would

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have an equivalent effect on market outcomes, and is relevant in cases where a barrier raises real resource costs (Dee 2013).

Tax and productivity equivalents are derived by developing partial equilibrium models of different service sectors using econometric methods (Barth, Caprio and Levine 2004; Clark, Dollar and Micco 2004; Kalirajan 2000; OECD 2005). These models include indexes of barriers to service trade as independent variables to estimate the effect that trade barriers have on market outcomes. A methodologically robust derivation of tax or productivity equivalents requires data on factors that influence demand and supply for the particular service (Dee 2013).

### Estimating the effects of reduced barriers to service trade

In the third step, tax or productivity equivalents are entered into a computable general equilibrium (CGE) model to estimate how the existence or reduction of barriers to trade in services affect broader economic outcomes, including economic welfare (CIE 2010; Copenhagen Economics 2005; Dee and Diop 2014; Dee, Hanslow and Phamduc 2003; OECD 2004). The effects of service trade liberalisation can be estimated for particular sectors in a given economy, and for particular economies or regions as a whole (Dee and Diop 2014). In addition to data on factors that influence demand and supply in the service sectors modelled, CGE models require estimates of price elasticities of demand between foreign and local service providers, and between different foreign service providers. Data are also required on service trade flows for each country and sector included in the model.

## The Commission's approach

The Commission's terms of reference direct it to assess the economic benefits of reducing barriers to Australian service exports in particular markets.

Insufficiently robust data are a major impediment to conducting modelling of reducing barriers to service exports for this study. As noted in chapter 1 and above, measurement of service exports is inherently difficult. Data sources on barriers to service exports are incomplete because they do not cover all supply modes, countries, sectors or barriers. For example, the World Bank and OECD service trade restrictiveness indexes only cover some of the service sectors included in the Commission's terms of reference, and do not have full coverage of supply modes (box 2.2). There are also limited data on Australian exports of services provided through commercial presence abroad as well as limited data on the contribution of services in the production of goods (the 'valued added' by services) (chapter 3).

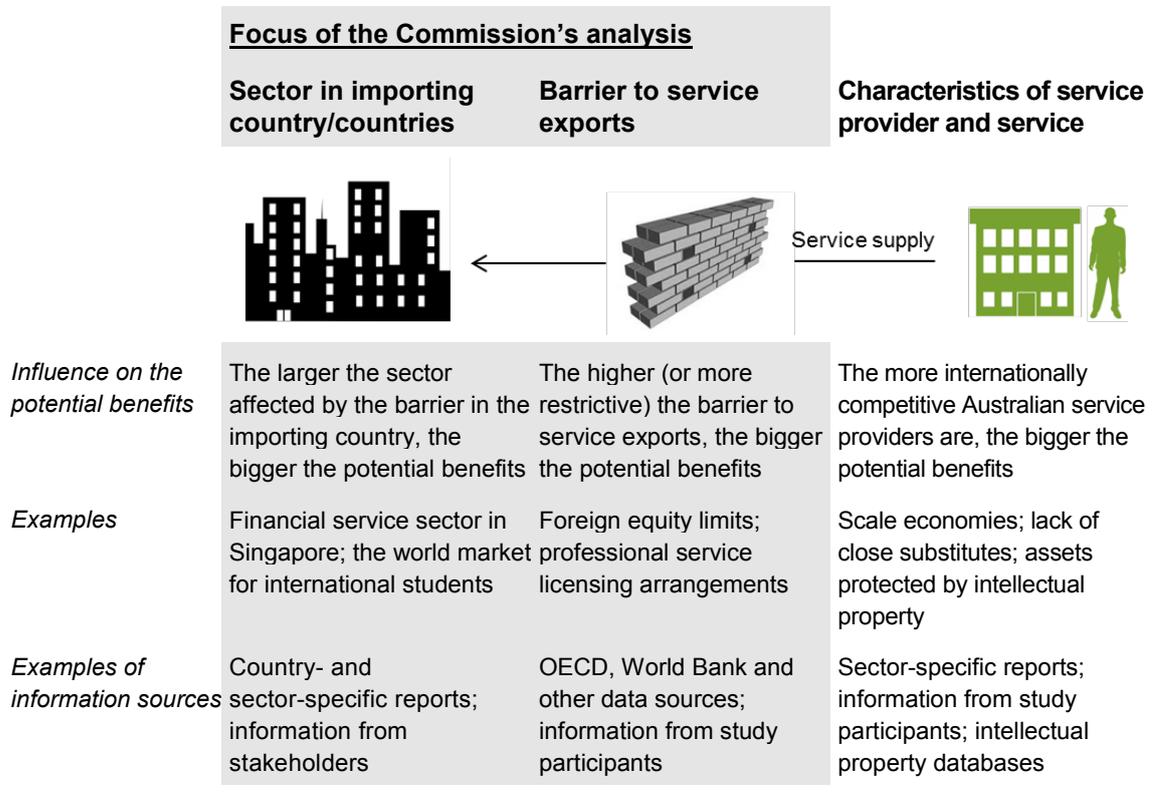
The Commission's approach to assessing the benefits to the Australian community from reducing barriers to service exports is qualitative in nature, drawing on consultations with stakeholders and other information sources such as case studies and quantitative evidence where available, including from other countries. To gauge the net benefits of reducing a

barrier, the Commission also considered the economic costs associated with particular reform options.

At a broad level, there are two main analytical questions relevant to considering the potential benefits to Australian service providers from reducing a barrier to service exports. First, what are the potential benefits available to service providers (in Australia and in other countries) from reducing the barrier? Second, given that Australian service providers would be competing with other service providers in a more liberalised market, how well placed are Australian service providers to capture some of these benefits?

The main focus of the Commission’s analysis is on the first of these questions (figure 2.3). The priorities for reducing barriers to service exports should be those areas that offer the largest potential benefits to the Australian community as a whole. If barriers are reduced in these areas, it is then up to Australian service providers to capture as many of the potential benefits as they can. Efficient domestic policy arrangements are important to ensuring that service providers are able to capture benefits from reduced barriers to export (discussed below).

**Figure 2.3 Conceptual framework for considering benefits to Australian service providers from reducing a barrier to service exports**



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## The potential benefits available to service providers from reducing a trade barrier

The potential benefits from reducing a barrier to service exports will be influenced by a number of factors. One of these factors is the height of the barrier — that is, the extent to which the barrier has distorted market outcomes and in doing so reduced the overall returns to exporters. Another factor is the size of the sector that is affected by the barrier in the importing country or countries. These two factors should be considered together — on their own they are insufficient to gauge the size of the potential benefits.

### *Height of the barrier*

The greater the extent to which a barrier distorts market outcomes, the greater the potential benefits to service providers if the barrier is reduced. This is illustrated in figure 2.4 for a cost-raising barrier using a simple model of a homogeneous service. While the model for a differentiated service used in figure 2.2 above provides a more realistic depiction of a typical service, the model of a homogeneous service enables illustration of different outcomes at the market level. The model of a homogeneous service shows that the more a barrier increases the costs of supplying a particular market, the greater the benefits to service providers in other countries from reducing the barrier. This model can also be used to show that the benefits to the importing country from reducing barriers to service trade are likely to increase with the size of the barrier.

It is difficult to assess the extent to which a barrier distorts market outcomes because the outcomes that would prevail in the absence of the barrier are unknown. For some sectors and countries the quantitative measures of barriers to service exports highlighted above (such as the OECD Services Trade Restrictiveness Index) may provide an indication of the extent to which a barrier has distorted market outcomes. In some cases it may also be possible to infer the relative extent to which different barriers distort market outcomes by considering how they impede service exports. The more a barrier raises the upfront or ongoing costs of export operations, restricts the provision of a service or reduces the demand for services supplied by exporters, the greater the expected benefits to exporters from reducing the barrier.

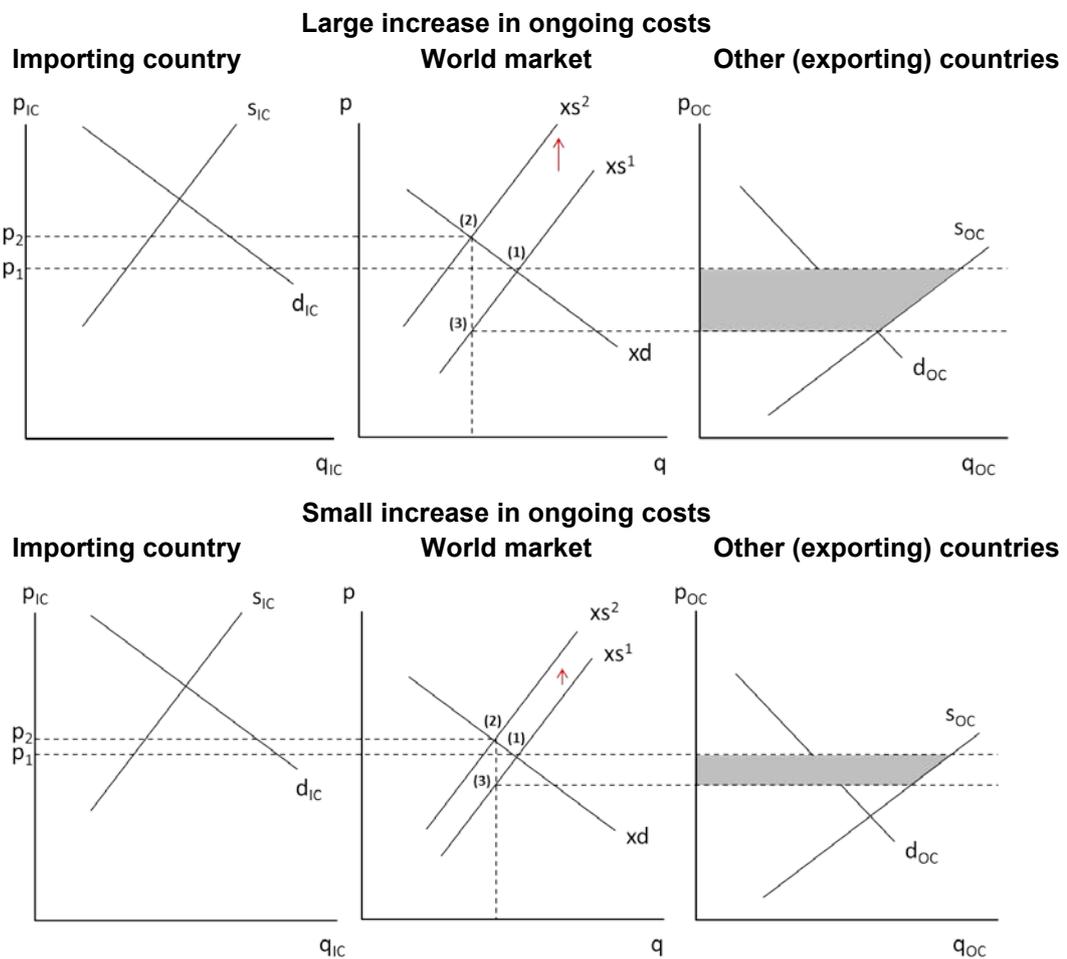
It is not possible to conclude that any one of the above types of barriers will in general be more distorting than another. For example, a barrier that fully restricts the provision of a service may have little effect on market outcomes because trade in the service would have been negligible even in the absence of the barrier, while a barrier that only partially restricts supply may have a large effect on market outcomes. The effects of different barriers must therefore be assessed on a case-by-case basis in conjunction with an assessment of the size of the affected sector in the importing country.

*Size of the affected sector in the importing country*

The potential benefits to exporters from reducing a barrier also depend on the size of the sector that is affected by the barrier in the importing country. For example, Dee (2009) has argued that while Indonesia has higher barriers to trade in telecommunications services than in distribution services, the estimated gains from reform in distribution are larger because it is the larger sector.

**Figure 2.4 Effect of the height of a barrier on the potential benefits from reducing a barrier<sup>a,b,c</sup>**

Barrier that increases the ongoing costs of export operations

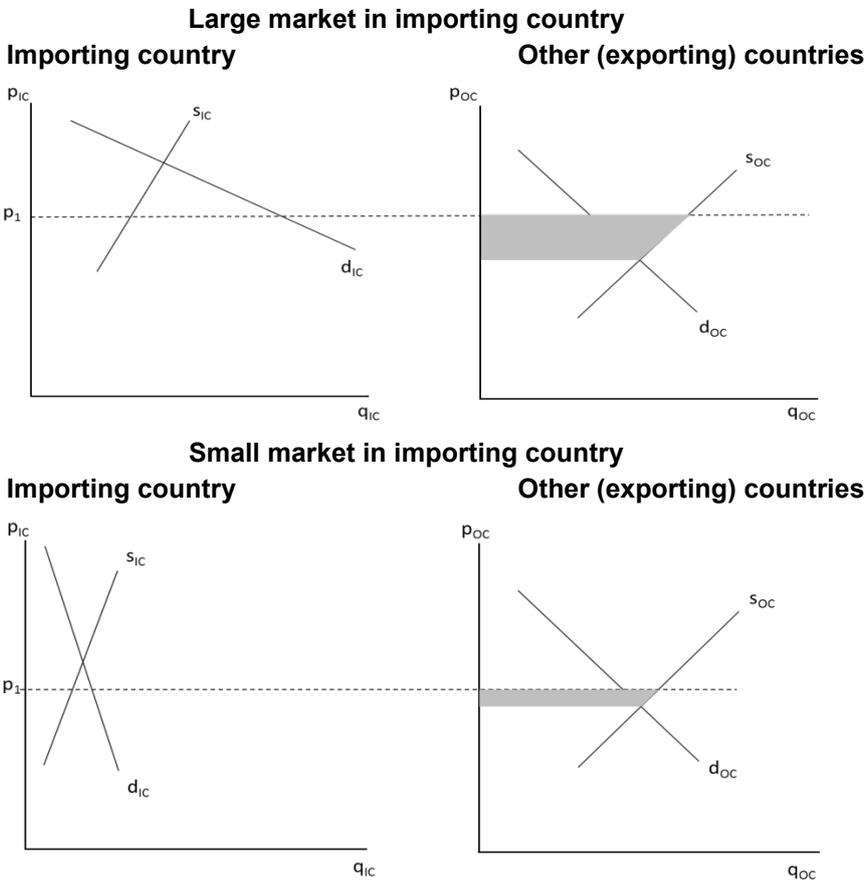


**a**  $p_{IC}$  price in importing country;  $s_{IC}$  supply from providers in importing country;  $d_{IC}$  demand in importing country;  $q_{IC}$  quantity in importing country;  $xs$  excess supply;  $xd$  excess demand;  $p_{OC}$  price in other countries;  $s_{OC}$  supply in other countries;  $d_{OC}$  demand in other countries;  $q_{OC}$  quantity in other countries. **b** In the absence of a cost-increasing barrier, the intersection between demand and supply in the world market at point (1) determines the price in both the importing country and other countries ( $p_1$ ). A cost-increasing barrier shifts the excess supply curve from  $xs^1$  to  $xs^2$ . Price in the importing country is now determined at point (2) in the world market. At this point, the cost of supplying other countries is given by point (3). **c** The size of the potential benefits available to service providers from removing this cost-increasing barrier is depicted by the shaded area. The analysis assumes that producers in other countries are more efficient than producers in the importing country.

Source: Krugman and Obstfeld (2006).

The relationship between the size of the affected sector in the importing country and the overall benefits to service exporters is illustrated in figure 2.5 using the same model of a homogeneous service as above. The figure illustrates that for any given price and level of domestic supply, the more demand for the service in the importing country, the greater the amount that could be supplied by service providers in other countries in the absence of barriers to service exports. The level of demand in a given sector will depend on a number of factors, including income levels and consumer preferences. The model in figure 2.5 can also be used to show that the benefits to the importing country from reducing barriers to service trade are likely to increase with the size of the affected sector in the importing country.

**Figure 2.5 Effect of the size of the sector in the importing country on the potential benefits from reducing a barrier<sup>a,b,c</sup>**



**a**  $p_{ic}$  price in importing country;  $s_{ic}$  supply in importing country;  $d_{ic}$  demand in importing country;  $q_{ic}$  quantity in importing country;  $p_{oc}$  price in other countries;  $s_{oc}$  supply in other countries;  $d_{oc}$  demand in other countries;  $q_{oc}$  quantity in other countries. **b** In the absence of a barrier that fully restricts imports, market outcomes are determined separately in each market through the intersection of demand and supply in those markets. **c** The size of the potential benefits available to service providers in other countries from removing the full restriction on supply are depicted by the shaded area. The analysis assumes that producers in other countries are more efficient than producers in the importing country.

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## Capturing the potential benefits from reducing trade barriers

The above factors only provide an indication of the potential benefits from reducing barriers to service exports — they are insufficient to guarantee that reducing barriers to service exports would result in large benefits to Australian service providers. Australian service providers would still be competing with other service providers (both providers in the importing country and other foreign providers) in the liberalised market. Even if barriers are only reduced for Australian service providers (through a bilateral trade agreement, for example), there is no guarantee that Australian service providers would be more competitive than local service providers. The Centre for International Economics argued:

... trade in financial services for instance, has historically been negligible between many trading partners due to legislated barriers, such as licence requirements ... when those legislated blockages are removed, it may be discovered that partner countries' financial sectors are much more competitive than was apparent ... (2009, p. 66)

How competitive Australian service providers are relative to foreign providers depends on a range of factors. The Asia–Pacific Economic Cooperation Business Advisory Council (2011) has considered factors that are relevant to the ‘international competitiveness’ of service providers in a given country. These factors include access to human capital, the quality of information and communications technology infrastructure, the quality of institutions and the efficiency of domestic regulation. Australian service providers will be more internationally competitive if they can produce their services at a lower cost than rival competitors in other countries (for example, due to scale economies), or because they offer highly valued services for which there are few close substitutes.

The role for Australian governments once barriers to service exports have been reduced is to help ensure that domestic policy arrangements do not unnecessarily hinder Australian service providers from responding to market opportunities and capturing the benefits from reduced barriers to service trade. The objective of policy reform should be to generate net benefits to the community, rather than the promotion of exports per se. Chapter 4 considers domestic barriers to service exports that apply to multiple sectors, while domestic barriers specifically relating to the financial sector, and education and health sectors are considered in chapters 6 and 7 respectively.



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## 3 Australian service exports: trends and drivers

### Key points

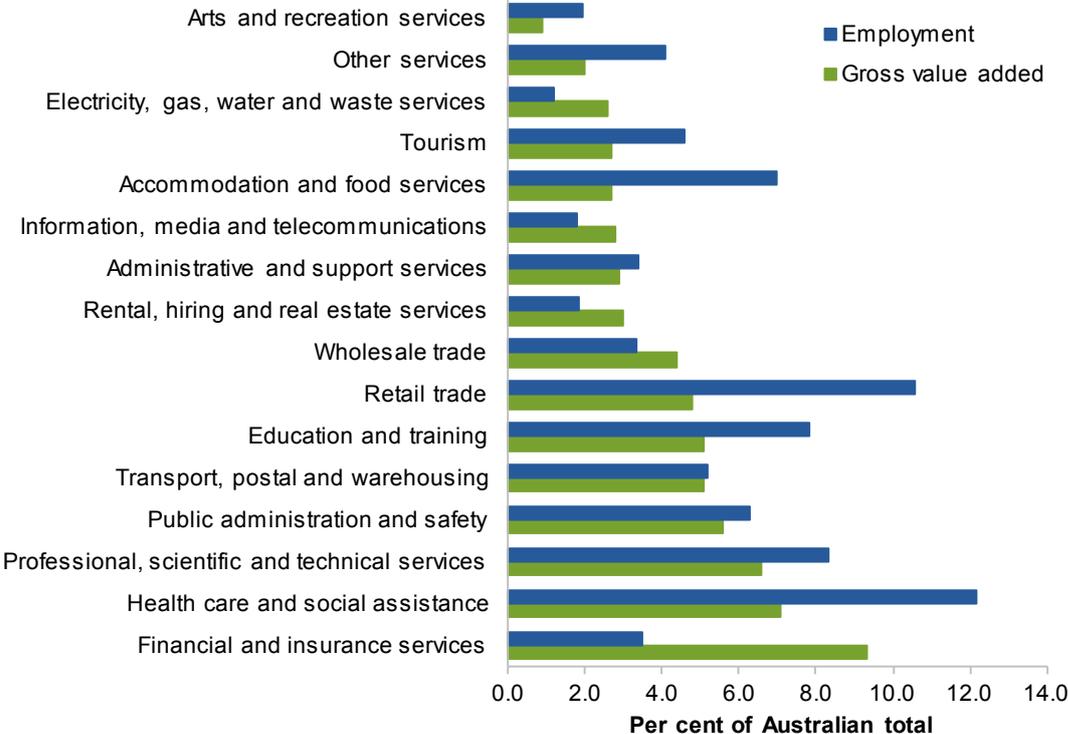
- The provision of services accounts for about 60 per cent of Australia's gross domestic product and almost 80 per cent of employment.
- The total value of Australian service exports was \$62 billion in 2014-15 — about 20 per cent of the total value of exports. The total value of service exports from all sectors has roughly doubled (in real terms) over the past two decades.
  - Service exports make up a greater share (about 40 per cent in 2013) of total exports when measured in value added terms.
  - Exports through commercial presence abroad, such as through foreign subsidiaries, are not included in balance of payments data used to measure exports. The lack of periodic data on Australian exports through commercial presence abroad makes it difficult to assess trends in service exports through this mode. An ABS survey estimated that the value of service exports through commercial presence abroad was about \$60 billion in 2002-03, at which time the value of service exports through other modes was about \$35 billion.
- Rising household incomes in Asia have been an important driver of demand for service exports from Australia. As incomes rise, consumers have more money to spend on goods and services and generally spend a greater share of their income on services.
- The cost of trading services has fallen. Reasons include lower airfares and the development of internet tools including email and video calls, and online payment systems.
- Australia's largest service exports are tourism, education and financial services.
  - There has been strong growth in the value of tourism exports. Over the past two decades the number of international visitors travelling to Australia rose from 3.5 million to over 7 million. Increasing income in many source countries has been a key driver of Australian tourism exports.
  - Although the annual value of education exports fell between 2009-10 and 2012-13, it has increased at an average rate of 12 per cent over the past two decades. Students from developing countries in Asia, particularly China, account for most of this growth, reflecting rapidly rising incomes. The quality and reputation of Australian education institutions, and the potential for study in Australia to lead to permanent residency, are important drivers of education exports.
  - Australian exports of financial services are mostly through commercial presence abroad. About half of these exports are of insurance services. The volume of goods and services trade is a key driver of financial service exports, as goods and services trade depends on services such as currency exchange. Common language is also an important determinant of financial service exports.

This chapter examines trends in service exports by Australian suppliers. It focuses on the six service sectors referred to in the terms of reference: tourism, education, financial, professional, information technology (IT) and health services.

### 3.1 Services and the Australian economy

Services make up the majority of the Australian economy. In 2014-15 the gross value added of service industries was about \$980 billion, or about 60 per cent of Australia’s gross domestic product (GDP) (figure 3.1).<sup>1</sup> Services’ share of GDP has increased by about 3 percentage points over the past two decades (ABS 2015a).

Figure 3.1 **Service industries’ gross value added and employment**  
2014-15, ranked by gross value added<sup>a</sup>



<sup>a</sup> Tourism is ‘direct tourism’ as defined in the ABS’s Tourism Satellite Account. For tourism, 2013-14 data are presented because 2014-15 Tourism Satellite Account data are not currently available. Other services includes a broad range of personal services; religious, civic, professional, and other interest group services; selected repair and maintenance activities; and private households employing staff. Ownership of dwellings is not included as part of rental, hiring and real estate services.

Sources: ABS (*Labour Force, Australia*, Cat. no. 6291.0.55.003; *National Accounts*, Cat. no. 5204.0; *National Accounts: Tourism Satellite Account*, Cat. no. 5249.0).

<sup>1</sup> Unless specified, ‘service industries’ include the electricity, gas, water and waste services industry (which produces both goods and services), but not the construction industry or ownership of dwellings. In 2014-15, service industries accounted for about 65 per cent of total industry gross value added (which is equal to GDP less net taxes on products).

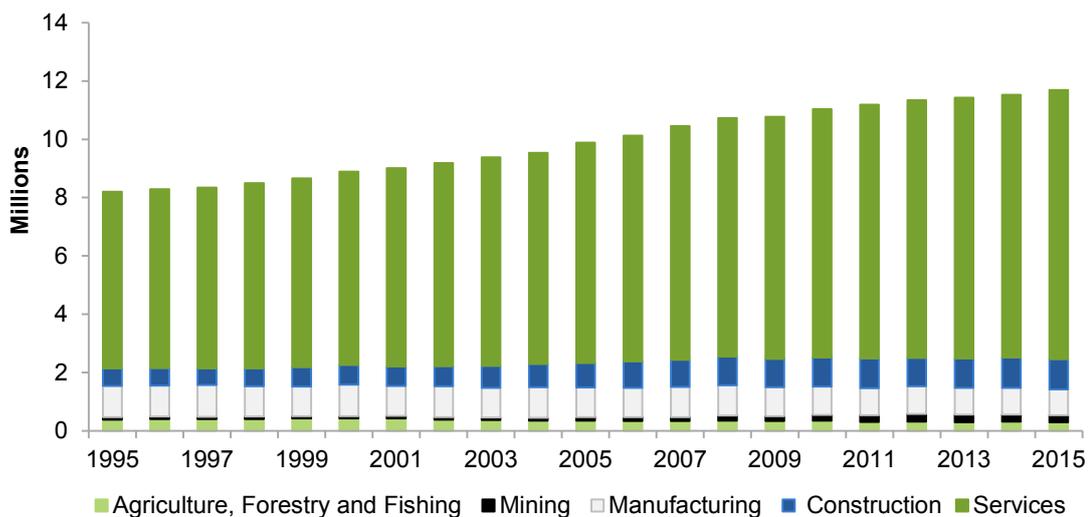
Services account for an even larger share of total employment in Australia, reflecting the labour-intensity of service industries compared to non-service industries, such as agriculture, mining and manufacturing. As at August 2015, service industries employed around 9.2 million people or almost 80 per cent of employed persons in Australia (figure 3.2).

The six service sectors together accounted for about one third of Australian gross domestic product and almost 40 per cent of employment in 2014-15 (ABS 2015a). (These estimates are approximate as the six service sectors studied do not do not fully align with the industry definitions used in official statistical publications, such as the national accounts.)

Services have been responsible for about 90 per cent of employment growth in Australia over the past two decades. Services' share of employment increased from 74 per cent to 78 per cent from August 1995 to August 2015. In contrast, manufacturing's share of employment decreased from 13 to 8 per cent over the same period (figure 3.2).

Services are typically more reliant on employees with high education qualifications than non-service industries. Service industries on average have a higher proportion of employees with a bachelor's degree or above (almost 20 per cent) than non-service industries (8 per cent). Education (33 per cent), professional services (31 per cent) and financial services (24 per cent) have the highest proportions of employees with a bachelor's degree or above across all industries (Productivity Commission estimates based on ABS (2011)).

Figure 3.2 **Employment in Australia, by industry<sup>a</sup>**



<sup>a</sup> Employed persons reported for August each year.

Source: ABS (*Labour Force, Australia*, Cat. no. 6291.0.55.003).

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## 3.2 The value of Australian service exports

Estimates of services' contribution to Australian exports vary across data sources due to differences in the approach to valuing exports ('gross value' or 'value added' terms) and the types of transactions that are included in estimates of exports.

### Direct service exports account for one fifth of total exports

The value of service exports is typically measured using Australia's balance of payments, which summarises the economic transactions occurring between residents of Australia and the rest of the world (non-residents). The balance of payments records 'direct exports', which are sales of services from Australian businesses to buyers from foreign markets. Examples include: financial services provided by a business located in Australia to a foreign customer over the internet; Australian university education provided to an international student; accommodation paid for by an overseas visitor (PwC, ANZ and Asialink Business 2015); and consulting services provided by an Australian engineer who has travelled overseas on a short-term basis (the balance of payments exports data corresponds to exports through modes 1, 2 and 4 — described in chapter 1.)

On the basis of balance of payments data, the total value of Australian service exports was \$62 billion in 2014-15 — about 20 per cent of the total value of exports (ABS 2015e). The six service sectors accounted for about \$53 billion (around 85 per cent) of the total value of Australian service exports from all sectors in 2014-15 (ABS 2015e). Many of Australia's largest trading partners are also key destinations for Australian service exports (table 3.1). (Export markets for particular services are examined in detail in section 3.4.)

### Services make up a greater share of exports when measured in value added terms

The balance of payments measures exports in 'gross value' terms, which means that the entire value of an exported good is attributed to the final industry in the export production chain. The gross value approach to measuring exports does not account for the value of services used to produce exported goods, which can often be a significant proportion of the exported goods' total value (box 3.1).

An alternative approach to measuring the value of exports is in 'value added' terms, which takes account of goods and services that are used in the production of exports. When measured in value-added terms (rather than gross-value terms), Australian service exports account for a greater proportion of total exports (box 3.1). One study estimated that Australian service sectors accounted for about 40 per cent of exports in value-added terms in 2013, compared with 17 per cent in gross-value terms (PwC, ANZ and Asialink Business 2015).

**Table 3.1 Australia's largest trading partners, 2014<sup>a</sup>**

Australia has trade agreements with the countries shaded green<sup>b</sup>

Country	Total trade (\$ million)	Service exports (\$ million)	Country	Total trade (\$ million)	Service exports (\$ million)
1 China <sup>c</sup>	152 554	8 212	21 Netherlands <sup>d</sup>	5 446	518
2 Japan <sup>d,e</sup>	69 780	2 054	22 Canada <sup>d,e</sup>	5 167	877
3 United States <sup>d,e</sup>	57 485	6 620	23 Spain <sup>d</sup>	4 318	302
4 South Korea <sup>d</sup>	33 839	1 621	24 Philippines <sup>i</sup>	4 070	634
5 Singapore <sup>e,f</sup>	30 121	3 670	25 Ireland <sup>d</sup>	3 194	537
6 New Zealand <sup>d,e,f,g</sup>	23 204	4 005	26 Saudi Arabia <sup>k</sup>	3 056	343
7 United Kingdom <sup>d</sup>	20 623	4 553	27 Belgium <sup>d</sup>	2 998	111
8 Malaysia <sup>e,f</sup>	20 389	1 828	28 South Africa	2 974	370
9 Thailand <sup>f</sup>	18 928	937	29 Sweden <sup>d</sup>	2 767	259
10 Germany <sup>d</sup>	16 555	1 169	30 Denmark <sup>d</sup>	2 743	331
11 India <sup>h</sup>	15 834	2 498	31 Mexico <sup>d,e</sup>	2 694	82
12 Indonesia <sup>i,j</sup>	14 975	1 287	32 Brazil	2 476	628
13 Taiwan <sup>d</sup>	12 369	817	33 Russia	2 083	151
14 Vietnam <sup>e,i</sup>	10 002	1 167	34 Nigeria	1 916	69
15 United Arab Emirates <sup>k</sup>	8 616	699	35 Fiji <sup>g</sup>	1 672	164
16 Italy <sup>d</sup>	8 586	549	36 Chile <sup>d,e</sup>	1 645	187
17 Hong Kong <sup>d</sup>	8 558	1 995	37 Turkey <sup>d</sup>	1 543	125
18 France <sup>d</sup>	7 628	781	38 Qatar <sup>k</sup>	1 538	109
19 Papua New Guinea <sup>g</sup>	6 749	529	39 Bangladesh	1 424	238
20 Switzerland <sup>d</sup>	5 733	1 048	40 Norway <sup>d</sup>	1 392	290

<sup>a</sup> By total value of goods and services trade (exports plus imports). <sup>b</sup> Trade agreements refers to bilateral trade agreements except for the ASEAN-Australia-New Zealand Free Trade Agreement, where indicated. <sup>c</sup> Excluding special administrative regions and Taiwan. Negotiations for the China-Australia Free Trade Agreement have concluded, although it is not yet in force. <sup>d</sup> Part of the ongoing Trade in Services Agreement negotiations. <sup>e</sup> Part of the negotiations on the Trans Pacific Partnership agreement concluded in October 2015. <sup>f</sup> Bilateral trade agreement with Australia and also part of the ASEAN-Australia-New Zealand Free Trade Agreement. <sup>g</sup> Part of the South Pacific Regional Trade and Economic Co-operation Agreement. Part of the ongoing Pacific Agreement on Closer Economic Relations 'Plus' Agreement negotiations. <sup>h</sup> The India-Australia Comprehensive Economic Partnership Agreement is currently being negotiated. <sup>i</sup> ASEAN-Australia-New Zealand Free Trade Agreement. <sup>j</sup> The Indonesia-Australia Comprehensive Economic Partnership Agreement is currently being negotiated. <sup>k</sup> Part of the ongoing Australia-Gulf Cooperation Council Free Trade Agreement negotiations.

Sources: Productivity Commission estimates based on ABS customised report and ABS (*International Trade in Goods and Services, Australia*, Cat. no. 5368.0); DFAT (2015i).

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### Box 3.1      **Global value chains and value-added measures of exports**

Over the past few decades the structure of international trade has changed with the emergence of global value chains — production networks that span multiple countries. The production of a single good, such as a mobile phone, typically now takes place across several countries, with each country contributing a part of the final product. Value-added measures of exports have been developed in response to these changes.

Gross measures of exports attribute all export value to the final industry in the export production chain, whereas value-added measures of exports take account of intermediate inputs (goods and services) that are used in the production of exports. For example, if engineering services are used in the production of minerals, which are then exported, then a value-added measure of exports would count the engineering services embodied in the minerals as a service export. A gross measure of exports would count the entire value as an export of minerals.

Services used as inputs in the production of goods typically account for a significant proportion of the value of goods exports and, as a result, gross measures of exports understate the contribution of services to total exports (PC 2015i). The focus of this study is on barriers to service exports, which in general do not affect services embodied in goods exports.

Value-added measures also show that patterns of trade are different when considered in terms of the final (rather than intermediate) destination of exports. Using value-added measures, more Australian exports of goods and services ultimately end up in Europe and the United States (and less in China, South Korea and Taiwan) than suggested by gross measures (Kelly and La Cava 2013).

## **Information on exports through commercial presence abroad is limited**

Unlike exports through other modes, service exports through commercial presence abroad are not included in Australia's balance of payments data and there are few estimates of Australian service exports through this mode.

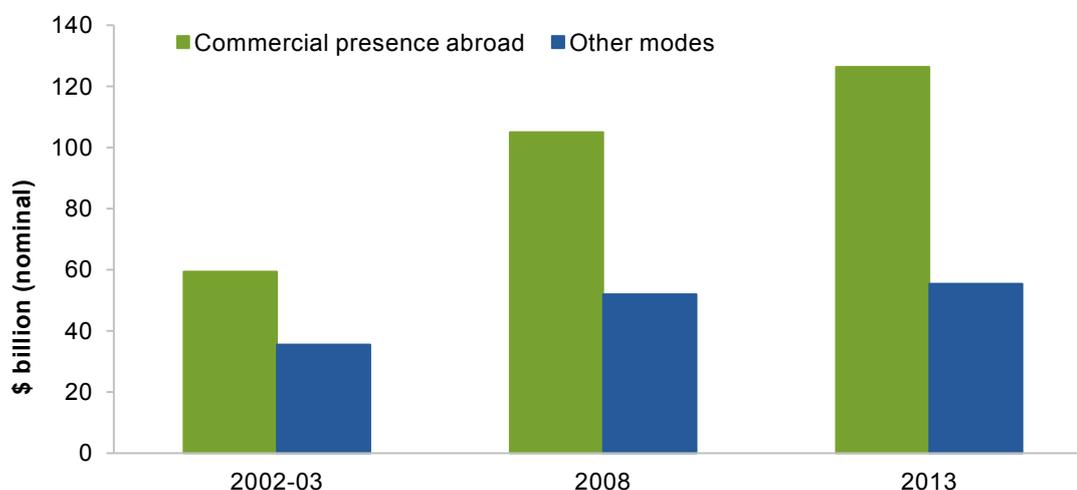
In the one-off survey of foreign affiliates of Australian companies conducted in 2002-03, the ABS estimated that the value of Australian service exports through commercial presence abroad was about \$60 billion (ABS 2004). This was almost twice the value of service exports through other modes in the same year (about \$35 billion) (ABS 2015e).<sup>2</sup>

Estimates of the value of Australian service exports through commercial presence abroad for years after 2002-03 are generally derived from direct investment abroad by service industries and are likely to be less reliable than survey data (CIE 2010; PwC, ANZ and Asialink Business 2015). Comparison of these estimates with those from the 2002-03 ABS survey suggest that between 2003 and 2013 the value of service exports through commercial presence abroad increased at a faster rate than service exports through other modes (figure 3.3).

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<sup>2</sup> For statistical purposes, a commercial presence abroad refers to an enterprise that is majority-owned by an Australian resident enterprise.

Figure 3.3 Service exports by mode of delivery<sup>a</sup>



<sup>a</sup> Foreign affiliates' sales consist of sales to residents of the country in which the foreign affiliate/commercial presence is located (exports through commercial presence abroad), and sales to residents of other countries. In 2002-03, the ABS estimated that 91 per cent of Australian foreign affiliates' sales of services were exports through commercial presence abroad. Where estimates of exports through commercial presence abroad are not available, but estimates of foreign affiliates' sales are, this study has estimated exports through commercial presence abroad based on the expectation that this percentage has been reasonably constant across sectors and over time. For statistical purposes, foreign affiliate/commercial presence refers to enterprises that are majority-owned by Australian enterprises.

Sources: ABS (*Australian Outward Foreign Affiliates Trade, 2002-03*, Cat. no. 5495.0; *International Trade in Goods and Services, Australia*, Cat. no. 5368.0); Productivity Commission estimates based on CIE (2010) and PwC et al. (2015).

Exports through commercial presence abroad are particularly significant for financial services and, to a somewhat lesser extent, professional services. Figure 3.4 reports exports for the six service sectors for 2002-03 (the most recent year for which comprehensive data on service exports through commercial presence abroad are available) and 2014-15. (Education-related travel, valued at \$18.2 billion in 2014-15, is counted as part of both education and tourism — consistent with the approach taken by the ABS in constructing Australia's balance of payments. As discussed in section 3.4, the ABS Tourism Satellite Account (TSA) uses an alternative approach to measuring tourism exports from Australia).

The lack of periodic data on Australian exports through commercial presence abroad makes it difficult to assess trends in service exports through this mode and analyse the effects of trade liberalisation. The Department of Foreign Affairs and Trade has noted:

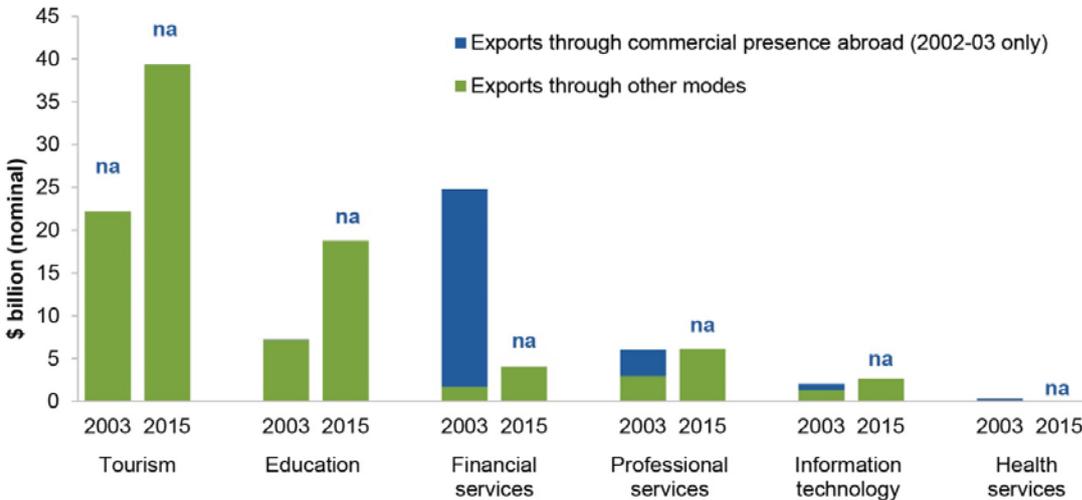
The absence of current foreign affiliate trade in services data is a major gap which impacts on analysis of trade and the benefits accruing to Australian businesses from trade liberalisation. In particular, full analysis of market access trends under Australia's North-Asia FTAs will not be possible without foreign affiliate's trade data (sub 31, p. 10).

ANZ strongly agreed that there would be benefits from inclusion of data on exports through a commercial presence abroad in official trade statistics (sub. DR45).

An ABS review of its international accounts in 2015 identified that there was strong interest from a number of stakeholders in securing more up-to-date data on exports through commercial presence abroad (as advised by the ABS, 6 October 2015).

Assessment of Australia’s service exports would be much enhanced by more comprehensive statistics — particularly in relation to the commercial presence abroad of Australian service providers.

**Figure 3.4 Australian exports by service sector<sup>a</sup>**  
2002-03 and 2014-15



<sup>a</sup> The 2002-03 value of exports of financial services through commercial presence abroad does not include margins earned by a bank from borrowing and lending (referred to as Financial Intermediation Services Indirectly Measured or 'FISIM'). In 2009-10, the estimated value of FISIM was about \$9 billion (Bingham 2011). Education-related travel (valued at \$18.2 billion in 2014-15) is counted as part of both education and tourism — consistent with the approach taken by the ABS in constructing Australia’s balance of payments. Medical tourism is counted as part of tourism and not as part of health services. The value of education exports through commercial presence abroad in 2002-03 and health service exports through modes other than commercial presence abroad in 2002-03 and 2014-15 are too small to be visible. Foreign affiliates’ sales consist of sales to residents of the country in which the foreign affiliate/commercial presence is located (exports through commercial presence abroad), and sales to residents of other countries. In 2002-03, the ABS estimated that 91 per cent of Australian foreign affiliates’ sales of services were exports through commercial presence abroad. Where estimates of exports through commercial presence abroad are not available, but estimates of foreign affiliates’ sales are, this study has estimated exports through commercial presence abroad based on the expectation that this percentage has been reasonably constant across sectors and over time. For statistical purposes, foreign affiliate/commercial presence refers to enterprises that are majority owned by Australian resident enterprises. **na** Not available (data on exports through commercial presence abroad for all sectors are not available after 2003).

Sources: Productivity Commission estimates based on ABS (*Australian Outward Foreign Affiliates Trade, 2002-03*, Cat. no. 5495.0; *International Trade in Goods and Services, Australia*, Cat. no. 5368.0); ABS (2015d).

### 3.3 Key trends and drivers of Australian service exports

This section examines general trends in service exports (excluding exports through commercial presence abroad, unless indicated otherwise) and associated drivers. The following section considers trends and drivers of exports for the six service sectors in more detail.

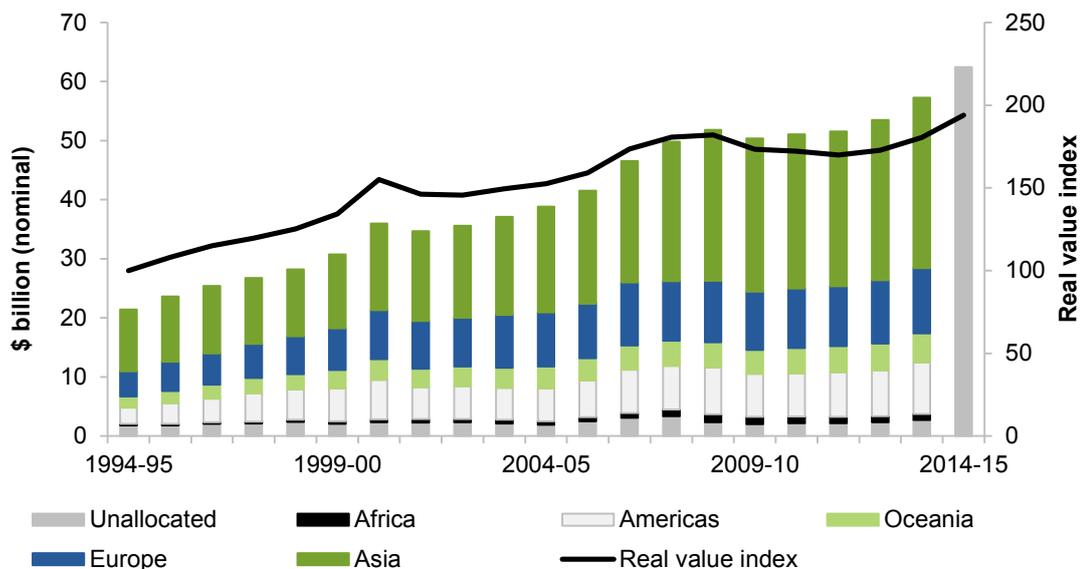
#### Service exports have doubled over the past 20 years

The total value of service exports from all sectors has roughly doubled (in real terms) over the past two decades, although the value of service exports was relatively flat from 2009-10 to 2013-14 (figure 3.5). Markets in Asia have been the fastest growing for Australian service exports, particularly China, with average annual growth in the value of service exports from Australia to China of 12 per cent over the ten years to 2014 (DFAT 2015h). There has also been strong growth in the value of Australian service exports to India, Malaysia and Singapore (DFAT, sub. 31).

The value of exports from all service sectors has grown at about the same average rate as services gross value added over the two decades since 1994-95 (ABS 2015a).

Figure 3.5 **Australian service exports, by region**

Value of exports (columns) left axis <sup>a</sup>, real value index (line) right axis

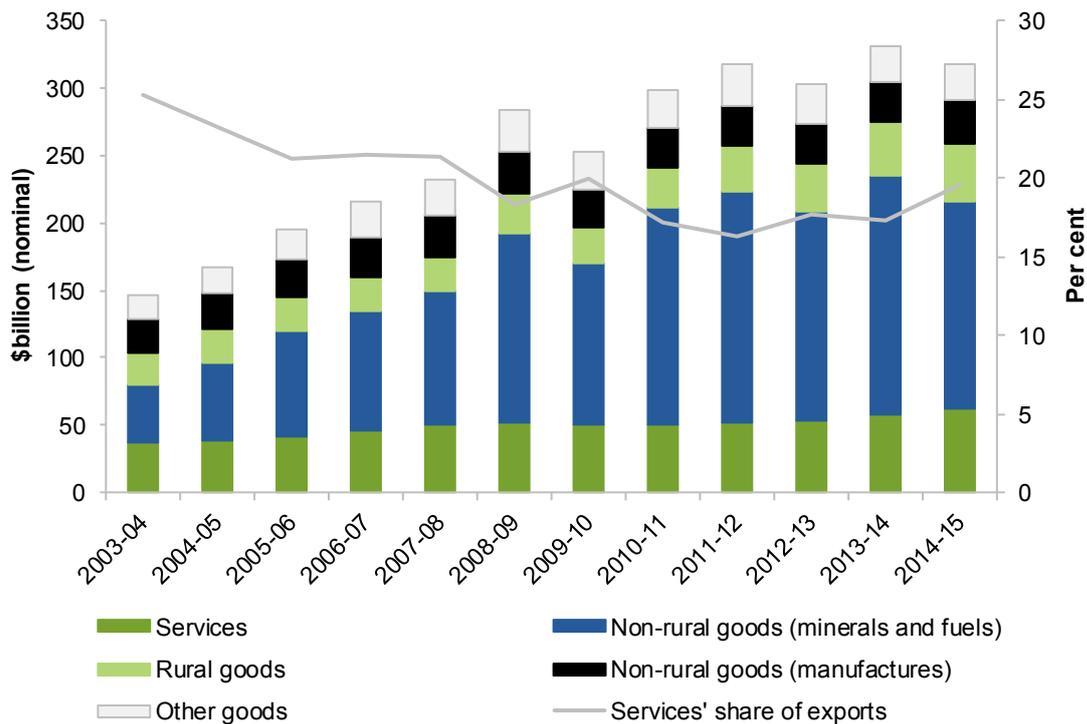


<sup>a</sup> Data on service exports by country for 2014-15 were not available at time of publication.

Sources: ABS (*Balance of Payments and International Investment Position, Australia*, Cat. no. 5302.0; *International Trade in Goods and Services, Australia*, Cat. no. 5368.0); DFAT (2015n).

Services' share of total exports declined over much of the past decade, falling from a peak of about 25 per cent in 2003-04 to a low of 16 per cent in 2011-12 (figure 3.6). This was due to both a decline in service exports in 2009-10 (figure 3.5) and an increase in goods exports driven by the mining boom.

**Figure 3.6 Value of exports by industry and services' share of exports**  
Value of exports <sup>a</sup> (columns) left axis, services' share of exports (line) right axis



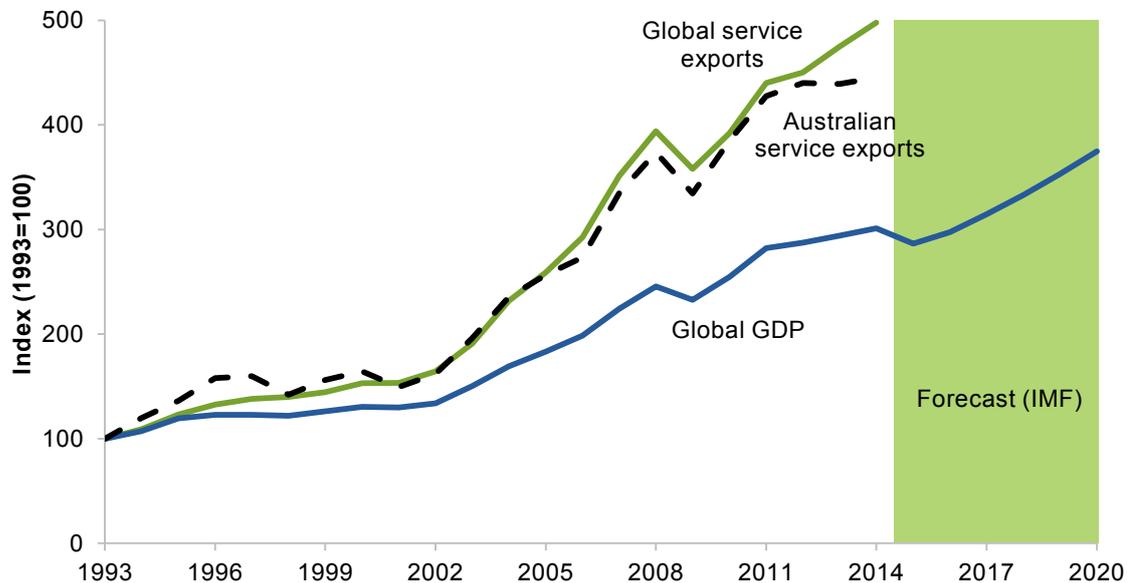
<sup>a</sup> Non-rural goods (minerals and fuels) includes metal ores and minerals, coal, coke and briquettes, other mineral fuels and metals (excluding non-monetary gold). Non-rural goods (manufactures) includes machinery, transport equipment, and other manufactures. Other goods includes net exports of goods under merchanting, non-monetary gold, goods procured in ports by carriers, and other non-rural goods including sugar and beverages.

Source: ABS (*International Trade in Goods and Services, Australia*, Cat. no. 5368.0).

Over the past two decades, global service exports and Australian service exports have largely moved together (although since 2012 growth in global service exports has outpaced Australian service exports). From 2004 to 2014, the average annual growth rate of global service exports was 8 per cent (figure 3.7).

These trends in Australian service exports reflect domestic and global drivers, including changes in global economic conditions, technology advances, productivity improvements, exchange rate movements, and changes in government policy settings in Australia and other countries.

Figure 3.7 **Australian and global service exports, and global GDP<sup>a</sup>**  
Nominal \$US



<sup>a</sup> Service exports data for 2014 is based on Balance of Payments Manual 6, data for all other years is based on Balance of Payments Manual 5.

Sources: IMF (2015); Productivity Commission estimates based on WTO (2015).

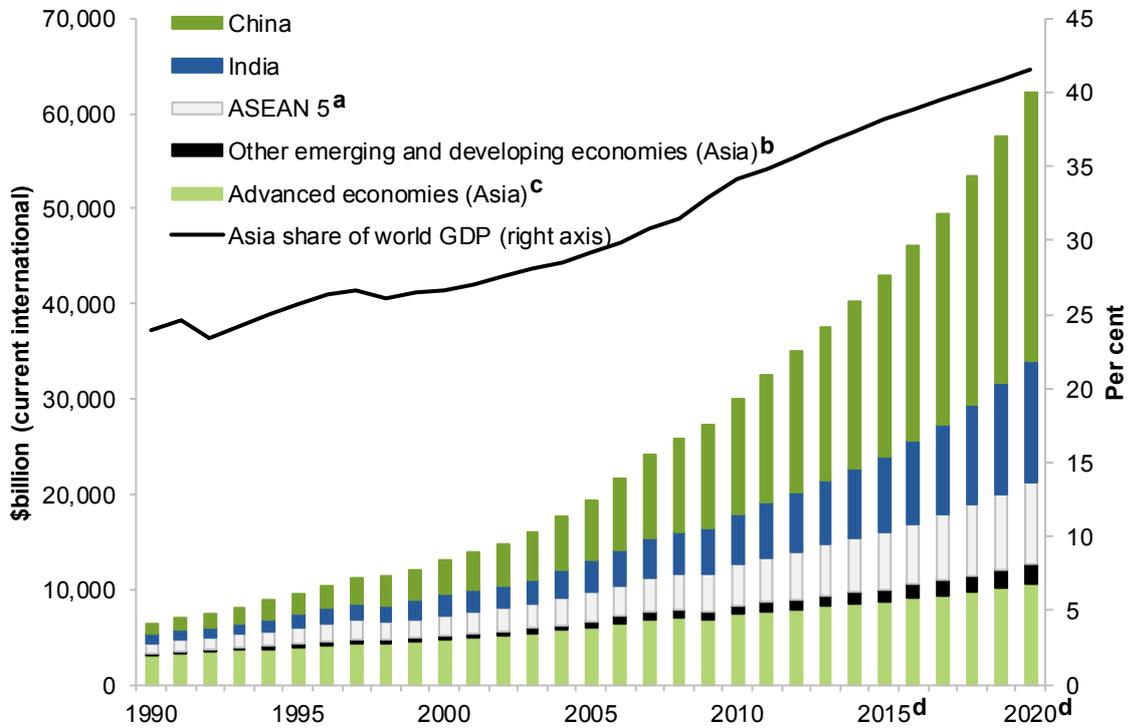
## Rising incomes in Asia are an important driver of demand for Australian services

Recent decades have seen rapid economic growth and rising incomes, particularly in Asia (figure 3.8). Real household incomes in China (as measured by Gross National Income) increased from about US\$470 per capita in 1980 to about US\$7500 per capita in 2014 (World Bank 2015b).

Rising household incomes in Asia have been an important driver of demand for service exports from Australia and globally. As incomes rise, consumers have more money to spend on goods and services and generally spend a greater share of their income on services (Jaaskela and Windsor 2011).

The IMF has forecast that global GDP will continue to grow and Asia is expected to continue to increase its share of global GDP (Auster and Foo 2015), which is likely to drive future growth in demand for service exports within the Asian region.

**Figure 3.8 Economic growth, historical and projected**  
GDP based on purchasing power parity valuation



<sup>a</sup> ASEAN 5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam. <sup>b</sup> Other emerging and developing economies (Asia) includes Bangladesh, Bhutan, Brunei Darussalam, Cambodia, Fiji, Kiribati, Lao P.D.R., Maldives, Marshall Islands, Micronesia, Mongolia, Myanmar, Nepal, Palau, Papua New Guinea, Samoa, Solomon Islands, Sri Lanka, Timor-Leste, Tonga, Tuvalu, and Vanuatu. <sup>c</sup> Advanced economies (Asia) includes Hong Kong, Japan, South Korea, Singapore and Taiwan. <sup>d</sup> Forecast (IMF). **Note:** An international dollar would buy in the cited country a comparable amount of goods and services a U.S. dollar would buy in the United States.

Source: IMF (2015).

### The global economic downturn in the late 2000s slowed export growth

While service exports have been trending upward over the past two decades due to rising global incomes, short-term fluctuations in economic conditions have resulted in periods of lower demand for services. A slump in global demand as a result of the global financial crisis is likely to have been the chief cause of the fall in both Australian and global service exports between 2008 and 2009 (figure 3.7).<sup>3</sup>

<sup>3</sup> The fall in Australian exports is exaggerated when measured in US dollars because of the weakening Australian dollar against the US dollar directly after the financial crisis.

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## The cost of trading services is falling

Travelling between countries to deliver or consume services has become significantly cheaper and more convenient. International Air Transport Association data show that the price of air travel has fallen by more than half (in real terms) over the past four decades. Although much of the fall in the real price of air transport services since the 1970s occurred before 2000, the real price of air transport has still fallen slightly since 2000 (IATA 2011; Pearce 2014). New air services have also commenced over the past decade, particularly by carriers from Asia and the Middle East. There has been significant expansion of the Middle-Eastern hubs which have the geographical ability to reach destinations anywhere in the world through nonstop services (PC 2015b).

Service providers that rely on face-to-face modes of delivery have benefited from the declining price of international air travel, and commencement of new air services. The tourism and education sectors, in particular, have benefited from lower price international air travel since about 99 per cent of international visitors travel to and from Australia by air (PC 2015b). Airfares comprise a large part of the total cost of a short-term visit by an international visitor to Australia and a smaller, but still sizable, part of the total cost of a longer-term visit (PC 2015b).

The increases in Australian and global exports over the past two decades are also due to the falling cost of trading services across borders. Technological advances in information and communications technology (ICT), including email, online video and audio calls, and online payment systems have greatly reduced the costs of trading a range of services and have allowed a wider range of service providers and consumers to come together (box 3.2). The internet allows trade in many types of services without the need for providers or consumers to be in the same physical location, avoiding travel costs (Freund and Weinhold 2002). Intran (sub. DR33) submitted that development of a national platform for internet content could provide further opportunities to export services.

Advances in ICT are also changing the way tourism services are delivered with more visitors researching and booking components of their trip on the internet, especially airfares and accommodation (PC 2015b).

Factors that affect comparative advantage and economies of scale are also important drivers of Australian service exports. For example, advances in technology mean that it is now possible to deliver a lecture once, and distribute it to any number of students over the internet — distribution is no longer restricted by the size of lecture halls, or distance between teacher and student. Education institutions that follow this online model have large economies of scale, enabling them to deliver courses to large numbers of students. Coursera, for instance, is a for-profit education company that offers ‘massive open online courses’, with course content provided by partner institutions, including three Australian universities. As of January 2014, Coursera had about 22 million enrolments from 190 countries (Coursera 2015).

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Language and cultural differences between countries can increase the cost of trading services. Research indicates that a common language between trade partners has a larger positive effect on the volume of services trade than goods trade (Hamanaka 2013). Australian evidence is consistent with this finding. In 2014, more than one third of Australian service exports were to countries where English is the first language, compared with just over 10 per cent of goods exports (DFAT 2015n; General Medical Council UK 2015). Over the past decade, the accuracy of text translation programs, such as Google Translate, has improved dramatically. In 2014, Skype — a provider of online video-calling services — launched a program that translates speech in real time. These innovations may reduce the costs of trading services between parties that speak different languages.

### **Box 3.2 Innovation in online payment platforms**

The global growth of e-commerce over the past 20 years has created demand for online payment systems. While credit cards were initially the main means for online payment, bespoke online payment services, such as Paypal, have emerged. The introduction of virtual currencies, such as Bitcoin, has provided a further means of online payment.

Online payment options allow service providers to reach a wider range of consumers, who might be less attracted to traditional credit card transactions. They also increase competitive pressures on providers of traditional payment methods (such as credit cards).

The use of online payment systems is increasing in key markets for Australian services, such as China. In 2014, McKinsey Global Institute found that the value of payments through internet payment platforms in China had an annual growth rate of 60 per cent over the five years to July 2014 — although internet payment platforms still accounted for only 0.4 per cent of total cashless payments. McKinsey found use of virtual currencies for online payments in China had been limited, with Bitcoin used mainly for speculative investment.

*Source:* Woetzel et al (2014).

## **The value of the Australian dollar affects exporters' competitiveness**

Movements in the value of the Australian dollar affect Australian service providers' ability to capture opportunities to meet rising global demand for services, as the exchange rate affects the price of Australian service exports relative to services provided by individuals or firms from other countries. In a 2013 survey of exporting Australian businesses, half of the respondents considered the high value of the Australian dollar the most important factor adversely affecting their international competitiveness (ECA and University of Sydney 2014).

The appreciation of Australia's exchange rate against the trade weighted index from the early 2000s to 2013 is likely to have contributed to the relatively slow growth in Australian service exports from 2008-09 to 2012-13. For example, it made travelling to Australia relatively more expensive and reduced the purchasing power of visitors to Australia. This may have caused some visitors to choose more affordable destinations — visitors seeking a

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beach holiday might have chosen to travel to Bali or Thailand instead of Queensland (PC 2015b). Since 2013, the value of the Australian dollar has fallen against the trade-weighted index (RBA 2015).

## **Productivity improvements are a driver of export competitiveness**

High rates of productivity growth among Australian service industries, relative to other industries in Australia and service industries in other countries, will tend to increase Australia's comparative advantage in producing and exporting those services (chapter 2). Productivity gains can arise from various sources. For example, when businesses in the same industry are concentrated in a particular area they might benefit from external economies of scale and easier diffusion of information and technology (chapter 2). Based on ABS data, productivity growth among service industries in Australia over the past 20 years has varied widely (box 3.3). For example, multifactor productivity in the financial services industry is estimated to have increased by just over 40 per cent, while multifactor productivity in the rental, hiring and real estate services industry is estimated to have decreased by more than 40 per cent.

One study found that the productivity of service industries in Australia compares favourably to other countries. Deloitte (2013) estimated that the productivity of Australia's tourism, international education, ICT, banking, and health service industries were higher than the average productivity of international competitors in those industries.

## **Service export patterns also reflect government policy settings**

Changes in government policies, both in Australia and overseas, also influence patterns of services trade. For example, the introduction of enhanced integrity measures for permanent visas in Australia in 2009 likely contributed to a decline in education exports. China implemented a tourism strategy in 2013 that encourages employers to promote the use of paid leave days, which is expected to boost outbound (and domestic) tourism (General Office of the State Council 2013). The Department of Foreign Affairs and Trade cited a number of examples where trade agreements address regulatory barriers to trade in other countries and thus could facilitate increased service exports from Australia. It noted key outcomes from trade agreements include:

... market openings for services that promote transparency and regulatory certainty in behind the border measures and institutional provisions that ensure that the legally binding commitments contained in the agreements can be enforced through dispute settlement procedures (sub. DR 49, p. 5).

Further discussion of the role of trade agreements in facilitating service exports is contained in chapter 9.

### Box 3.3 Productivity growth has varied between service industries

Productivity is the efficiency with which firms, organisations, industries, and the economy as a whole, convert labour, capital and raw materials into output. Multifactor productivity measures the growth in value added output per unit of labour and capital input used. According to ABS estimates, multifactor productivity growth has varied widely between Australian service industries over the past two decades (see figure below).

The calculation of multifactor productivity typically requires independent measures of inputs and output. For Australia, this can only be done for 16 industries, which the ABS terms the ‘market sector’. For industries such as health care and education where independent measures of output are not available — the value of output is estimated as the sum of the cost of inputs — the ABS does not calculate multifactor productivity (Gordon, Zhao and Gretton 2015).

Estimating productivity for the tourism sector is complex, as tourism includes many different industries that provide tourism goods and services to visitors (PC 2015b). Tourism Research Australia estimated that multifactor productivity for the tourism sector (including only market sector industries) increased by 5 per cent between 1998-99 and 2012-13 (TRA 2014).

#### Change in multifactor productivity in service industries, 1994-95 to 2013-14

ABS estimates



Note: Gross value added, quality adjusted hours worked basis.

Source: ABS (*Estimates of Industry Multifactor Productivity, 2013-14*, Cat. no. 5260.0.55.002).

## 3.4 Trends and drivers: sectoral analysis

### There has been strong growth in tourism exports

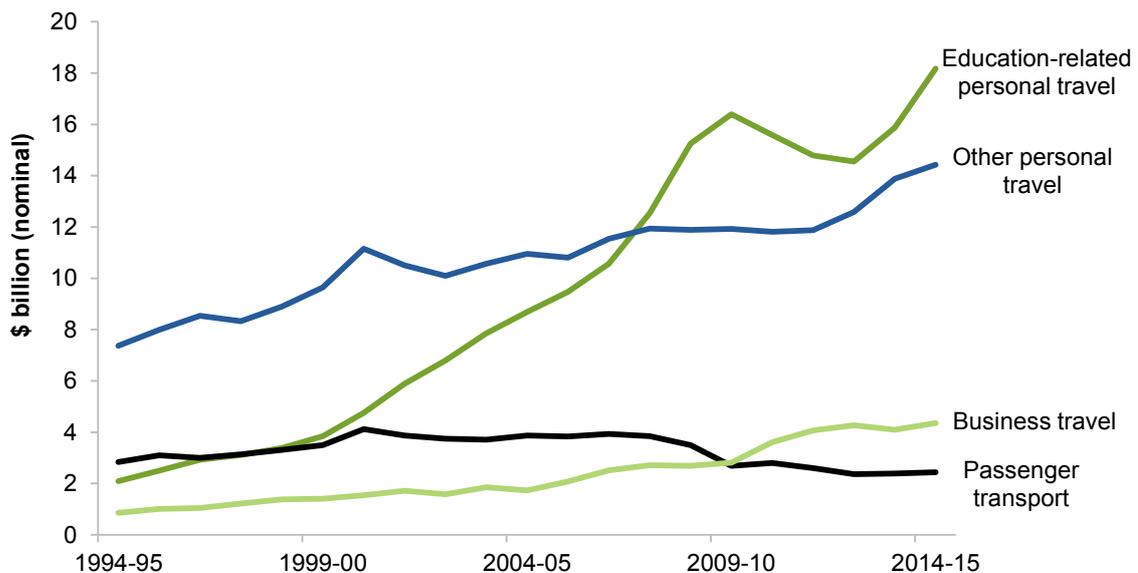
The value of Australian tourism exports was about \$39 billion in 2014-15 (ABS 2015e). This includes the value of expenditure by international students in Australia (‘education-related personal travel’). (Education-related personal travel is also included in education exports — consistent with the approach taken by the ABS in constructing Australia’s balance of payments.)

The ABS Tourism Satellite Account uses an alternative approach to measuring tourism exports than that used for the balance of payments and excludes education-related personal travel by students who stay in Australia for more than one year. In 2013-14, the most recent year for which TSA data are currently available, the value of international tourism consumption was \$27 billion under the TSA (ABS 2014a). The value of tourism exports under the balance of payments in the same year was \$36 billion (ABS 2015e).

There has been strong growth in Australian international tourism over the past two decades. The number of international visitors travelling to Australia rose from 3.5 million in 1994-95 to over 7 million in 2014-15 (ABS 2015g). The nominal value of tourism exports has grown by an average of 6 per cent per year over this period (ABS 2015e). This strong growth is due mostly to increases in education-related personal travel and ‘other personal travel’ (which includes expenditure by those visiting Australia for a holiday, to visit friends and relatives, and for health-related reasons) (figure 3.9). While a much larger number of visitors come to Australia for ‘other personal’ reasons than for education, the value of exports of education-related personal travel is higher, as those coming to Australia for education tend to stay about five times as long, and spend much more (PC 2015f).

The Association of Australian Convention Bureaux has highlighted that international business events (such as meetings, employee incentive programs, conventions, and exhibitions) is a fast growing component of Australia’s visitor economy (sub 15; Deloitte Access Economics (2014)).

**Figure 3.9 Australian tourism exports by segment**  
1994-95 to 2014-15



Source: ABS (*International Trade in Goods and Services, Australia*, Cat. no 5368.0).

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New Zealand was the largest source market for international visitors to Australia in 2014-15, followed by China. Over the past decade, the growth in the number of visitors to Australia has mostly come from developing countries in Asia, particularly China, and New Zealand (figure 3.10). China is likely to continue to be a significant source of growth in visitor numbers as real incomes in China continue to rise. The proportion of international visitors who travel to Australia to visit their friends and relatives has increased from 21 per cent to 28 per cent between 2005-06 and 2014-15 (PC 2015a; Tourism Research Australia 2015 unpublished). Increased migration to Australia contributed to this growth, as friends and relatives of migrants may visit them in Australia (Seetaram and Dwyer 2009; Seetaram 2012).

The number of visitors travelling from Japan to Australia declined by about 50 per cent between 2004-05 and 2014-15. Although the number of visitors from Japan who travel overseas has remained largely unchanged over the past decade, they are increasingly travelling to short-haul destinations in northeast Asia. This could be due to a range of reasons such as the effects on demand of the 1997 Asian financial crisis. Some studies have found that repeat visitors are less likely to travel to long-haul destinations (such as Australia for Japanese visitors) compared with short-haul destinations (PC 2015b).

### Drivers of Australian tourism exports

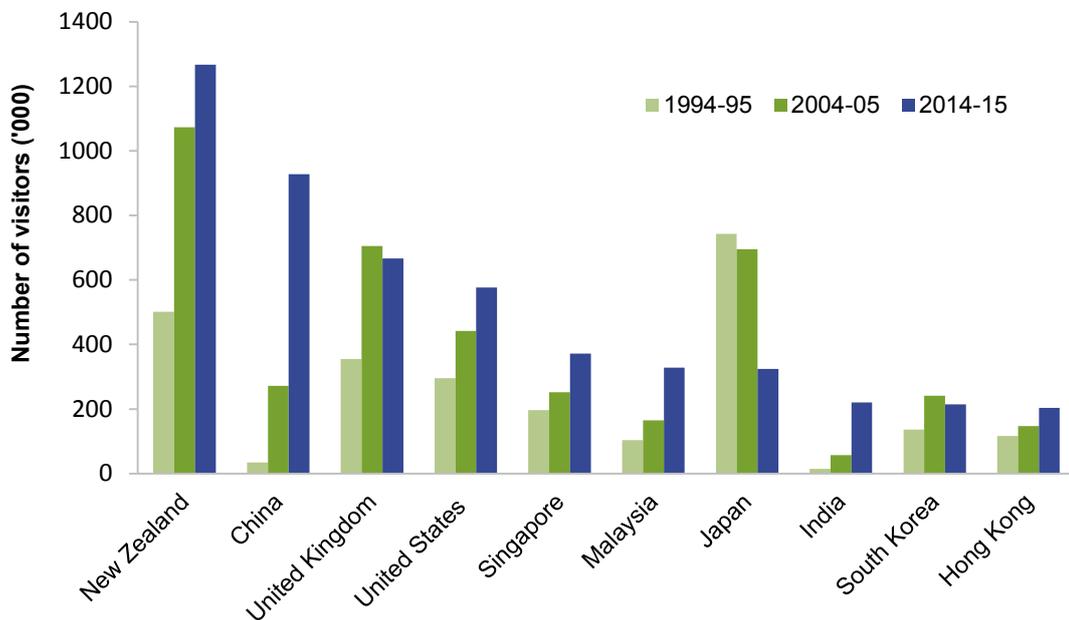
Drivers of demand for Australian tourism exports include the income and preferences of potential visitors, and the relative price of visiting Australia, including the price of air travel (section 3.3). The Commission examined the drivers of Australian tourism exports in more detail in its 2015 research paper on international tourism (PC 2015b).

Numerous factors influence the preferences of visitors, including ‘destination marketing’ undertaken by national tourism bodies (Kulendran and Dwyer 2009), the study preferences of international students (see below), country of origin, purpose of travel, demographics, sociocultural factors and perceptions of a destination’s tourism assets and amenities (Lohmann and Beer 2013). In a 2014 survey, ‘world class beauty and natural environments’ was rated by Chinese consumers as the most important factor, and by Indian consumers as the second most important factor, in selecting a holiday destination (Tourism Australia 2014a, 2014b). High-quality infrastructure in areas such as national parks is also important for attracting visitors to Australia.

Visitors from China lead the world in total international tourism expenditure (UNWTO 2015). As a result, there is strong competition amongst countries to maintain or increase their share of visitors from China. Tourism agencies in many countries, including the United Kingdom and the United States, are running international destination marketing and other programs focused on attracting visitors from China (Brand USA 2014a, 2014b; British Tourist Authority 2014; Visit Britain 2015). India, Thailand and the United Kingdom, have implemented reforms over the past few years to improve visa arrangements, particularly for visitors from emerging Asian markets, to facilitate growth in visitor numbers (PC 2015a; TTF, sub. 25). The Australian Tourism Export Council

(sub. 16) noted that the number of travellers needing a traditional visa to visit an international destination fell from 77 to 63 per cent over the past four years — the result of restrictions being lifted, an easing of requirements to get a visa on arrival and the waiving of visa requirements altogether. A Chinese survey found that ‘most Chinese tourists admit that visa applications influence their travel plans’ (Australian Tourism Export Council, sub. 16, p. 5) — a sentiment echoed in other submissions as an important influence on the decision to travel to Australia (Advance Cairns, sub. 13; NTA, sub. 11).

**Figure 3.10 Short-term visitors to Australia<sup>a</sup>**  
Top ten source countries in 2014-15



<sup>a</sup> Arrivals of visitors that stay in Australia for less than one year. Includes visitors coming to Australia for any purpose — including tourism, visiting friends and relatives, business, education and health reasons.

Source: ABS (*Overseas Arrivals and Departures, Australia*, Cat. no. 3401.0).

The relative price of goods and services in Australia is also an important factor influencing visitors’ decisions to choose Australia over competitor destinations. Some participants in the Commission’s tourism research paper argued that Australia was a relatively high cost destination and that this adversely affects Australia’s tourism sector (PC 2015b). Relative prices are particularly influential for highly mobile visitors who have discretion over their choice of destination. People travelling for education or a holiday have more discretion over whether and where they travel, and are likely to be more sensitive to differences in price than people travelling for business.

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## Education exports are mostly to Asia

In 2014-15 the total value of Australian education exports was around \$19 billion, or about 30 per cent of total Australian service exports from all sectors (ABS 2015e). (Education-related travel accounted for about 97 per cent of the total value of Australian education exports.) Australian education institutions provide a range of education services to international students, from school level (primary and high school), to English language courses, vocational education and training (VET), and higher education. Australian exports of education services have increased significantly over the past two decades — growing at a nominal average annual rate of 12 per cent — despite falling between 2009-10 and 2012-13 (ABS 2015e).

About three quarters of international students enrolled with Australian education providers are studying in Australia (table 3.2). The value of Australian exports to onshore international students (‘education-related personal travel’) has grown rapidly over the past two decades (figure 3.9). This includes not just expenditure on course fees, but all expenditure by international students in Australia, including on accommodation, food and transport.

Students from Asia accounted for about three quarters of all international student enrolments in Australia in 2014 (DET 2015a). In that year, students from China and India accounted for the largest proportion of enrolments — 26 per cent and 11 per cent respectively (DET 2015a). The countries that account for the most student enrolments vary by the type of education institution — China is the largest source country for higher education enrolments, India is the largest source country for VET enrolments, while the main source countries for primary and secondary school enrolments are China, South Korea, and Vietnam (DFAT 2015m). Over the past decade, developing countries in Asia have accounted for most of the growth in Australian education-related travel exports (figure 3.11).

The remaining quarter are studying offshore, either at foreign campuses or through distance education, including online courses. In 2014, there were more than 160 000 international students studying with Australian education providers offshore — either at foreign campuses (about 85 per cent) or through distance education (about 15 per cent) (table 3.2). The vast majority of offshore students are based in Asian countries (AEI 2014b; DET 2015e). In 2014-15, the value of Australian education exports through cross-border supply and fly-in/fly-out was \$570 million (ABS 2015e). This includes only part of Australian offshore education exports — revenue from students enrolled at foreign campuses controlled by Australian education institutions is not included.

**Table 3.2 International student enrolments with Australian education institutions<sup>a</sup>**

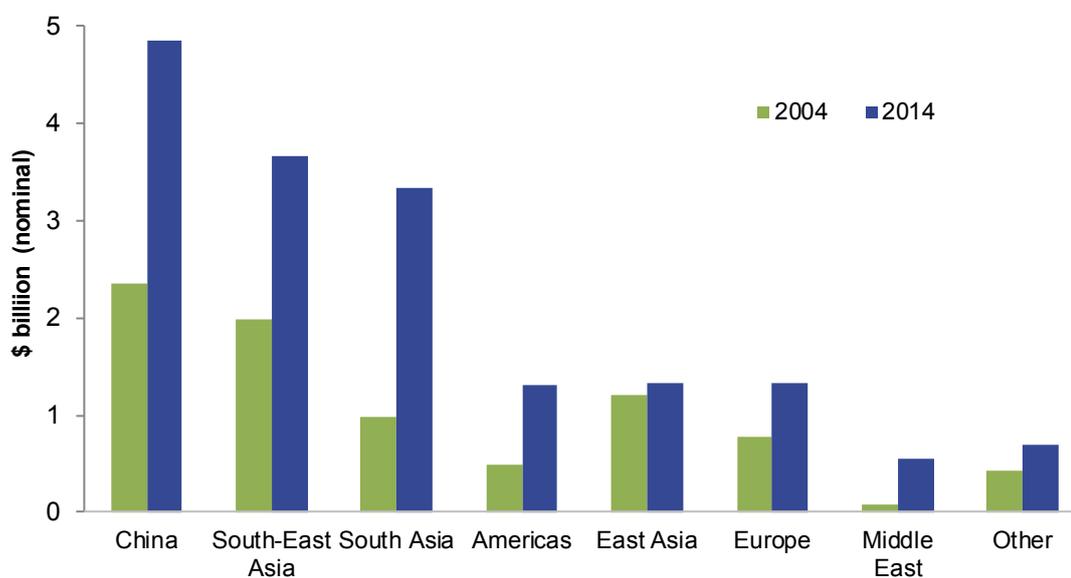
2014

<i>Sector</i>	<i>In Australia<sup>b</sup> (onshore)</i>	<i>Foreign campus (offshore)</i>	<i>Distance education (offshore)</i>	<i>Total</i>
Higher education	250 000	86 000	26 000	361 000
Vocational education and training (VET)	150 000	49 000 <sup>c</sup>	na <sup>d</sup>	199 000
School education	18 000	..	..	18 000
English language	137 000	na	na	137 000
Other <sup>e</sup>	34 000	na	na	34 000
Total	590 000	135 000	26 000	751 000

<sup>a</sup> Students may enrol in more than one course during a year. Numbers rounded to the nearest thousand. <sup>b</sup> Excludes students from New Zealand. <sup>c</sup> Relates to 2013. Excludes students studying with private VET providers (estimated at about 7000 students in 2011 in a pilot survey). <sup>d</sup> In 2013, there were 90 offshore enrolments in public VET courses delivered solely online. Data for private VET providers are not available. <sup>e</sup> Includes enabling, foundation, bridging and non-award courses. na Not available. .. Not applicable.

Sources: AEI (2012, 2014b); DET (2015a, 2015e, 2015g).

**Figure 3.11 Australia education-related travel exports, by region<sup>a</sup>**



<sup>a</sup> China includes Hong Kong and Macao.

Source: ABS (International Trade in Services by Country, by State and by Detailed Services Category, Calendar Year, 2014, Cat. no. 5368.055.004).

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## Drivers of Australian education exports

The quality and reputation of education institutions, and the potential for international students to obtain permanent residency in Australia after studying here, are important drivers of Australian education exports. Increased demand as a result of rapidly rising incomes in Asia (section 3.3) has also been important. From 2000 to 2012, the number of international tertiary students globally grew by more than 5 per cent a year on average, and Asia has been the source of most of this growth (Productivity Commission estimate based on OECD 2000, 2014a). The Commission examined the drivers of Australian education exports in more detail in its study of international education services, finding that key factors influencing where students choose to study include the reputation of the provider (and the quality of the learning experience it offers) and the cost of studying in Australia (PC 2015f). Participants in this study also raised the importance of quality as a factor in the choice of which education institution to attend (ABDC, sub. 21; ACPET, sub. 8; Export Council of Australia, sub. 32; Universities Australia, sub. 17).

Several studies have found that institutional quality is a key factor affecting the country in which international tertiary students choose to study (Beine, Noël and Ragot 2013; Hobsons EMEA 2014; Kahanec and Králiková 2011). In 2012, six countries accounted for more than half of all international university enrolments — the United States (16 per cent), the United Kingdom (13 per cent), Germany, France, Australia and Canada (each about 6 per cent) (OECD 2014a). Competition for international students is intensifying as foreign governments and institutions (including in emerging markets) invest in onshore and offshore education services (Australian Government 2015c). Countries in Asia and the Middle East are investing heavily in higher education systems. China is also actively engaged in improving the range and quality of its domestic education services (PC 2015f).

Although education quality is clearly an important driver of education exports, the means by which international students assess quality is less clear. Universities Australia argued that the export success of Australian universities requires (among other things) ‘a strong and successful research program which delivers high standings in university rankings’ (sub. 17, p. 1). This sentiment is supported by a survey conducted by Hobsons EMEA (2014), which found that academic reputation ranking was the most important factor for students intending to study in the United Kingdom, and the fourth most important factor for students intending to study in Australia. In a study based on UK data, Soo (2013) found that university rankings may not have an influence on international student applications, and that word-of-mouth recommendations are an important influence. Australian-based research also points to the importance of word-of-mouth recommendations (Abubakar, Shanka and Muuka 2010).

Studying in Australia can be a pathway to permanent residency in Australia for international students. As of August 2015, just under one third of those with a student visa expiring between 1 July 2006 and 30 June 2011 had gone on to get a permanent or provisional visa (Department of Immigration and Border Protection, unpublished data, 21 September 2015). Blackmore et al. (2014) and Tremblay (2005) found that the potential

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for obtaining permanent residency in the host country is a key factor in the choice of study destination for many international students. The Department of Immigration and Border Protection identified that some of the rapid growth in the number of Australian student visas issued between 2007 and 2009 resulted from non-genuine students applying for student visas as a ‘back door’ to permanent residency (DIBP 2015n). There was a pattern of students choosing VET courses that provided the easiest path to a permanent visa, such as cookery and hairdressing courses (DIBP 2015n). In response, the Australian Government introduced ‘enhanced integrity measures’ in 2009 and 2010, including tightening the list of occupations for the skilled migration program (Koleth 2010). International enrolments in VET courses in Australia fell by about a third between 2010 and 2013 (DET 2015a), although other factors — including a small number of highly publicised attacks on (mainly Indian) international students — may also have contributed to this fall. International student enrolments in Australia were higher in all sectors (including VET) in 2014 than in 2013, with total onshore enrolments increasing from 525 000 to 590 000 (DET 2015a).

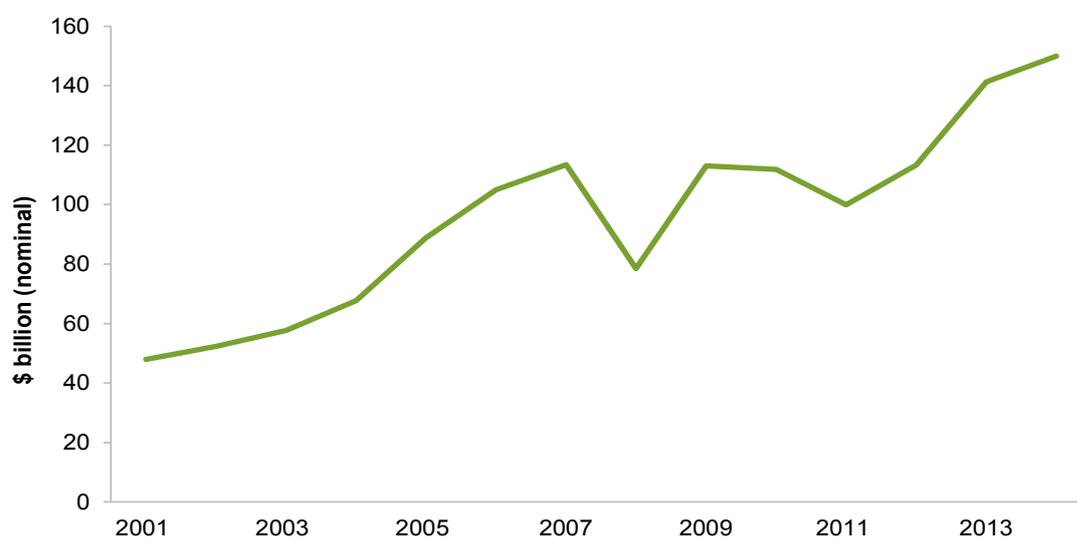
### **Financial service exports are mostly to English-speaking countries**

Commercial presence abroad is particularly important as a mode of export for the financial service sector. In 2009-10, the value of exports of financial services through this mode was over \$35 billion (Bingham 2011). In 2014-15, the value of financial service exports (excluding exports through commercial presence abroad) was \$4.1 billion (ABS 2015e).

In 2009-10, exports through commercial presence abroad accounted for more than 95 per cent of financial service exports through all modes (ABS 2015c; Bingham 2011). There are several explanations for the relative importance of commercial presence abroad as a mode of export for Australian financial services. Auster and Foo (2015) stated that a commercial presence abroad may be necessary for a financial services firm to build trust with retail customers, or to comply with the requirements of local regulators. The Australian Financial Markets Association (sub. 14) stated that exports through commercial presence abroad may reflect barriers to cross-border supply of financial services.

Movements in the stock of Australian outward foreign direct investment (FDI) in financial services have been used as a proxy for movements in exports through commercial presence abroad, given the limited data available (AFMA, sub. 14). This approach suggests that exports of financial services through commercial presence abroad followed an upward trend between 2001 and 2014, but with limited growth between 2007 and 2012 due to the global financial crisis (figure 3.12). The value of financial service exports through other modes increased by about 70 per cent over the same period, despite falling substantially during the global financial crisis (ABS 2015c).

Figure 3.12 **Stock of Australian outward FDI in financial services<sup>a</sup>**  
2001–2014



<sup>a</sup> FDI: foreign direct investment as of 31 December.

Source: ABS (*International Investment Position, Australia: Supplementary Statistics*, Cat. no. 5352.0).

In 2009-10, more than three quarters of Australia's financial service exports through commercial presence abroad were to countries where English is the first language (compared to about one third of all Australian service exports) (Bingham 2011; DFAT 2015n; General Medical Council UK 2015). The three largest markets were New Zealand, the United Kingdom and the United States, each accounting for about 20–25 per cent of exports (Bingham 2011). The next largest was Hong Kong, which accounted for 10 per cent of financial service exports through commercial presence abroad (Bingham 2011). In Hong Kong, English is often used in business — especially in Hong Kong's sizable financial services sector.

In 2009-10, the value of exports of insurance services was much larger than the value of exports of any other type of financial service, accounting for more than half of Australian financial service exports through commercial presence abroad (about \$18 billion) (Bingham 2011). Three companies account for most of the value of Australian exports of insurance services — QBE Insurance Group, Insurance Australia Group and Suncorp Group. All three have a large commercial presence in New Zealand. QBE also has a large commercial presence in Asia, Europe and the United States. In 2014, QBE earned more than \$12 billion in premium income in markets outside Australia and New Zealand (QBE 2014).

The margins earned by financial institutions from borrowing and lending (referred to as Financial Intermediation Services Indirectly Measured or 'FISIM') also accounted for a large part of exports through commercial presence abroad in 2009-10 (a little over

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\$9 billion) (Bingham 2011). The value of exports of credit granting services (\$2.3 billion) and portfolio management services (\$1.3 billion) were also significant (Bingham 2011).

### Drivers of financial service exports

The volume of goods and services trade is a key driver of financial service exports. Currency exchange and hedging products are necessary to facilitate trade between countries with different currencies. Banks can provide trade finance to foreign clients to assist with the import and export of products. Firms exporting through commercial presence abroad require banking services in multiple countries — some Australian banks, including ANZ and Westpac, have responded to growing demand by opening more branches and offering a broader range of financial services in the Asia–Pacific region (box 3.4).

Over the past few decades, rapid income growth in Asia has also led to greater individual wealth — increasing demand for fund management services. Investing in offshore funds is a way for investors to diversify their portfolios (APEC 2014b). Growth in the wealth of ‘ultra-high net worth individuals’ (individuals with investable assets of US\$30 million or more, who are more likely to be seeking international diversification) is a key driver of demand for exports of funds management services. From 2009 to 2014, the wealth of ultra-high net worth individuals in the Asia–Pacific region grew at an average annual rate of 13 per cent (compared with 6 per cent in other regions) and the number of ultra-high net worth individuals in the region grew at an average annual rate of 12 per cent (Capgemini and RBC Wealth Management 2015).

Technological change has lowered the cost of delivering financial services such as insurance, loans and brokerage, with these services now commonly provided online. The development of new products in the financial service sector may also influence the demand for financial service exports. The development and increasing popularity of exchange-traded funds, which give investors low-cost exposure to overseas markets, may reduce investors’ appetite for other means of gaining exposure to overseas markets, such as offshore investment advisors and financial products (Auster and Foo 2015).

Tax and other regulatory settings are among the factors that investors consider when deciding where to locate and how to structure their investments. Countries such as Ireland and Singapore have been able to attract foreign funds to their financial sectors partly because they levy lower taxes than competitor countries on financial service exports (Access Economics 2007; APEC 2014b). Tax and regulatory settings are discussed further in chapter 6.

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### Box 3.4 ANZ's expansion in the Asia-Pacific

In 2008, ANZ launched its Super Regional Strategy — focused on Australia, New Zealand and the Asia-Pacific — in response to shifting growth in demand for banking services. Between 2007 and 2012, ANZ:

- increased its Asia-Pacific customer base from less than 1 million to 2.6 million
- opened more than 70 branches in Asia (in addition to 30 existing branches)
- obtained new licences to provide a wider range of services in countries such as the Philippines and Vietnam
- introduced new technology infrastructure, including cross-border systems in trade, cash management, capital markets and foreign exchange
- invested in its offshore operations and technology centres in Bangalore, India (which in 2012 had more than 5000 staff) and established new centres in Chengdu, in China, and Manila (ANZ 2012).

ANZ considers that, in addition to responding to existing demand for banking services, its regional expansion can facilitate exports by small- and medium-sized businesses. It stated that: 'the presence of a trusted bank or lawyer in a foreign market makes exporting easier for new entrants' (sub. 23, p. 3).

ANZ now has a presence in 33 countries — including 15 in Asia and 12 in the Pacific — and 26 000 employees outside Australia, which is more than half its total workforce (sub. 23).

## North America is the largest market for professional service exports

It is estimated that the value of Australian exports of professional services in 2014-15 was about \$6.1 billion (figure 3.4) (ABS 2015e). This includes services provided by engineers, architects, accountants, lawyers, management consultants, advertisers, market researchers and other professionals. The nominal value of professional service exports has grown rapidly over the past two decades, averaging 10 per cent annual growth (ABS 2015e).

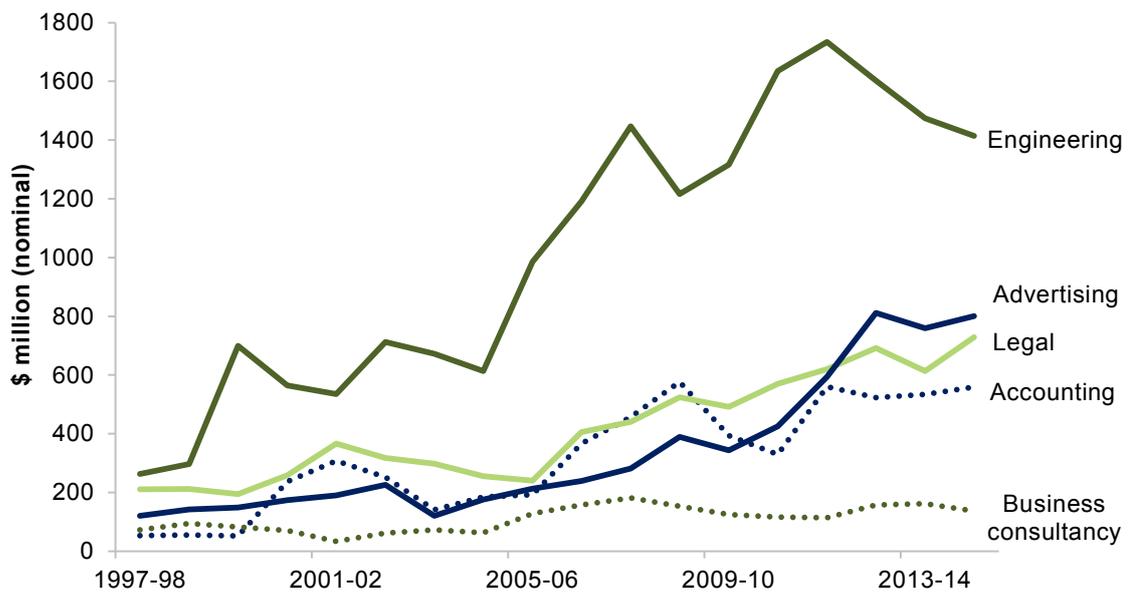
Engineers accounted for the greatest value of service exports of any professional group in 2014-15, despite a fall in the value of engineering exports over the previous few years (ABS 2015e). The rapid growth in the value of professional service exports over the past two decades is partly due to a sharp increase in the value of engineering service exports between 1997-98 and 2011-12 (figure 3.13). The Western Australian government estimated that exports of specialist mining services from Australia increased from \$65 million from 2006-07 to \$250 million in 2012-13 (sub. DR41).

Exports of professional services through commercial presence abroad are also significant. In 2002-03, their estimated value was about \$3 billion (ABS 2004), which in that year was similar to the value of professional service exports through other modes (ABS 2015c).

North America is the largest export market for Australian professional services. A 2015 survey by the Export Council of Australia (sub. 32) found that the top three markets

(by revenue) for Australian exporters of professional services were the United States, China and Singapore. Other surveys of engineering service exports and of legal service exporters have exposed similar patterns. North America was the largest export market for both professions; East and South-East Asia (and Europe) were also important (Engineers Australia 2009; Law Council of Australia 2014).

**Figure 3.13 Australian exports of selected professional services<sup>a</sup>**  
1997-98 to 2014-15



<sup>a</sup> Advertising includes market research and opinion polling services.

Source: ABS (*International Trade in Goods and Services, Australia*, Cat. no 5368.0).

Data on Australian legal service exports suggest that the mode of export depends on the export market. In 2010-11, about three quarters of the value of Australian legal service exports was exported through cross-border supply, and less than 20 per cent was exported through commercial presence abroad (Law Council of Australia 2014). A 2008-09 survey found that, although North America was the largest market for Australian legal service exports, no Australian law firms had a commercial presence there (ILSAC 2012). In releasing the survey results, the International Legal Services Advisory Council noted that:

... establishing a commercial presence ... is not crucial in servicing mature markets (the United States is an example) unless mature markets are used as hubs to service the region (the United Kingdom). However, establishing a branch office is important in developing markets where legal services by branch offices are supplemented by services provided by telecommunication systems and flying-in, flying-out expertise. (ILSAC 2012, p. 4)

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## Drivers of professional service exports

The costs of trading services (section 3.3) are an important driver of professional service exports. A 2013 global survey of managers and business professionals found that IT and communications infrastructure — which affect the costs of trading services, particularly for exports through cross-border supply — were considered to be among the most important drivers of competitiveness in all professional services (Evans, Burritt and Guthrie 2014). One example of the costs of trading services driving professional service exports is the increase (since the mid 2000s) in the number of websites that facilitate outsourcing, such as Upwork and Freelancer. These websites enable professionals to market themselves internationally at very low cost, including through user-ratings systems.

Professional service exports, such as architecture, engineering and legal services tend to follow investment flows (box 3.5). Investment in infrastructure and other large-scale construction projects is a key driver of demand for engineering services globally. Australian exports of engineering, and other construction, services fell during the global financial crisis, due to fewer construction projects globally and increased competition for these projects (Austrade 2014c). The International Legal Services Advisory Council has found that investment flows are also an important driver of demand for legal service exports (ILSAC 2008). This is because key areas of legal service exports — such as mergers and acquisitions, and intellectual property — are closely linked to investment.

### **Box 3.5 Investment drives demand for architecture exports**

Investment in the built environment in other countries (particularly in the Asia–Pacific and, to a lesser extent, the Middle East) drives demand for Australian exports of architectural services. Large, specialised projects such as sports stadiums and airports are particularly likely to attract international architecture firms. Such projects are often funded by government, so governments' investment priorities are a key driver of demand.

Cox Architecture is an Australian company that has exported its services (including designs for sports stadiums and exhibition centres) to Asia, Europe and the Middle East. As of 2015, the firm's most significant international markets were Malaysia, New Zealand, China and Singapore.

Architecture firms often provide a broad range of services. For example, Populous is a global architecture firm that designs major public infrastructure venues such as stadiums, arenas and convention centres, as well as providing planning services for major international events, such as Olympic games. While Populous has offices in six countries, including in three countries in Asia, it directs and manages all work in the Asia–Pacific from its Australian base (ECA, sub. 32; Populous 2015). As a result, investment in major events in the Asia–Pacific is the key demand driver for Populous' exports from Australia.

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## IT consultancy accounts for two thirds of IT service exports

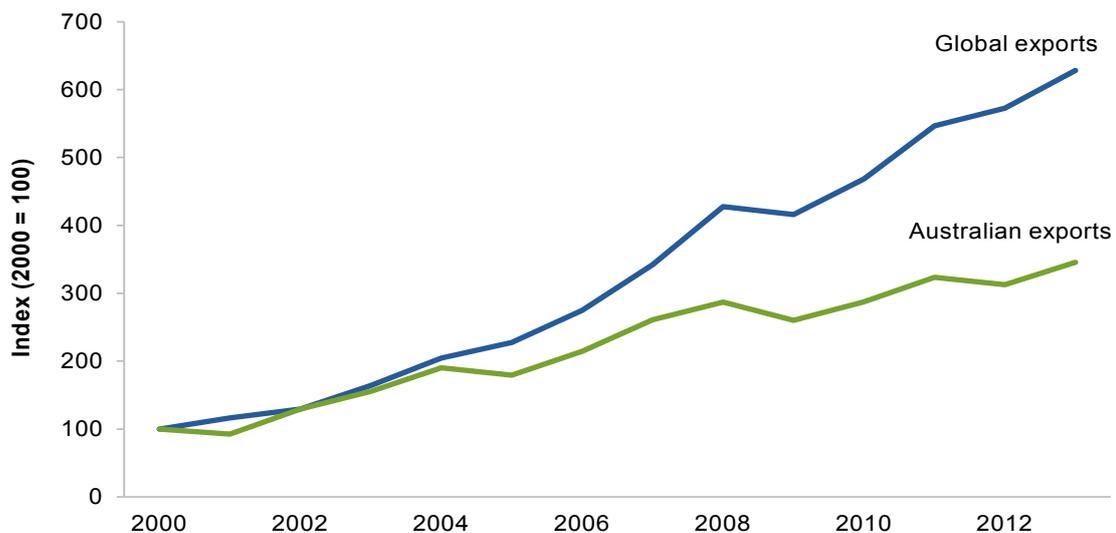
In 2014-15, the value of Australian IT service exports was \$2.7 billion (ABS 2015e). This is less than 1 per cent of global IT service exports, which were valued at almost US\$300 billion in 2013 (WTO 2015). Since 2000, the value of Australian exports of IT services has grown, but has not kept pace with growth in the value of global exports (figure 3.14).

IT consultancy services (hardware and software) accounted for about two thirds of total Australian IT service exports in 2014-15 (\$1.7 billion). Exports of software licenses were significant in that year too, valued at \$320 million (ABS 2015e).

Available data on the destination of Australian IT service exports are sparse. A 2015 survey by the Export Council of Australia found that the top three markets (by revenue) for Australian IT exporters were all English-speaking countries — the United States, the United Kingdom and New Zealand (ECA, sub. 32).

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Figure 3.14 **Australian and global exports of IT services<sup>a</sup>**



<sup>a</sup> Measured in nominal US\$. IT defined as 'computer and information services'.

Source: WTO (2015).

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## Drivers of IT service exports

Advances in technology, which have allowed the creation of new hardware and software, are a driver of IT exports. For example, advances in battery technology and exponential growth in computing power have allowed the creation (and export) of new electronic products including smartphones and tablets. In turn, the spread of electronic products has led to a boom in software development for these devices. This boom is reflected in the

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quantity of smartphone and tablet software (apps) available in Apple's iOS App Store. Between 2008 and 2014, the number of apps available grew from 500 to 1.2 million, and over this period more than 75 billion apps were downloaded from the store (Apple 2013; Perez 2014). Advances in technology have also allowed for the creation of innovative online platforms — for example, Aconex is an Australian company that provides online management of documents and other information for construction projects. Aconex services over 6000 projects across 65 countries, and has offices throughout the Americas, Europe and Asia (Austrade nd).

IT consultancy services account for most of the value of Australian IT service exports. Exports of consultancy services may be linked with software distribution. For example, Opmantek is an Australian company that develops network management software. The software is available to companies around the world at no charge, and Opmantek generates revenue by providing customisation and support services to those using the software (Opmantek nd).

### **Health-related services are a small contributor to service exports**

Australian exporters are meeting the increasing demand for health services through commercial presence abroad, medical tourism, and the provision of education and training services in health-related disciplines.

In 2002-03, commercial presence abroad was the dominant mode for Australian health service exports. In that year, the value of health service exports through commercial presence abroad was \$330 million (ABS 2004). Although more recent data are not available, it is likely that this remains the dominant mode for Australian health service exports. For example, Ramsay Health Care — the largest operator of private hospitals in Australia — operates more than one hundred hospitals across France, Indonesia, Malaysia and the United Kingdom (Ramsay Health Care 2015a).

There are limited data available on medical-related travel to Australia. Tourism Research Australia estimated that in 2014-15, there were around 11 700 visitors to Australia for medical reasons, which was only about 0.2 per cent of the total number of visitors to Australia in that year. These visitors' total expenditure — including airfares, accommodation, medical treatment and care, and other goods and services purchased — was approximately \$58 million (Deloitte Access Economics 2011; Tourism Research Australia 2015 unpublished data).

Most people visiting Australia for medical reasons come on visitor visas rather than medical visas (chapter 7). In 2014-15, Australia issued about 2900 medical visas — equal to about 25 per cent of those people estimated to have visited Australia for medical-related reasons (DIBP 2015h; Tourism Research Australia 2015 unpublished data).

The main source markets for medical-related travel to Australia between 2009-10 and 2014-15 were countries in Australia's immediate region — New Zealand, as well as Pacific nations such as Papua New Guinea, New Caledonia, Vanuatu and East Timor.

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These countries accounted for about two thirds of the total number of visitors to Australia for medical reasons; the remaining third came mostly from Asia (Tourism Research Australia 2015, unpublished data).

Education and training in health-related disciplines is also an important Australian service export (typically included in the definition of education exports). Health courses accounted for more than 7 per cent of total enrolments (about 26 000 out of 360 000 international enrolments) in Australian higher education courses in 2014 (including both onshore and offshore enrolments) (table 3.2; DET 2015f). Enrolment numbers may not capture all health-related education provision where courses are included in other fields (for example, a hospital administration course may be considered a management course), or where training is not provided through a VET provider or a university (such as training provided offshore by independent Australian doctors or nurses on a fly-in/fly-out basis).

In 2014-15, the value of Australian health service exports through cross-border supply and fly-in/fly-out was \$23 million (ABS 2015e). Considering all modes of export supply, the value of Australian exports of health services is small relative to the size of the sector domestically. In 2014-15, the gross value added of the domestic health care and social assistance industry was over \$106 billion (ABS 2015a).

### Drivers of health service exports

Global demand for health services is growing significantly. Economic development, higher household incomes and demographic change (particularly population ageing) are key drivers of demand for health services (Pocock and Phua 2011).

The number of people aged 60 years or over globally is expected to increase from 841 million in 2013 to more than 2 billion in 2050 (UN DESA 2013). This increase is being driven by rising life expectancy — itself a result of higher incomes, advances in medicine and improved access to health services (CEPAR 2013a). Growth in the number of older people will increase demand for health service exports, as older people have higher rates of disease, and health treatments for older people are on average more expensive than those for younger people (CEPAR 2013b).

In many Asian countries, labour mobility and the growing proportion of older people (driven partly by increases in life expectancy) are eroding traditional family support networks in which older people live with their families (CEPAR 2013a). This boosts demand for health service exports to Asian countries, especially exports of aged care services through commercial presence abroad.

The increasing cost of health care, or a lack of accessibility to services, in the home country means more people are seeking treatment elsewhere, usually by travelling to another country. Medical tourism is becoming an increasingly sophisticated market with countries specialising in types of care or procedures. For example, holidays and medical

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care are packaged together in Malaysia and Thailand, sometimes with the help of an agent to connect patients with health care providers (Deloitte Access Economics 2011).

The availability and quality of health care provided in Australia are key drivers of Australian health service exports, particularly for health-related travel to Australia (Helble 2010). Australian health service providers offer high quality and specialist services that are unavailable in some other countries, most notably in less-developed countries in our region (Deloitte Access Economics 2011).

The relative cost of health care in Australia is also a factor affecting medical tourism. Health services provided in Australia are typically more expensive than in key competitor destinations for medical-related travel such as India, Singapore, and Thailand — partly as a result of Australia’s high labour costs relative to these countries (Deloitte Access Economics 2011). This is not such a significant factor for health services provided through commercial presence abroad where labour is primarily employed under market conditions in lower-wage countries.

Various factors can influence firms’ willingness and ability to export health services by establishing a commercial presence abroad. These include firms’ strategic orientation (such as whether they have a primarily domestic, regional or global mindset), access to suitably qualified and/or lower-cost health professionals, proximity to consumers, the degree of privatisation and commercialisation in the host country’s health services sector, and foreign investment regulations (Mahmood 2010).

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## 4 Domestic barriers to service exports

### Key points

- The priority for Australian governments should be domestic policy reform that promotes competition and provides incentives for firms, including in service sectors, to innovate and lift their productivity. Determining domestic policy on the basis of matching policies implemented in other countries may well benefit some service providers or industries, but is likely to have consequences far beyond services and could impose substantial costs.
- Consistent screening thresholds across investors from different countries for Foreign Investment Review Board examination of investment proposals would provide a more uniform approach to addressing national interest concerns arising from inward foreign investment.
- Concerns about the adequacy of education and tourism infrastructure should be addressed by implementing best practice project selection processes for public infrastructure projects that incorporate well-informed, high-quality and consistently applied cost-benefit analysis; in conjunction with ongoing review and reform of development approval processes (including planning and zoning) that apply to private and public infrastructure.
- In general, labour market issues should be addressed in the context of broader inquiries. Some steps that could reduce domestic barriers to service exports include:
  - removing the priority afforded to specific industries under the Industry Skills Fund, which would improve the efficiency with which workforce capability improvements are achieved while facilitating exports from sectors that are not given priority, such as tourism
  - relaxing the requirement that work in a specific region or industry must be undertaken to obtain a second year extension to the working holiday visa, which has the potential to increase service exporters' access to labour, in particular in the tourism sector.
- Government export assistance programs, including grants to businesses, should only be undertaken where there is a sound case for government involvement based on addressing a market failure, or to meet an equity objective, and the communitywide benefits of providing the assistance would be expected to outweigh the costs.
  - There may be scope for some government agencies to strengthen efforts to recover the costs of providing information, advice and market research to service providers that are seeking to export, particularly where the information provided goes beyond that collected to meet governments' own information and data requirements.
  - The case for government involvement in international marketing and promotion campaigns should be supported by an economic analysis of the costs and benefits to the community, both prior to the campaign being funded, and following the completion of the campaign. The analysis undertaken should be fit for purpose, and the scale and complexity of the analysis should be commensurate with the value of government funding to be provided to the activity.
  - The Export Finance and Insurance Corporation (EFIC) should be confined solely to providing export finance to newly exporting small and medium-sized enterprises. In addition to existing legislative requirements, a new performance management framework should be developed to improve the transparency of EFIC's operations.

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Service exports, and trade more generally, are intrinsically linked to policy (including regulatory) settings in Australia. In many instances service sectors can be heavily regulated, particularly in sectors where services have traditionally been provided by governments such as health, education, public transport and utilities (ASR 2006).

Empirical evidence suggests that the gains from domestic policy reform are likely to be large. For example, Dee (2005b) found that the gains from comprehensive unilateral regulatory reform in many regions were far greater than the gains from regional trade liberalisation. The largest gains identified were in reforming the non-discriminatory restrictions on competition that affect both foreign and domestic new entrants (Dee 2005b). There is scope for substantial gains through reforms to promote competition in key areas of the Australian economy (Harris 2015).

This chapter examines the domestic barriers to service exports that apply to more than one service sector. It also examines government provision of export assistance. Barriers that are specific to the financial; education and health; and tourism, professional and information technology service sectors are considered in chapters 6 to 8.

## **Maximising community wellbeing should be the objective**

Domestic policy should be guided by whether it generates a net benefit to the Australian community overall, not its effects on service exports alone. Although exports can deliver benefits, the goal of increasing exports, in and of itself, will not necessarily result in a net benefit to the Australian community (chapter 2). The domestic policy reform effort should have the objective of enabling businesses to perform those activities they do best by promoting competition and providing incentives to innovate and lift their productivity, which will invariably lead to exports of some goods and services and imports of others.

The Australian Financial Markets Association (AFMA) noted that there are problems with setting policies based solely on the effect they would have on exports:

A focus on the promotion of exports at the expense of imports can lead to the introduction of policies that distort the allocation of resources in the economy ... The focus of public policy should be on the reduction of barriers to trade more generally, of which specific barriers to services exports are a component. (sub. 14, p. 6)

Sound policy settings that facilitate competition and promote a flexible and productive economy can enable all sectors of the economy, including service providers, to respond to market opportunities in Australia and in international markets. As noted by participants:

... the basis for an effective and prosperous export market – across any industry – is a robust domestic business environment that drives productivity, competitiveness and innovation. (AIIA, sub. 7, p. 3)

The Export Council of Australia strongly agrees that domestic policies that promote competition and a flexible and productive economy help facilitate trade and should be a focus for government. (ECA, sub. DR52, p. 4)

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Reform in competition policy, in particular those that result in Australia's competition policies, laws, and institutions being flexible, responsive and adaptive will benefit the Australian services sector. Greater competition within Australia will provide incentives for domestic producers, including in the services sector, to innovate and lift their productivity ... (DFAT, sub. 31, p. 30)

Where there are regulatory concerns that affect the service sector, governments should follow good practice principles for regulatory process — in particular, regulation should directly address a market failure or equity objective in a way that is no more burdensome than necessary. For example, concerns have been raised in relation to new forms of service provision such as Uber and Airbnb (concerns include safety and local noise respectively). Regulations to address any information asymmetries or external costs should be sufficiently flexible to accommodate alternative models of product delivery so as not to stifle innovation within the service sector.

Since pursuing comprehensive domestic policy reforms on a unilateral basis is likely to deliver large gains to the community — as was the case when Australia reduced its trade barriers, and introduced national competition reforms, in the 1980s and 1990s — implementation should not be delayed on the basis that they may provide leverage in trade negotiations. A better approach is to create a level playing field for all firms (domestic and foreign). Enabling internationally competitive firms to provide services in Australia could help to improve the competitiveness of local businesses that contest those markets. More generally, increased competition from foreign service providers could put downward pressure on domestic prices, providing benefits to businesses (including exporters and prospective exporters) and individuals consuming those services.

The broader purpose of domestic policy settings is germane to this study as there is a need to explicitly consider overall community wellbeing when assessing the benefits of reducing domestic barriers to service exports. This means that in cases where domestic considerations beyond service exports are important, such assessment should be undertaken in the context of broader policy reviews.

### Examples of domestic reforms that facilitate service exports

Historically, domestic reforms in Australia have delivered communitywide benefits through facilitating competition and enhancing productivity. Where reforms have links to service sectors, they can enable service providers to respond to opportunities in international markets. For example, liberalisation of the finance sector in Australia during the 1980s and 1990s (including liberalising foreign bank entry and the removal of exchange and interest rate controls) contributed to rapid productivity improvements in the financial service sector (Banks 2005). Domestic reforms were also important in aviation: deregulation of intrastate aviation, the end of the two airline policy, the removal of barriers between domestic and international markets and the privatisation of airlines and airports were all progressed during the late 1980s and 1990s (IC 1998).

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There remain opportunities for productivity-enhancing reforms, in particular reforms set out in the Harper Competition Policy Review that would apply competition principles-based thinking to health and other social welfare service provision, to road reform, and to urban planning (Harris 2015). The Harper Review also noted that access to, and creation of, intellectual property will become increasingly important in facilitating benefits from exploiting technology to its full extent (Harper et al. 2015) — the Productivity Commission commenced an inquiry into Intellectual Property Arrangements in August 2015 (PC 2015e).

### **‘Competitive’ policy settings are not necessarily in the community’s best interests**

Some participants submitted that Australia should have ‘competitive’ policy settings to allow Australian service providers to win a greater share of export markets:

Australia needs to implement competitive taxation policy settings in order to attract foreign investment (FSC, sub. 20, p. 16). ASIC’s mandate [should include] international competitiveness. (FSC, sub. DR43, p. 5)

While ACPET supports efficient allocation of funding the risks of government withdrawal from such assistance, including a stronger user pays approach, may diminish efforts to grow the market and simply give a ‘free kick’ to competitor nations that are active in seeking to grow their markets. (ACPET, sub. DR38, p. 3)

It is increasingly important that Australian prudential regulations not prejudice the relative ability of Australian general insurers to achieve commercial presence offshore, compared with competitors based in other jurisdictions such as Europe. (Insurance Australia Group, sub. 10, p. 2)

We have also been pleased with the commitment Austrade has made to attend international student recruitment fairs around the world to promote Australia as a preferred destination for international students. Despite their efforts though it is clear that Australia’s level of investment in promotion is much less than other governments of our competitor countries. (AIPE, sub. 22, p. 14)

The \$535 [Student Visa Application Charge] (\$550 from 1 July 2015) for Australia is more expensive than any other competitor country and does not distinguish between short course ... students and three-year degree students. Unlike the UK which has a short course Student Visitor Visa at \$A153. (English Australia, sub. 19, p. 5)

Being ‘competitive’ can have several meanings, some of which are inconsistent with the goal of maximising community wellbeing. While fostering an open and competitive market is desirable, as it promotes innovation and productivity growth, it should not be conflated with setting policy on the basis of matching subsidies or concessions, or applying regulatory rules applying in other countries. For example, setting prudential regulation to maintain competitiveness with other countries could undermine financial system stability in Australia, with ramifications that are broader than those specific to service exports (chapter 6).

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Broader community welfare considerations should be the basis for domestic policy settings, regardless of how other governments proceed. It may be possible to draw on the experiences of other countries, but seeking to ‘out compete’ them through accommodative policy settings is not necessarily optimal and could impose substantial costs.

## 4.1 Investment barriers

Participants have identified potential domestic barriers to investment in two key areas:

- Australia’s foreign investment framework
- investment in infrastructure.

Barriers to investment in other countries can be an important barrier to establishing a commercial presence in those countries and are discussed in chapter 5.

### Australia’s foreign investment framework

Under the *Foreign Acquisitions and Takeovers Act 1975* (Cwlth) (FATA) and associated regulations, the Treasurer or their delegate reviews foreign investment proposals against Australia’s national interest on a case-by-case basis. The Treasurer can block proposals that are contrary to the national interest, or apply conditions to the way proposals are implemented to ensure they are not contrary to the national interest. When making decisions on foreign investments, the Treasurer receives advice from the Foreign Investment Review Board (FIRB).

Notification and prior approval (triggering examination by the FIRB) is required for foreign investment proposals that exceed prescribed thresholds set out in Australia’s Foreign Investment Policy (table 4.1). Separate legislation imposes other requirements and/or limits on foreign investment in specific sectors, such as banking, airports and airlines, shipping, and telecommunications. The vast majority of investments considered under the FATA are approved. In 2013-14, 24 102 proposals received foreign investment approval (23 428 were in real estate), but only three were rejected (FIRB 2015).

The Australian Government announced reforms to the foreign investment framework on 2 May 2015, and also announced that it would conduct further consultation on options to modernise and simplify the framework. As of 30 October 2015, the *Foreign Acquisitions and Takeovers Legislation Amendment Bill 2015* (Cwlth) was before the Senate.

**Table 4.1 Foreign investment review thresholds**

	<i>Threshold — partner countries subject to higher threshold<sup>a</sup></i>	<i>Threshold — other countries</i>
	<i>\$ million</i>	<i>\$ million</i>
Residential real estate or vacant land	0	0
Developed commercial real estate	1 094	55
Heritage-listed developed commercial real estate	1 094	5
Business acquisitions in non-sensitive sectors	1 094	252
Business acquisitions in sensitive sectors <sup>b</sup>	252	252
Rural land	1 094 <sup>c</sup>	252 <sup>d</sup>
Foreign government investors: all direct investments, new business proposals and interests in land	0	0

<sup>a</sup> Currently applies to investors from the United States, New Zealand, Japan, South Korea and Chile. Will also apply to Chinese investors once the China–Australia trade agreement enters into force. <sup>b</sup> Sensitive sectors are media, telecommunications, transport, defence and military-related industries, and the extraction of uranium or plutonium or the operation of nuclear facilities. <sup>c</sup> Proposed change to \$15 million (cumulative value of rural land owned by the foreign investor) for China, Japan and South Korea before the Senate (as of 30 October 2015). <sup>d</sup> Proposed change to \$15 million (cumulative value of rural land owned by the foreign investor) before the Senate as of 30 October 2015 (subject to some exceptions associated with trade agreements).

Source: Australian Government (2015i).

### The effect of Australia’s foreign investment framework on service exports

There are several mechanisms through which the foreign investment framework might act as a barrier to service exports by inhibiting supply. First, it might reduce the sources of capital available to service providers and thereby increase the cost of capital. The small number of transactions that have been blocked suggests that the direct effect of the foreign investment framework on the cost of capital may be small and any substantive effect would need to manifest via the threat of regulation dissuading further capital inflows (some investment proposals might not be submitted, on the expectation that they would be rejected).

There is also potential for the foreign investment regime to impose costs on Australian businesses by reducing access to foreign technology and know-how and reducing competition from foreign investors (PC 2014c). AFMA highlighted the potential for the foreign investment framework to restrict productivity spillovers:

A more liberal approach to inward [foreign direct investment] could be expected to enhance Australia’s capacity to export through increased knowledge transfers and greater access to global managerial networks and supply chains. (sub. 14, p. 18)

The Australian Services Roundtable highlighted the potential for the framework to indirectly affect investment abroad by Australian service firms if other countries respond with reciprocal restrictions on investment:

Australia’s own stance on foreign direct investment also has negative implications for

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Australian services companies seeking to operate overseas. Media coverage of Australian Government decisions to reject significant foreign direct investment in Australia has an impact on their ability to invest in other countries. (sub. 30, p. 10)

Finally, there is potential for conditions placed on the way foreign investment proposals are implemented to impose costs on businesses by stipulating how they run their business,<sup>1</sup> which could increase costs for service providers seeking to export.

### *Potential issues with Australia's foreign investment framework*

The Commission has noted concerns that have been raised with Australia's foreign investment framework in its concurrent inquiry into business set-up, transfer and closure. These concerns relate to the different thresholds applied to investors from different countries, additional scrutiny applied to foreign government investors, and uncertainty about the Australian Government's approach to foreign investment proposals. This uncertainty arises due to the Treasurer's discretionary power to determine proposals on a case-by-case basis and the lack of an explicit definition of 'national interest' in the FATA (PC 2015c). An OECD comparison indicates that Australia's foreign investment framework is relatively restrictive compared with other developed countries, primarily due to its screening processes (chapter 5).

### **Costs and benefits of changes to Australia's foreign investment framework**

Barriers to foreign investment can affect all sectors of the Australian economy, so reducing these barriers could potentially lead to benefits across a range of businesses, including those that export services. By increasing capital stocks, supporting access to foreign technology and promoting competition, foreign investment can deliver economywide benefits (Access Economics 2010; Choong 2012; OECD 2009a). However, the foreign investment framework in Australia is unlikely to be highly restrictive to service exports — the height of the barrier is fairly small — as most foreign investment in Australia is not subject to restrictions and few investments have been blocked.

Notwithstanding the issues noted above, wide-reaching reforms to the foreign investment framework are not canvassed in this study (AFMA (sub. DR37) and the Export Council of Australia (sub. DR52, attachment 1) advocated a separate comprehensive inquiry into impediments to foreign investment). More relevant in the context of this study are foreign investment screening thresholds applied across investors from different countries. As the Department of Foreign Affairs and Trade (DFAT) noted regarding screening thresholds for investors from different countries:

Differences between [free trade agreements], such as in relation to foreign investment screening, simply reflect the complexity of obtaining a negotiated outcome with different parties at different times, where parties' interests are subject to change. (sub. DR49, p. 10)

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<sup>1</sup> For example, China Minmetals's acquisition of mining assets of OZ Minerals had several conditions imposed, including that production and employment is maintained or increased at specified mines.

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Preferential trade agreements have extended higher thresholds for FIRB examination to investors from some countries without any clear basis that national interest considerations will be systematically different for investors from those countries. Making thresholds the same across investors from different countries would be consistent with the World Trade Organization's most favoured nation principle and OECD guidance that investment policies should be non-discriminatory (OECD 2009b).

Consistency in foreign investment review thresholds would provide a clearer and more uniform policy than allowing thresholds to be negotiated in preferential trade agreements. If consistency is achieved through extending higher screening thresholds to foreign investors from some or all countries, this would be expected to promote foreign investment, potentially increasing service providers' access to capital and foreign technology. Lower foreign investment screening thresholds should not be maintained solely for use as a bargaining chip in trade negotiations.

#### RECOMMENDATION 4.1

Under Australia's Foreign Investment Policy, the Australian Government should make screening thresholds for examination of investment proposals by the Foreign Investment Review Board consistent across investors from different countries.

## Barriers to infrastructure investment

Enabling infrastructure investment is important for exporting services. Investment in tourism-related infrastructure, such as transport infrastructure, accommodation, and recreational, cultural and heritage assets, is crucial to the ongoing success of Australia's international tourism sector. Similarly, student accommodation and facilities are important for attracting international students. Lack of appropriate infrastructure can act as a barrier to exporting services either by increasing the cost of delivering a service or by directly restricting the provision of a particular service.

Participants in the Commission's research paper into Australia's international tourism industry raised concerns about tired and inadequate infrastructure, particularly relating to short-term accommodation, cruise ship terminals and national parks (PC 2015b). In a submission to this study, the National Tourism Alliance stressed that 'tourism requires urgent and extensive investment in its infrastructure' (sub. 11, p. 21), identifying aviation and port infrastructure, accommodation, and tourist attractions as areas where increased capacity is needed. The Tourism and Transport Forum Australia noted that 'capitalising on the potential benefits of our natural assets requires a supportive legislative framework and strategic public investment in critical infrastructure' (sub. DR48, p. 15) and highlighted a

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potential role for the Commonwealth Government in funding business events assets, visitor infrastructure in national parks and national cultural institutions.<sup>2</sup>

StudyNSW (questionnaire 11) identified the high cost of accommodation in Australia as a barrier to exporting education services. Similarly, participants in an international student accommodation symposium held in June 2015 (supported by the Department of Education and Training and StudyNSW) highlighted a lack of accommodation as a problem that undermines Australia's capacity to attract international students (IEAA 2015a).

More general infrastructure — such as roads, water and electricity — might also be used in the export of services. Advance Cairns (sub. 13) stated that transport infrastructure needs to be improved to cater for tourism in tropical north Queensland. This infrastructure is primarily provided for a broader range of purposes than supporting service exports and is not considered in detail in this report. The provision of more general infrastructure was considered in the Commission's inquiry into public infrastructure (PC 2014a).

The discussion below is limited to cases where government policy settings are a barrier to infrastructure investment. Government involvement in infrastructure investment (for example, support for investment in visitor infrastructure such as accommodation and conference facilities) is only justified where this addresses a market failure or equity objective. The cost of student accommodation (which in part reflects commercial realities such as the value of the Australian dollar and the comparatively high cost of accommodation in Australia (AEI 2013)) is not, of itself, a rationale for government involvement. However, there might be regulatory barriers to investment in student accommodation or tourist facilities associated with planning and approval processes (Chaney Advisory Council 2013; DET 2015a).

## Options to overcome barriers to the provision of infrastructure

### *Government investment in infrastructure*

The ability of governments to provide services-related infrastructure is constrained by the alternative uses or demands for public funding. The existence of infrastructure constraints does not necessarily mean that funds should be directed toward more public infrastructure — there may be better uses for government funds from a communitywide perspective. More important is an appropriate project-selection process to determine whether governments are selecting the highest-value projects and whether there is a sound rationale for government involvement in these projects in the first place.

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<sup>2</sup> The Tourism and Transport Forum Australia (sub. DR48) also suggested that cruise ship access to the naval base at Garden Island in Sydney is critical. However, previous analysis has concluded that the requirements of the Navy at Garden Island are incompatible with cruise ship access to the facilities, except on an ad hoc basis (PC 2015b).

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Government provision of services-related infrastructure could be improved by reforms to the institutional and governance arrangements underpinning infrastructure investment decisions. These include reforms recommended by the Commission in its 2014 inquiry into public infrastructure (box 4.1), the majority of which were supported by the Australian Government (DIRD 2014). In particular, good project selection for government-provided infrastructure requires the use of well-informed, high-quality and consistently applied cost-benefit analysis. Implementation of these reforms could improve export prospects for services that rely on public infrastructure, but also improve the efficiency of the economy more broadly.

For national parks, the Commission has previously concluded that greater user charging and more private investment would provide an additional source of funding and facilitate innovation in the provision of tourism-related infrastructure (PC 2015b). A good example is the July 2015 request for potential partners to submit expressions of interest for culturally appropriate and environmentally sensitive tourism within the Uluru-Kata Tjuta National Park (expressions of interest closed at the end of September 2015 and will subsequently be evaluated by the Uluru-Kata Tjuta National Park Board of Management) (Parks Australia and Uluru-Kata Tjuta Board of Management 2015).

**Box 4.1      Commission recommendations on institutional and governance arrangements for infrastructure provision**

The Commission's 2014 inquiry into public infrastructure made several recommendations designed to improve institutional and governance arrangements for general infrastructure provision. These include:

- defining that the principal objective of infrastructure decisions should be that they are undertaken in the public interest, for the welfare of the community as a whole
- setting clear and transparent infrastructure service standards
- instituting effective processes, procedures and policy guidelines for planning and selecting infrastructure projects
- using transparent, innovative and competitive processes for the selection of private-sector partners for infrastructure projects
- ensuring efficient allocation and monitoring of project risks between government and the private sector
- reviewing funding and financing policies, including efficient user charging policies
- monitoring and evaluating project performance
- requiring that governments should commit to subjecting all public infrastructure investment projects above \$50 million to rigorous and transparent cost-benefit analysis prior to the projects being announced
- requiring that Australian Government funding to state, territory and local governments should be conditional on best practice investment principles being adopted, and only where there is evidence of a demonstrable net benefit from the project.

Source: PC (2014a).

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### *Private investment in infrastructure*

Much of the infrastructure required to facilitate service exports is provided and funded privately. For example, accommodation for international students and visitors is generally built and owned by the private sector. In these instances, government policy can still create barriers to the provision of infrastructure through overly onerous development approval processes. Development approval processes can be lengthy: development approval for a four star hotel is estimated to take between 25 and 87 weeks in Australian capital cities (Urbis 2015).

Previous Commission inquiries and studies have recommended that development approval processes (including planning and zoning processes) should be reformed to ensure investment decisions are not unnecessarily impeded (PC 2011a, 2012, 2013, 2015b). Key proposals include that governments should ensure regulatory objectives are clear, consistent and coherent, avoid duplication of regulatory oversight across jurisdictions, undertake development approvals in a timely manner, and undertake risk-based assessments where feasible. For tourism-related infrastructure in particular, improvements could be achieved through approval processes that are only as thorough as is necessary to ensure that regulatory objectives are met given the (often small) scale of tourism developments (PC 2015b). Planning and zoning systems should not be overly prescriptive, so that service providers are not excluded from areas where they would otherwise be suited. Defining zones in terms of broad uses rather than prescriptive definitions will allow firms (including service exporters) more scope to innovate and adapt to changes in demand.

#### RECOMMENDATION 4.2

The Australian, state and territory governments should facilitate service exports by pursuing sound policy settings that promote competition and a flexible and productive economy. Policy settings should be guided by expected net benefits to the Australian community overall rather than effects on service exports alone. This includes government actions to address concerns about infrastructure acting as a constraint to service exports.

Consistent with the Commission's conclusions in its Public Infrastructure inquiry report, the Australian, state and territory governments should:

- implement best practice selection processes for public infrastructure projects
- regularly review and reform development approval processes for public and private infrastructure projects to ensure they are risk-based (where feasible) and only as thorough as is necessary to ensure that regulatory objectives are met
- ensure that planning and zoning systems applying to public and private infrastructure are not overly prescriptive and do not unnecessarily impede service providers from innovating and adapting to changes in demand.

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## 4.2 Barriers to attracting skilled employees

Firms operating in service sectors are particularly reliant on the availability of labour — in particular, skilled labour — as many service sectors are relatively labour intensive and have a highly qualified workforce (chapter 3). Any barriers to attracting and retaining appropriately skilled staff could have a substantial effect on the supply of service exports, either by increasing the ongoing costs of export operations or by restricting the supply of exports. Participants identified skill shortages as a barrier to service exports (AIIA, sub. 7; AIPE, sub. 22; Service Skills Australia, sub. 27).

In a competitive and dynamic market economy there will always be incidences of skill shortage. Structural adjustment during the mining boom was a key reason for the ubiquity of concerns about skill shortages in the 2007 House of Representatives inquiry into the current and future directions of Australia's service export sector (HRSCEFPA 2007). Employment in the mining industry peaked in mid-2012 and by February 2015 had fallen by almost 20 per cent from that peak (ABS 2015f), releasing labour back into the rest of the Australian labour market. In general, finding necessary skills is one of the core tasks of a business, and labour markets will adjust over time (and signal areas of demand for additional skilled workers) to address imbalances between skills and labour demand.

However, there is potential for policy-relevant barriers to exist in areas where governments are heavily involved, including the workplace relations framework, education and training, eligibility for temporary work visas, and arrangements for access to public services for temporary immigrants.

### Workplace relations framework

The workplace relations framework is a set of labour laws, regulations and institutions that set out (among other things) minimum conditions for employment, employee protections and bargaining arrangements between employees and employers. The workplace relations framework directly affects wages, employment and business profitability, but can also significantly influence innovation, skill formation and industry growth (PC 2015j).

### Workplace relations changes should be assessed in a broader context

Workplace relations policy settings can have substantial implications for all parts of the economy, including service exports. The National Tourism Alliance (sub. 11) stated that the current provisions of the *Fair Work Act 2009* (Cwlth) and modern awards impose artificial constraints on tourism businesses (which are typically labour-intensive small businesses) as well as onerous administrative and compliance burdens. The National Tourism Alliance went on to argue that there is a need to reform workplace regulation to recognise the 24/7 economy. Adagent Pty Ltd cited rigid and restrictive employment laws as a key barrier to service exports (questionnaire 1).

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Changes to the workplace relations framework involve complex tradeoffs and have ramifications that go well beyond service providers. Such changes should be assessed in a manner that gives due consideration to communitywide effects. The Commission has not made any recommendations or findings regarding the workplace relations framework in this study because the framework has been reviewed in a concurrent Productivity Commission inquiry. The final report of the workplace relations inquiry was provided to the Government in November 2015 and included recommendations relating to the workplace relations issues raised by participants in this study.

## **Arrangements for education and training**

Governments have an important role in the delivery of education and training to meet skill needs in the Australian economy. This role includes funding, information provision, planning for skill needs, and regulation of education and training providers. Education of international students (both in Australia and internationally by Australian providers) is a service export in itself and is discussed in chapter 7.

Education and training are important to build skills required to provide services for export. Where policy settings do not facilitate training of employees with the skills that service firms require, this can be a barrier that inhibits the supply of service exports. Service Skills Australia (sub. 27) raised the need for a strengthened vocational education and training system that delivers the skills that industry needs.

The Australian Information Industry Association (sub. 7) and the Export Council of Australia (sub. 32, sub. DR52) recommended additional support for training and skills development tailored to meet the needs of service providers looking to expand into global markets, covering issues such as local culture and business practices, payment issues and understanding local regulations.

The Export Council of Australia (sub. DR52), National Tourism Alliance (sub. 11) and Service Skills Australia (sub. 27) highlighted issues with restrictive criteria attached to the Australian Government's Industry Skills Fund. The objective of the Industry Skills Fund is to address workforce capability issues that affect Australian businesses (Department of Industry 2014). The Fund gives priority for government assistance with training to small and medium enterprises in five industries, chosen on the basis of their export growth potential: advanced manufacturing; food and agribusiness; mining equipment, technology and services; medical technologies and pharmaceuticals; and oil, gas and energy resources. The Tourism and Transport Forum Australia (sub. DR48) stated that the removal of priority attached to specific industries would ensure equitable access to the Industry Skills Fund, which would be especially important for service sectors characterised by a large number of small and medium enterprises, such as tourism.

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## Education and training programs should have broad-based eligibility

The need to match workforce capability to employer needs is far broader than service exports and is important for the economy as a whole. Assessment and planning for skill needs is often imprecise — it is challenging for governments to find out what employers need and future demand for skills is subject to considerable uncertainty. Previous Commission work (PC 2011b) has highlighted potential benefits from improvements to training arrangements through use of explicit on-budget community service obligation payments<sup>3</sup> and greater managerial independence for public training providers.

The rationale for additional government support for training tailored to the needs of service providers looking to expand into global markets is weak. Government funding of education and training generally is justified on market failure grounds (in terms of spillover benefits that accrue to the community beyond the firm that provides the training or the employee that receives it) and on the basis of equitable access to education. The Commission has not received any evidence that training in skills that are relevant for exporting services will have greater community benefits than other forms of education and training.

This same logic points to training programs — such as the Industry Skills Fund — having broad-based eligibility in the absence of evidence that community benefits are greater from training in particular sectors. Funding through the Industry Skills Fund is appropriate to the extent that there are spillover benefits from training. It is not clear that those spillover benefits are, or will be, larger for the five sectors that the Fund currently targets.

There are issues around the methods used to select the priority industries targeted by the Industry Skills Fund and questions as to whether an approach based on selectivity affords net benefits to the community (PC 2015i). Further, as noted above, increasing exports, in and of itself, will not necessarily result in a net benefit to the Australian community, so there is little basis for favoring industries according to their export growth potential. Giving priority to some sectors disadvantages other, potentially more competitive, sectors such as tourism.

Eligibility conditions for the Industry Skills Fund are unlikely to be a substantial barrier to service exports as the Fund is a small part of the overall education and training system. Rather, reform is warranted to improve the efficiency with which government funds are used.

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<sup>3</sup> Some funding of community service obligations has since been implemented in New South Wales and South Australia (Government of South Australia 2011; NSW Department of Education and Communities 2015).

#### RECOMMENDATION 4.3

The Industry Skills Fund seeks to address workforce capability issues by providing training assistance that prioritises five industries, chosen on the basis of their export growth potential. To improve the efficiency with which workforce capability improvements are achieved, the Australian Government should remove the priority afforded to specific industries under the Fund.

## Eligibility for temporary work visas

Permanent and temporary immigrants from a range of different visa programs are eligible to work in Australia (table 4.2). Issues relating to student and short-term visitor visas are covered in chapters 7 and 8 respectively.

Table 4.2 Migration streams

<i>Migration stream</i>	<i>Visa grants 2013-14</i>	<i>Planning level for 2015-16<sup>a</sup></i>
<b>Migration Program</b>	<b>190 000</b>	<b>190 000</b>
Skill	128 550	128 550
Family	61 112	57 400
Special eligibility	338	565
<b>Humanitarian Program</b>	<b>13 768</b>	<b>13 750</b>
<b>Temporary entry — selected visa subclasses<sup>b</sup></b>		
International students	292 060	Uncapped
Temporary skilled migration (subclass 457)	98 571 <sup>c</sup>	Uncapped
Temporary graduate (subclass 485)	22 867	Uncapped
Working holiday makers (subclasses 417, 462)	239 592	Uncapped <sup>d</sup>

<sup>a</sup> Planning levels are set by the Australian Government each year and monthly monitoring ensures visa grants are consistent with planning levels. <sup>b</sup> A number of other temporary resident visas are also available, the majority of which are granted for short stay or entertainment purposes (DIBP 2014b). Under the Trans-Tasman Travel Arrangement, New Zealand citizens are able to enter Australia freely and live in Australia on an indefinite basis. <sup>c</sup> Includes 51 939 visas granted to primary applicants, with the remainder granted to their dependents (DIBP 2014b, 2014c). <sup>d</sup> Annual limits apply to the number of 462 visas that can be issued to applicants from all countries except the United States. The annual limits vary by country.

Sources: Australian Government (2015b); DIBP (2014a, 2014b, 2014c, 2015c).

A number of Australian Government studies currently underway are relevant to temporary immigration. The Department of Immigration and Border Protection is currently undertaking a review of the skilled migration and temporary activity visa programs (DIBP 2014e). There is also a Senate Inquiry underway into the effect of Australia's temporary work visa programs on the Australian labour market and on holders of temporary work visas — an interim report was delivered in October 2015 (Senate Education and Employment References Committee 2015). A Joint Review of Border Fees, Charges and Taxes was undertaken by the

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Department of Immigration and Border Protection and the Department of Agriculture during 2014 and 2015.

### The effect of constraints on eligibility for temporary work visas on service exports

Constraints on eligibility for work visas can reduce the extent to which temporary immigration can address short-term skill shortages and facilitate service exports.

- *Temporary skilled migration*: The National Tourism Alliance stated that ‘the system is not conducive to processing many low-skilled workers required by the tourism sector’ and that the Temporary Skilled Migration Income Threshold (the minimum wage for a position to be nominated for a skilled migration visa) ‘is often higher than the minimum wage set out in the Industry Award for Australian workers in the same position’ (sub. 11, pp. 38–40). The Tourism and Transport Forum Australia urged that ‘consideration be given to expanding the skilled occupation lists to include more tourism and hospitality jobs’ (sub. 25, p. 18).
- *Temporary graduate visas*: The Tasmanian Government (sub. 29) submitted that greater flexibility in post-study visa arrangements could offer an additional source of labour for tourism services.
- *Working holiday maker visas*: The National Tourism Alliance (sub. 11) and the Tourism and Transport Forum Australia (sub. 25) argued that greater flexibility should be allowed on working holiday visas by expanding eligibility in terms of ages and countries included, as well as by expanding eligibility for visa extensions.

The Commission has not made any specific recommendations or findings on issues relating to temporary skilled, temporary graduate or working holiday maker visas, as these are being considered further in the concurrent Productivity Commission inquiry into the migrant intake into Australia, the draft report of which was released in November 2015 (PC 2015g).

### Costs and benefits of changes to eligibility for temporary work visas

Reducing constraints to filling skill shortages using temporary immigration could offer benefits to some service providers that are unable to fill vacant positions. Costs would be imposed on Australian employees in competition with temporary immigrants if wage increases are constrained relative to a situation where skill shortages continued. There can also be costs imposed through temporary immigrants’ use of government services. The merits of changes to temporary visa types proposed by participants are considered in turn below.

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### *Temporary skilled migration*

The objective of the temporary skilled migration visa program is to enable employers to address labour shortages by bringing in skilled workers where they cannot find an appropriately skilled Australian worker (DIBP 2015b). The Commission considers that this objective is appropriate, although identifying areas of genuine skill shortage is difficult.

The temporary skilled migration program should continue to be targeted towards skilled workers. Where necessary skills can be acquired relatively quickly and many people have the ability to learn these skills, then the normal adaptation mechanisms of the domestic labour market (such as adjustments in wages) are likely to work reasonably well (Richardson 2009). As such, the Australian Government should not broaden temporary skilled migration to act as a source for semi-skilled labour, as proposed by the National Tourism Alliance (sub. 11).

### *Temporary graduate visas*

Temporary graduate visas allow graduates who have completed their studies in Australia to live and work in Australia temporarily if they graduate with skills and qualifications that relate to an occupation on the Skilled Occupation List or a bachelor, masters or doctoral degree (DIBP 2015d). Policy changes in 2010 made it more difficult to obtain work visas after study in Australia (Knight 2011), while further changes in 2013 made it easier for international students graduating with a bachelor, masters or doctoral degree to obtain temporary graduate visas (DIBP 2013).

The Commission considers that it would be premature to make further adjustments to temporary graduate visas before changes in 2010 and 2013 have been in place for several years, allowing assessment of any effects on student enrolments, breaches of visa conditions and effects on the labour market.

### *Working holiday maker visas*

The objective of the working holiday maker program is to encourage cultural exchange and closer ties between Australia and eligible countries, in addition to helping employers in regional Australia meet short-term employment needs (DIBP 2015f). Working holiday maker arrangements are reciprocal, providing young Australians with similar opportunities internationally.

There would be tradeoffs in expanding the working holiday maker intake as recommended by the National Tourism Alliance and the Tourism and Transport Forum Australia. There could be benefits to a number of parties:

- employers, through a greater pool of (generally low-skilled or unskilled) labour
- businesses that benefit from increased visitor activity

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- young Australians who wish to work abroad, if reciprocal schemes were also expanded.

Costs would be imposed on specific employees who compete for work with working holiday makers, who would generally be low skilled (Tan et al. 2009). On balance, it is not clear that substantial expansion would be consistent with the objectives of the program, particularly in the absence of expansion of reciprocal arrangements.

There could be greater merit in further consideration of relaxing eligibility conditions for extensions to working holiday (subclass 417) visas.<sup>4</sup> Three months of work must be completed in agriculture, mining or construction in a regional area to receive a second-year extension to a working holiday visa (DIBP 2015f). This has the potential to impose costs on service exporters (in particular, those seeking low-skilled or unskilled labour) by reducing the pool of immigrant labour they can draw from. As noted by the National Tourism Alliance (sub. 11), tourism businesses can also experience high demand for labour during seasonal peaks but do not benefit from specific treatment under the working holiday visa.

Relaxing eligibility conditions for extensions to working holiday visas has the potential to deliver benefits. Current arrangements for extension of working holiday visas may distort regional labour markets by forcing workers into regional areas (where they might be willing to work for less than market rates) to secure a visa extension. Allowing normal labour market signals (in particular, wages) to determine where working holiday makers choose to work would have efficiency benefits if their skills could be used more productively elsewhere. For example, a person with experience in the tourism sector might no longer be compelled to work in agriculture, mining or construction, with a net benefit for Australia along with a potential increase in tourism exports. However, the costs of any increase in the number of visa extensions granted would also need to be considered.

## **Access to public services for temporary immigrants**

Universities Australia and the University of Tasmania suggested that restrictions on the benefits accessible to temporary immigrants can act as a barrier to service exports by making it more difficult to temporarily employ foreign staff.

Visa restrictions can create significant difficulties in the employment of staff in universities. Specific visa settings can adversely affect postdoctoral fellows in respect of health insurance costs and access to schooling for their children — a major disincentive to them coming to Australia and a barrier to our services exports due to the alignment of reputations for research excellence with the student recruitment success. (Universities Australia, sub. 17, p. 2)

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<sup>4</sup> Work and holiday (subclass 462) visa holders are not currently eligible to extend their visa for a second year. The Australian Government's Northern Australia White Paper, released in July 2015, indicated that the Government will expand the Working Holiday Maker Visa Programme to allow subclass 417 and 462 visa holders to work for longer in high demand areas in northern Australia and to allow subclass 462 visa holders a second year extension on their visa if they work for three months in agriculture or tourism in northern Australia (Australian Government 2015g).

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The visas available for those on short-term employment contracts do not provide for healthcare or schooling for children as well as other benefits extended to residents, despite contributing equivalent or higher income tax. This creates difficulty in attracting postdoctoral fellows and research assistants who simply cannot afford to take up a position — especially if they have a family. (University of Tasmania, sub. 18, p. 3)

On a related topic, the International Student Experience Association (sub. 4; DR40) raised the inability for students to access public transport concessions and healthcare on an equal basis to local students as an issue for exports of education services.

These issues are relevant to substantial export markets — in particular, education exports to a wide range of countries — but neither are likely to represent a particularly restrictive barrier to exports in aggregate as public services are, in general, a small part of overall expenses for temporary immigrants.

### Costs and benefits of extending access to public services

As submissions from universities have noted, restrictions on access to public services for temporary immigrants make it more difficult to hire foreign staff on a temporary basis to fill skilled vacancies. Most temporary immigrants do not have access to social welfare benefits or national public health cover (DIBP 2015e).<sup>5</sup> In many cases school fees payable for children of temporary visa holders are greater than for children who are permanent residents (although specific arrangements vary by state and territory). In some cases, employers might need to offer higher wages to attract staff so that they can increase (or maintain) service exports, leading to ongoing increases in the cost of exporting.

The relevant policy question is not the ease of hiring or the effect on service exports, but whether there would be net benefits to the community from extending access to public services for temporary immigrants.

#### *Access to public health cover and subsidised education*

There is a risk of adverse selection from extending access to subsidised public services to temporary immigrants: people who may need medical care and/or who have many children might seek temporary residency in Australia as a means to access high-quality public services. There would be costs to the Australian community from employing these people over people with similar skills who are likely to demand a smaller quantity of public services (and who would pay a similar amount of tax).

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<sup>5</sup> Access to services for New Zealand citizens are not dealt with in this section as New Zealand citizens are able to enter Australia freely and live in Australia on an indefinite basis. Access to social security and public education for New Zealand citizens was considered by the Productivity Commission as part of a joint study with the New Zealand Productivity Commission (Australian Productivity Commission and New Zealand Productivity Commission 2012).

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There is not a strong efficiency argument for extending access to public services. Efficiency grounds for providing subsidised access to public services such as schooling are centred on broader community benefits that accrue beyond the individual accessing the public service (PC 2011b). As these broader benefits will accrue over an extended period, they are less likely to accrue within Australia if the recipient returns home after a temporary stay in Australia.

Nor are there strong equity grounds for extending access to public services to temporary immigrants, in particular for holders of temporary skilled visas. On average, temporary skilled migrants earned \$95 500 in total remuneration in 2014-15 (to March 2015) (DIBP 2015l), compared with the average full time adult wage in Australia (averaged over November 2014 and May 2015) of \$80 460 (ABS 2015b). At a minimum, temporary skilled migrants must be paid the Temporary Skilled Migration Income Threshold (currently set at \$53 900), which ensures they earn sufficient income to be self-reliant in Australia (Department of Employment et al. 2015). Other temporary immigrants (in particular, students and working holiday makers) have lower incomes, but the adverse selection issues and efficiency issues outlined above are still pertinent.

For these reasons, the Commission does not see a strong case for extending temporary immigrants' access to national public health cover or subsidised education. Access to healthcare through Reciprocal Health Care Agreements is an exception, as these also provide direct benefits to Australian residents through help with the cost of essential medical treatment when visiting countries with which Australia has an agreement. Scholarship programs for international students are another exception, as these have objectives beyond increasing service exports.

#### RECOMMENDATION 4.4

In relation to temporary immigrants, the Australian, state and territory governments should not extend access to public health cover beyond the level provided through Reciprocal Health Care Agreements, or provide access to subsidised education, for the purpose of increasing service exports.

#### *Access to public transport concessions for international students*

All states and territories other than New South Wales and Victoria (which collectively account for about two thirds of international student enrolments in Australia (DET 2015a)) provide access to concessional fares for international students on the same basis as for domestic students (ACPET 2012). Since 2012, some discounted fares have been introduced for international tertiary students in New South Wales (on 90-day and annual passes) and Victoria (on a three-year trial basis, for annual passes only) (O'Farrell and Stoner 2012; Public Transport Victoria 2015; Transport for NSW 2015).

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Peak education bodies have regularly argued for access to transport concessions to be extended to international students on the basis of international student welfare and safety, and increases in student numbers (ACPET 2012; Universities Australia 2010). Although public transport fares are a small part of international students' total expenditure when studying in Australia, survey data have been used to argue that the lack of access to concession fares could influence a student's decision to study here (ACPET 2012).

Extending access to public transport concessions for international students in New South Wales and Victoria would carry budgetary costs. Estimates of budgetary costs have spanned a broad range, in the order of \$20 million to \$90 million per year for each state (ACPET 2012; Universities Australia 2010). There could also be congestion costs from any increase in peak usage of public transport.

Unlike public healthcare, there is little or no adverse selection risk associated with public transport concessions for international students (students would not come to Australia because they have an inherently high need for public transport) and the marginal costs of international students' use of public transport are relatively low. There would be merit in the New South Wales and Victorian governments reviewing the case for extending concessional fares for international students to match that available to domestic students, drawing on newly available data from the discounted fares offered since 2012, to determine whether the benefits from any increase in student numbers would outweigh the budgetary (and other) costs.

The Australian Business Deans Council (sub. DR44), English Australia (sub. DR36), the International Student Experience Association (sub. DR40) and the Tourism and Transport Forum Australia (sub. DR48) supported the Commission's draft recommendation regarding concessional access to public transport for international students in New South Wales and Victoria. English Australia further argued that the recommendation should be directed to the Council of Australian Governments, but the Commission does not see a need for a nationwide approach on this issue.

#### RECOMMENDATION 4.5

The New South Wales and Victorian governments should review the case for extending concessional access to public transport for international students to match that available to domestic students, as occurs in other states and territories. The assessment should take into consideration budgetary costs, any increase in peak usage of public transport, and any effect on international student numbers.

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## 4.3 Export assistance schemes

### The role of government in assisting service exporters

The Australian, state and territory governments provide a range of export assistance programs that can be grouped into five broad categories:

- grants programs, including those provided by the Australian Trade Commission (Austrade) (the Export Market Development Grants Scheme (EMDG), the Asian Business Engagement Plan and Austrade grants for tourism). State and territory programs also provide grants to firms seeking to export (box 4.2)
- grants or in-kind support for major cultural, sporting or business events to promote tourism (considered further in chapter 8)
- international marketing and promotion, including Austrade's marketing and promotion of Australian education and training providers, general brand and image marketing undertaken under the Australia Unlimited program, and destination marketing such as that conducted by Tourism Australia and state and territory agencies
- information, advice and market research, including services provided by the Australian Government through Austrade and by state and territory governments
- finance and insurance products and services provided by the Export Finance and Insurance Corporation (EFIC), an Australian Government agency.

Several submissions to this study were supportive of export assistance programs and called for their expansion:

[To] optimise the export opportunities derived from our ICT/ICT services industry it is recommended that ... Austrade is provided appropriate funding to build and support the export capability of Australia's ICT services sector. (AIIA, sub. 7, p. 9)

Australian businesses have significant opportunities with the emerging growth of the Asia Pacific region ... We suggest that the Government should provide more support for Australian companies operating in this region. (Insurance Council of Australia, sub. 12, p. 2)

... an extension of the financial assistance available to exporters would be a welcome change and make a significant difference to private education providers. (AIPE, sub. 22, p. 14)

AFMA was not supportive:

Export assistance and subsidy schemes can distort the allocation of resources in the domestic economy. The excess burden of taxation needed to fund these schemes falls on the rest of the economy and this dead-weight loss is potentially a significant offset to any benefit derived in terms of increased exports. (sub. 14, p. 24)

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#### Box 4.2      **Examples of state and territory export facilitation programs**

Most state and territory governments fund trade organisations or programs that assist firms seeking to export, including service providers.

- New South Wales — the Export Accelerator Program offers eligible businesses a one year strategic engagement with an adviser plus assistance towards the implementation of export strategies. The Export Capability Building Program funds workshops, webinars and export development sessions delivered to small and medium-sized businesses seeking to export (NSW Department of Industry 2014).
- Victoria — the Access Program offers free overseas facilities and advice for the first two weeks and for a reduced rate thereafter of US\$250 per month for up to three months. The program is available for eligible businesses seeking to expand into China, Hong Kong, India, Japan, the Middle East, South East Asia, South Korea, and the United States (Victorian Government 2015).
- Queensland — Trade and Investment Queensland provides consultation and planning advice to businesses as well as conducting trade missions and holding seminars and networking events (Queensland Government nd).
- South Australia — The Export Partnership Program assists small to medium-sized businesses by distributing grants reimbursing 50 per cent of eligible export-related expenditure, up to a maximum of \$50 000 (South Australian Department of State Development 2015).
- Tasmania — the New Market Expansion Program is available to eligible small and medium-sized businesses with a sales turnover of between \$300 000 and \$15 million for approved marketing activities related to developing new national and international markets (Tasmanian Department of State Growth 2015).
- Northern Territory — the Trade Support Scheme allows organisations to offset up to 50 per cent of the cost of marketing activities associated with exporting (Northern Territory Department of Business 2015).
- Australian Capital Territory — Trade Connect provides grants to businesses for costs directly associated with export market development activities (ACT Government 2015).

#### The Commission's framework for assessing export assistance

The Commission has assessed each of the five categories of export assistance programs outlined above based on whether:

- the program meets an equity objective or addresses a market failure
- the benefits of intervention are likely to outweigh the costs to the community
- the costs of the program should be (and are) recovered from the beneficiaries.

As noted in chapter 2, domestic policies designed to facilitate service exports, including export assistance, should address a market failure or meet an equity objective, and should be expected to provide net benefits to the community. Even where there is a role for government intervention, this does not necessarily mean there is a case for government

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*funding* of export assistance programs. As the benefits of export assistance accrue primarily to the recipients, funding assistance from general revenue constitutes a subsidy from taxpayers. Recovering the costs of government assistance from those benefiting may improve resource allocation, in line with the ‘beneficiary pays’ principle:

The ‘beneficiary pays’ principle ... is based on the notion that those that benefit from the provision of a particular activity or product should pay for it. ... It encourages those who benefit from the activity or product to recognise that there are resource costs involved, and it decreases the taxation burden on those who do not benefit. (PC 2001, p. 15)

Improvements in resource allocation from cost recovery must be weighed against the administrative and compliance costs of identifying and charging those benefiting from government provision of export assistance.

## **Is there a rationale for the current export assistance schemes?**

The provision of grants to businesses seeking to export

In addition to state and territory government grants programs (box 4.2), the Australian Government, through Austrade, provides grants specifically aimed at businesses seeking to export (including service providers) (box 4.3).

Submissions to this study from exporting businesses and industry representatives were supportive of grants schemes, particularly the EMDG scheme, with some participants calling for expansion of the EMDG (AIPE, sub. 22; ATEC, sub. 16). The ECA submitted:

Australian businesses exporting abroad are competing with companies from around the world that are receiving varying levels of government support, financial or otherwise. ... The ECA, therefore, believes that maintaining the EMDG scheme is critical ... (sub. 32, p. 21)

The EMDG scheme was reviewed in 2015 and assessed against three criteria:

- increasing the number of businesses that develop into new exporters
- increasing the number of businesses that achieve sustainability in export markets and generate additional exports
- further developing an export culture in Australia (Lee 2015).

This review did not give extensive consideration to the rationale for the provision of government grants to businesses seeking to export. Instead the review noted that the 2008 review of the scheme found market failure rationales in the form of information deficiencies and positive ‘spillovers’. These rationales were also noted by the Export Council of Australia (sub. DR52). The Commission outlined its reservations about the rationales advanced for the EMDG scheme in the 2007-08 Trade and Assistance Review and remains of this view (box 4.4).

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## Box 4.3      **Austrade grant programs**

### **The Export Market Development Grants scheme**

The Export Market Development Grants (EMDG) scheme provides grants to aspiring and current exporters, with the objective of providing an incentive for businesses to begin exporting and grow to become sustainable exporters. The EMDG scheme is aimed at small and medium-sized enterprises (SMEs) and:

- reimburses up to 50 per cent of eligible export promotion expenses above \$5000 provided that the total expenses are at least \$15 000
- provides grants with a maximum value of \$150 000, with each eligible applicant able to receive up to eight grants.

In 2013-14, total expenditure on the EMDG was \$122.8 million, of which \$113.6 million was paid out as grants to 2445 recipients. The service sector is the largest beneficiary of the scheme, with services making up about 64 per cent of the number of grant recipients and about 63 per cent of the value of grants received.

The principal export markets targeted by EMDG recipients were the United States, the United Kingdom, China, Singapore, Hong Kong and Germany.

### **Asian Business Engagement Plan**

The Asian Business Engagement Plan is a merit-based, competitive grants program with an annual round of grants. The grants aim to assist industry bodies to develop commercial opportunities in Asia for Australian SMEs.

In 2013-14, total expenditure was \$1.8 million on grants to 27 recipients. The Plan funds up to 50 per cent of the total cost of an eligible project, with the remaining 50 per cent provided by the applicant.

### **Grants to support tourism exports**

Austrade previously provided competitive grants for projects to support the tourism sector under two separate programs.

- The Tourism Quality Projects Grants Program offered matched funding of between \$15 000 and \$100 000 to support tourism development.
- The Tourism Industry Regional Development Fund Grants Program offered grants from \$50 000 to \$250 000 on a matched dollar-for-dollar funding basis. The focus of the program was to improve the quality of accommodation and attractions in regional areas.

These grants programs were completed in June 2015 and uncommitted funding was redirected to the Tourism Demand-Driver Infrastructure Program. Under the Tourism Demand-Driver Infrastructure Program, the Australian Government committed to providing \$43 million over four years to fund state and territory tourism projects. To receive the grant, projects must align strategically with relevant state plans, drive demand, improve quality and increase tourism expenditure, with the aim of meeting the Tourism 2020 targets.

*Sources:* Austrade (2014, 2015d, pers. comm., 29 July 2015).

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#### Box 4.4      **The rationales for grant schemes are questionable**

The Commission's 2007-08 Trade and Assistance Review (PC 2009) questioned the rationales advanced in the 2008 review of the EMDG scheme; namely:

- that there are information deficiencies, such as insufficient knowledge about the general benefits of exporting and specific knowledge about suitable export markets
- the inexperience of participating firms — learning-by-doing generates productivity spillover benefits *within* the firm such as improved organisational capabilities, better managerial systems, improved skills and a focus on quality
- that the pioneering efforts and experience of EMDG participants spill over to other exporters.

While information deficiencies can provide the basis for government intervention (discussed further below), generally investments in generating or gathering information on export market opportunities are part of the cost of doing business and are appropriately borne by businesses (PC 2009). Even where the case for government provision of information is made, grants are unlikely to be the best mechanism to deal with lack of awareness and knowledge about the general benefits of exporting. The direct provision of information through government trade promotion organisations such as Austrade targets such deficiencies more directly.

A business's initially low level of experience in exporting is not a market failure. The value of internal spillover benefits from learning-by-doing is fully captured by the firm, and as such, firms have strong incentives to realise these gains without government assistance (PC 2009).

The extent to which EMDG grants support pioneering export activity is unclear.

- The majority of EMDG supported exports are to traditional markets — in 2012-13, the two largest target markets for EMDG recipients were the United States and the United Kingdom (58.6 per cent of EMDG recipients conducted promotion activities in the United States and 34.4 per cent in the United Kingdom) (Austrade 2014b).
- A survey conducted for the 2015 EMDG review revealed that:
  - only 18 per cent of EMDG recipients believed that learning from other businesses had been beneficial or very beneficial to them, and only 22 per cent believed that competitors had benefited from their firm's export activities
  - the large majority of EMDG businesses are experienced exporters, with 64 per cent having exported products or services for more than five years, and a further 27 per cent for between two and five years
  - most businesses that received EMDG grants exported identical (41 per cent) or virtually the same (36 per cent) products to what they sell domestically (TNS Consultants 2015).

#### RECOMMENDATION 4.6

The Australian, state and territory governments should only provide grants to businesses seeking to export where they address a market failure, or meet an equity objective, and the communitywide benefits of providing the grants would be expected to outweigh the costs.

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## International marketing and promotion

The Australian, state and territory governments market and promote service exports through a variety of means including:

- national brand and image marketing, such as the Building Brand Australia Program (box 4.5)
- marketing and promotion of Australian education and training providers, such as that undertaken by state and territory government bodies (for example, Study Queensland and Study Melbourne), and nationally by Austrade (box 4.6)
- tourism promotion through destination marketing, such as the work of Tourism Australia and its state and territory equivalents (chapter 8).

International marketing can address a market failure as the benefits arising from international marketing and promotion campaigns such as these can have ‘public good’ characteristics. Public good characteristics are present where the benefits of marketing can be captured by a variety of businesses (non-rival), and it is not feasible to exclude those businesses that benefit from the campaign but do not contribute to the costs (non-excludability). In such circumstances businesses face an incentive to free ride on any marketing and promotion undertaken by others. Free riding may mean that industry players do not face incentives to undertake the optimal level of international marketing and promotion from the community’s perspective.

### Box 4.5      **The Building Brand Australia Program**

The Building Brand Australia Program was a four-year, \$20 million initiative delivered by Austrade starting in 2010. The aim of the program was to brand Australia as a confident and globally engaged business partner. Although the program has concluded, the marketing materials and branding funded by the program are still in use by the Australian Government.

The program’s primary focus was the development of the *Australia Unlimited* brand. The Australian Government owns the rights to the brand and it is used by government agencies and industry as part of international marketing activities and at major international events. The brand is used by Austrade, the Department of Foreign Affairs and Trade, the Defence Materiel Organisation and the Commonwealth Scientific and Industrial Research Organisation. Businesses can also apply to licence the Australia Unlimited brand and logo.

*Sources:* Austrade (2014b, 2015a).

The presence of free riding is not sufficient to justify government provision of marketing. As noted earlier, the case for government involvement also depends on whether the benefits of intervention are likely to outweigh the costs. A business may have sufficient incentives to provide marketing if it can capture substantial private benefits from the activity, even where free riding exists. Governments should be mindful of this possibility and take care not to crowd out private provision of marketing activities.

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#### Box 4.6      **Austrade's promotion of international education**

Austrade's support for Australia's international education sector has three goals:

- promoting Australia as an international education destination and a provider of high quality education services
- helping to grow demand for Australian education and training
- contributing to the development of a sustainable international education sector.

Austrade aims to achieve these goals by:

- improving perceptions of Australia's international education sector through:
  - the use of the *Future Unlimited* brand to promote Australian education internationally
  - an official Australian Government website, Study in Australia, which provides information for international students on courses, education providers and scholarships.
- identifying opportunities for Australian international education providers, including cross-industry and transnational education opportunities, with a focus on Asia and other emerging markets
- engaging with offshore education agents by providing information about Australian education services and assisting with administrative and enrolment matters.
- engaging with other government and non-government organisations.

*Source:* Austrade (2015b).

#### *The need for economic assessments of international marketing and promotion campaigns*

Whether governments are justified in undertaking international marketing and promotion campaigns can only be determined on a case-by-case basis through economic analysis prior to the activity proceeding. The analysis undertaken should be fit for purpose, and the scale and complexity of the analysis should be commensurate with the value of government funding to be provided to the activity. While economic analyses of some (but by no means all) tourism marketing activities are available (chapter 8), such studies are generally not publicly available for activities associated with education or national branding.

National brand and image marketing has the greatest potential for public good characteristics to be present, owing to its wide set of beneficiaries (all Australian businesses that are exporting or seeking to export) and the difficulty of excluding them from capturing benefits. The benefits to each individual business of such programs are likely to be small overall due to the limited extent to which a nation's brand is likely to be associated with a particular business or product.

Programs aimed at a particular sector such as tourism or education are likely to provide greater benefits for individual businesses as each business has a stronger association with the brand, but such programs have a narrower set of beneficiaries (more so for the education sector than tourism) and the risk of crowding out private activity is heightened. Crowding out can occur where the benefits captured by an individual business are large

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enough that the business would have an incentive to undertake marketing, even where some benefits also flow to other businesses.

In general, the more highly concentrated a sector, the more likely it is that the larger businesses in that sector would conduct marketing and promotion in the absence of government provision (as they stand to capture the greatest proportion of the benefits), and there is less of a case for government involvement. For example, larger providers in the higher education sector have the incentive to promote their institution *and* the wider benefits of studying in Australia.

These complexities suggest that in addition to marketing and promotion campaigns being assessed prior to funding, programs should also be assessed following the completion of the campaign. An ex post evaluation of the costs and benefits following the completion of the campaign, also released publicly, would provide further rigour and accountability on the use of taxpayer funds. It would also create information on which to base future policy settings. This principle is consistent with that outlined for destination marketing to promote tourism and is covered in recommendation 8.1.

#### *Cost recovery of international marketing and promotion campaigns*

Where it is feasible for governments to recover the cost of international marketing and promotion campaigns from industry, doing so is likely to enhance efficiency (in line with the beneficiary pays principle outlined above). However, there will be practical difficulties in administering cost recovery where it is costly to identify the businesses that are the beneficiaries of such programs. This is particularly relevant to instances where there are a wide set of ill-defined beneficiaries. In the case of national branding, the potential beneficiaries are extremely diverse and difficult to identify. In these cases, levying charges only on the easily-identified beneficiaries would be inequitable and would not necessarily enhance efficiency. In some instances, there may be scope for government agencies to seek industry funding on a voluntary basis (chapter 8).

#### Government provision of information

The Australian Government through Austrade (box 4.7) and some state and territory governments (box 4.2) provide information, advice and market research to firms seeking to export. Participants were supportive of government provision, due to the ‘public good’ characteristics of information (ACPET, sub. DR38; TTF, sub. DR48). Others noted that language, culture and a lack of information on export market particulars (such as regulatory settings) were impediments to exporting for some firms. For example, around 60 per cent of respondents to Australia’s International Business Survey 2014 identified a lack of information on local culture, business practices, and language as impediments to doing business in overseas markets (AIIA, sub. 7).

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Austrade collects its knowledge of international markets and economic conditions through its network of personnel located in 48 overseas markets (Austrade 2014b). The information sourced through this network is provided to other government agencies, as well as to businesses seeking to export. The presence in overseas markets also allows Austrade to more directly assist businesses by providing access to networks and badge-of-government assistance to firms. For example, the Royal District Nursing Service noted that Austrade helped it broker a joint venture with China's Zhongshan College to develop and operate an aged care facility. The Royal District Nursing Service observed that being associated with the Australian Government provided a level of credibility with Chinese partners that would not be available from entering the Chinese aged care market independently (box 7.4).

The Commission's inquiry into cost recovery by government agencies found public good characteristics to be present in many information products (PC 2001). Drawing on that inquiry, government provision of information to service providers seeking to export can be sorted into three categories.

- Basic information products, which have public good characteristics.<sup>6</sup> This includes information collected to meet a government's own information and data requirements and to deliver services, which can be disseminated at little additional cost. For example, Austrade collects information to provide advice to the Australian Government on its trade, investment, international education and tourism policy agenda, and delivers Australian consular, passport and other government services in specific overseas locations (Austrade 2014b).
- Incremental information products, which involve additional collection, compilation or analysis of information by government beyond that required to provide basic information products. For example, research undertaken by Austrade to provide information on opportunities and barriers for Australian legal and advisory firms across Indonesia, Japan, Singapore and South Korea (DFAT, sub. 31).
- Commercial (contestable) products, which compete with similar products offered by private firms. Examples include tailored advice, coaching or specialised market research reports designed to meet the needs of specific users, where private research consultancy firms can prepare similar products.

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<sup>6</sup> Another reason for classifying basic information products is the presence of significant positive spillovers such as those associated with weather forecasting and basic statistical data about the economy (PC 2001). For example, the Tourism and Transport Forum Australia (sub. DR48) highlighted the importance for the tourism sector of robust and timely national statistics and data from the ABS. Other sectors of the economy similarly benefit from ABS statistical data. Positive spillovers are less relevant for information, advice and market research provided to firms seeking to export by Austrade and state and territory agencies, as the benefits from exporting largely accrue privately.

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#### **Box 4.7 Austrade's provision of information**

Austrade provides information, advice and market research through its network of advisers, located offshore and in Australia. Principally Austrade helps businesses by:

- delivering market insight and intelligence
- providing advice on how to do business in prospective markets
- providing access to networks of key decision makers, customers and contacts in overseas markets
- identifying and assessing business opportunities in international markets, and helping Australian businesses capture them
- promoting the capability and capacity of Australian businesses
- providing badge-of-government assistance to firms in-market and helping them with behind-the-border barriers to trade and investment. For example by:
  - helping businesses to understand foreign regulatory processes and providing advice on how to engage local authorities
  - advocating for Australian businesses in dealings with foreign governments and other bodies
  - working with the Department of Foreign Affairs and Trade to reduce exporting barriers, by helping other countries improve their local regulatory systems.

Austrade also provides businesses with individually tailored services, such as:

- market or country research to assist with the selection of new export markets, including information on barriers and regulations, market trends and specific market insights
- identification of potential partners and customers, including introducing potential partners, service providers and customers for a product or service
- setting up meetings with potential partners and customers. In some markets, Austrade can also join meetings to provide language and cultural support
- targeted representation using Austrade's status as a government organisation to facilitate strategic introductions overseas.

Austrade also refers businesses, and potential foreign investors, to advisors with the specialist expertise to help them navigate complex international markets or seek assistance in Australia.

In 2013-14, Austrade provided 15 026 services to 6608 businesses and education institutions.

*Sources:* Austrade (2014, pers. comm., 21 July 2015); DFAT (sub. 31).

#### *There is a case for government provision and funding of basic information*

There is an in-principle case for government bodies to provide basic information to businesses where the information is collected anyway to improve the effectiveness of government activities (PC 2015b). The benefits of providing basic information to businesses are likely to outweigh the costs as the fixed costs of collecting the information have already been incurred during the course of government policy purposes and, once the information is available, the marginal cost of its supply to an additional business is generally small.

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Cost recovery is unlikely to be viable as the costs of identifying and excluding the diffuse beneficiaries are likely to be large in comparison to the (small) cost of providing the information. Funding the provision of basic information from general taxation revenue is therefore preferable.

*Cost recovery should apply to incremental information*

Information products that are incremental extensions of basic products are unlikely to have any competitors (PC 2001) so it may fall to government to provide this information. However, there is unlikely to be a clear or permanent divide between what is incremental information and what can be provided commercially, so governments should regularly review the case for providing incremental information on a case-by-case basis, considering the risk of crowding out private provision.

Cost recovery will often be feasible for incremental information and cost recovery of the additional costs (of collection, analysis and dissemination) incurred by the government agency should be pursued. This enhances efficiency by providing a signal to users about the costs of the additional resources involved, which gives users an incentive to adjust or modify their usage in line with their willingness to pay. In addition, by charging for their incremental products, government agencies receive signals about which products are in demand and which are not, thereby helping them to adjust the mix of products and services offered (Gunasekera 2004).

*Provision of commercial information products are best left to private providers*

There is generally no market failure rationale associated with the provision of commercial products, as these can be provided privately in the absence of government involvement. In these instances, the costs of government provision of information or advice are likely to outweigh the benefits, as government provision risks crowding out private sources.

Where governments do provide commercial products such as tailored advice, coaching or specialised market research reports, competitive neutrality principles should apply. Prices set according to competitive neutrality reflect the advantages and disadvantages of public ownership and should at least cover costs, including a return on capital investment and all relevant taxes and charges (PC 2001).

*There is scope to strengthen efforts to recover the costs of information provision*

In summary, whether cost recovery is appropriate depends on the nature of the information provided and the extent to which governments can identify and charge the beneficiaries. The Commission notes that at present cost recovery of information provision is applied inconsistently across government agencies. Examples include:

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- The bulk of Trade and Investment Queensland’s services (including the provision of market research, consultation and advice provided by trade advisors, and the identification of trade partners) are free of charge with the exception of:
    - charges applied to applications to the Business and Skilled Migration unit
    - charges made on a cost recovery basis for the staging of overseas trade missions and trade exhibitions (Trade and Investment Queensland, pers. comm., 31 July 2015).
  - The NSW Government does not currently charge businesses accessing the Export Accelerator Program (currently under review) or the Export Capability Program (box 4.2), or businesses that receive coaching from Export Advisors. The NSW Government does occasionally charge a ‘participation fee’ for businesses’ trade missions. However, these charges are not on a full cost recovery basis (NSW Department of Premier and Cabinet, pers. comm., 31 July 2015).
  - Austrade charges on a cost recovery basis for tailored trade services that are deemed to provide a private or exclusive benefit for that business. Many of Austrade’s services are provided free of charge, for example when the services are delivered entirely in Australia by Austrade’s Trade, Education and Investment Advisers or TradeStart Advisers (Austrade, pers. comm., 31 July 2015).

There may be scope for some government agencies to strengthen efforts to recover the costs of providing information, advice and market research to service providers that are seeking to export. In particular, governments should seek to recover the costs of providing information that goes beyond that collected to meet governments’ own information and data requirements.

#### RECOMMENDATION 4.7

The Australian, state and territory governments should strengthen efforts to recover the costs of providing information, advice and market research to service providers that are seeking to export.

- Basic information, such as that collected to meet a government’s own information and data requirements, should be funded from general taxation revenue.
- Incremental information, which involves additional collection, compilation or analysis of information by government beyond that required to provide basic information products, should be cost recovered.
- Commercial products, such as tailored advice, coaching or specialised market research reports are best left to the private sector, but where governments are involved, the products they provide should be priced according to competitive neutrality principles.

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## The provision of export finance and insurance products to exporters

EFIC was established by the Australian Government to facilitate and encourage Australian export trade (including service exports) through the provision of financial services and insurance products, and to publish information relevant to Australian exporters. Its main functions under the *Export Finance and Insurance Corporation Act 1991* (Cwlth) are to:

- encourage and facilitate Australian export trade
- encourage banks and other financial institutions carrying on business in Australia to assist in financing export contracts
- manage the Australian Government's aid-supported loan program
- provide information and advice regarding insurance and financial products available to support Australian exports.

The Commission's 2012 inquiry into export credit provided through EFIC found that the only potential rationale for government involvement in export finance and insurance related to information problems affecting newly exporting small and medium-sized enterprises (SMEs). Newly exporting SMEs may not have a credit history with a bank or have successfully fulfilled an export contract. There is a possibility that this may lead to inefficient outcomes if the information-related market failures prevent commercially viable export transactions from proceeding. The Commission recommended that EFIC's role on its commercial account should be to efficiently address the information-related market failures faced by newly exporting SMEs.

As noted in a joint submission from DFAT and EFIC, the Australian Government has taken steps to align EFIC's role with the Commission's 2012 recommendations (DFAT, sub. DR49). Specifically, the passing of the *Export Finance and Insurance Corporation Amendment (Direct Lending and Other Measures) Act 2015* (Cwlth) removes EFIC's exemption from competitive neutrality. In addition, the Ministerial Statement of Expectations for EFIC, issued on 13 November 2014, requires that EFIC primarily focus on providing support to SMEs and introduces some stipulations on the support EFIC can provide to large firms and large projects. Stipulations introduced by the Statement of Expectations require EFIC to cease support of onshore resource projects, but allow it to continue to support large overseas resource projects. The support of large overseas projects is contingent on EFIC demonstrating that it is not crowding out private sector financial providers, that the project has significant Australian content, and that such support is not at the expense of SME transactions (Robb 2014).

Further reform is required to ensure that EFIC's activities are targeted to a market failure. The Australian Government has not adopted the requirement that SMEs receiving assistance be 'newly exporting' (DFAT, sub. DR49; ECA, sub. DR52) and the changes made to the Statement of Expectations stopped short of ruling out the provision of financial support for large firms. The Commission acknowledges that only around 11 per cent of EFIC's signings (by number) in 2014-15 were with firms that had a turnover of more than \$50 million (DFAT, sub. DR49). However, assistance to large firms, with an annual

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turnover of more than \$150 million, continues to represent a large proportion of the value of EFIC's transactions. In 2014-15, EFIC's support for large businesses accounted for 40 per cent of the face value of facilities signed in that year (EFIC 2015).

The Commission remains of the view that EFIC's mandate should not permit support for large firms and that its commercial role should be *solely* focused on reducing barriers for newly exporting SMEs in accessing financial services.

RECOMMENDATION 4.8

The Australian Government should make amendments to the *Export Finance and Insurance Corporation Act 1991* (Cwlth) to confine the Export Finance and Insurance Corporation solely to meeting the objective of addressing market failures that affect newly exporting small and medium-sized enterprises. Small and medium-sized enterprises should be defined as entities, including any related entities, with fewer than 100 full-time equivalent employees or annual turnover of less than \$50 million.

Changes to enhance transparency are also required to ensure that EFIC's activities are consistent with the objective set out above. Presently, EFIC's performance management framework is set by its Board in accordance with the requirements of the *Public Governance, Performance and Accountability Act 2013* (Cwlth) (DFAT, sub. DR49; ECA, sub. DR52). In addition, EFIC now formally shares its pricing of facilities with the relevant relationship bank of each exporter prior to signing, and aggregate pricing of its facilities will be published in EFIC's Annual Report and on its website (DFAT, sub. DR49).

Although the Public Governance, Performance and Accountability Act requires EFIC to meet certain transparency standards, particularly in relation to planning, reporting and performance, additional measures are required to ensure that the facilities being provided are in line with the Commission's market failure mandate for EFIC. Consistent with the Commission's 2012 review of EFIC, a new transparent performance management framework should be developed by EFIC with indicators based on the objective of addressing the market failures affecting newly exporting SMEs.

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#### RECOMMENDATION 4.9

The Minister should amend the Statement of Expectations to require the Export Finance and Insurance Corporation (EFIC) Board to establish a performance management framework directed at achieving the objective for EFIC set out in recommendation 4.8.

The framework should be developed in consultation with other Australian Government agencies, be consistent with requirements under the *Public Governance, Performance and Accountability Act 2013* (Cwlth), and use relevant performance benchmarks and indicators for EFIC's business units, including treasury operations.

EFIC should publicly report its performance against this framework in its annual report and corporate plan.

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## 5 International barriers to service exports

### Key points

- International barriers to service exports are pervasive, affecting all Australian service export sectors. Data localisation measures, for example, can affect any service sector where businesses manage data. Other international barriers can impede the provision of services through specific modes of supply. Visa and licensing arrangements, for example, affect the provision of services via the movement of people across borders.
- Two barriers to service exports that have been an increasing focus for those interested in services trade are restrictions on cross-border data flows and violation of intellectual property rights.
  - Unnecessary restrictions on cross-border data flows can force businesses to invest in data centres that cost tens of millions of dollars, or develop costly workarounds. Allowing service providers to store data offshore can help them to better manage risks associated with handling data, and to exploit the scale economies offered by cloud computing services. Methods other than restrictions on cross-border data flows, such as contracts or legislation, could be used to address data security and privacy concerns.
  - Some Australian service providers, including providers of architectural, engineering and software services, would benefit from better enforcement of commitments to protect intellectual property rights in other countries.
- There are also restrictions on the movement of people, such as overly burdensome professional licensing regulations and visa processes, as well as restrictions on Australian service firms establishing a commercial presence abroad.
  - Of the sectors covered in this study, professional service providers are likely to benefit most from reducing barriers arising from licensing and standards regulations. Some industry associations and service providers have identified the market for legal services in India as an area where large gains from reducing barriers could be achieved.
  - Barriers to Australian firms establishing a commercial presence abroad are particularly high in key markets in Asia, notably China, India and Indonesia. These barriers are especially costly for financial service providers, as establishing a foreign commercial presence is the most common mode of trade in financial services and there remain substantial restrictions to financial services investment in key markets in Asia.
  - Reducing investment barriers would not only improve market access for Australian services firms but could reduce the ongoing costs of providing services if it avoids firms having to implement costly workarounds to their business structures.

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## 5.1 Overview of international barriers

Strong demand over the past decade for better information on barriers to international trade in services from trade negotiators, researchers and the private sector has seen the volume of information on barriers grow significantly (Borchert, Gootiiz and Mattoo 2012). The World Bank and the OECD have developed databases on international trade in services (chapter 2). Of the two, the OECD database is based on more recent information and covers more of the service sectors included in the Commission's terms of reference (in particular, the financial, professional and information technology (IT) service sectors).

The OECD services trade restrictiveness index enables analysis of differences in barriers to international trade in services across countries. While the indexes are subject to data and methodological limitations (chapter 2) they can provide some insight into the restrictiveness of trade barriers. The index scores suggest that developing countries have the greatest restrictions on services trade in the financial, professional and IT service sectors (figure 5.1). Some of these countries are among the largest importers of services from Australia, including China (the largest), India (the 6th largest) and Indonesia (the 11th largest) (table 3.1). The data also suggest that Australia imposes a low level of restrictions to services trade for these sectors relative to other countries in the database.

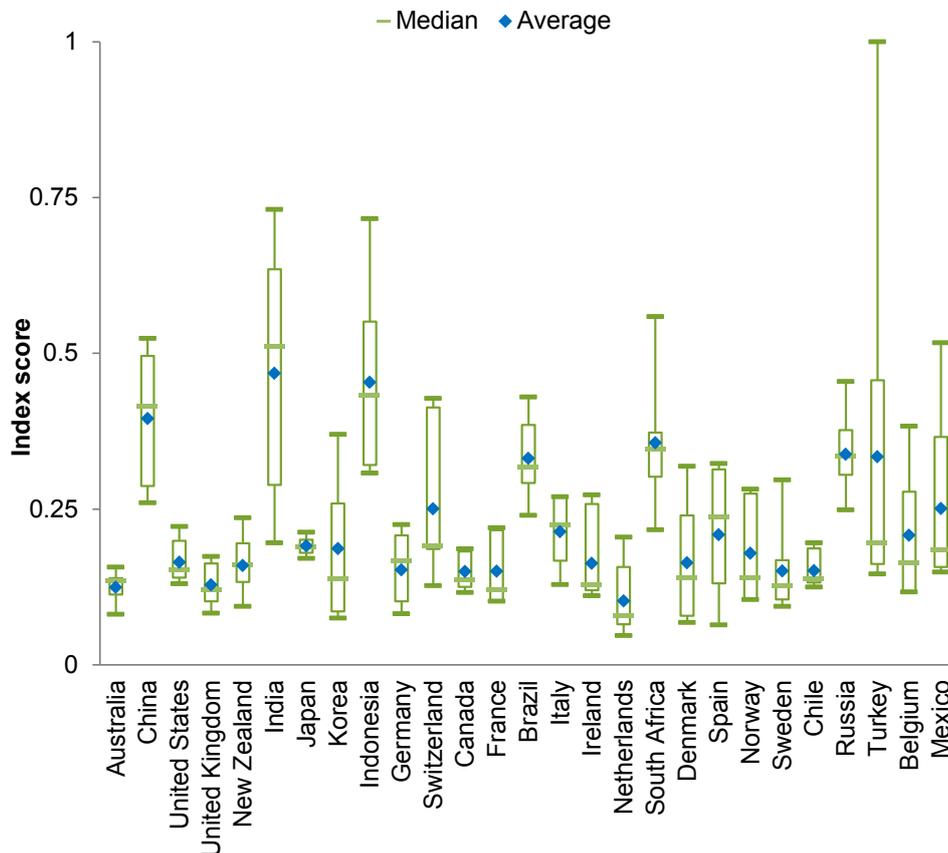
The highest index scores are in subsectors that have traditionally been subject to a high level of regulation — the legal, accounting, insurance and banking subsectors (figure 5.2). India and Indonesia have the two highest index scores in the legal, insurance and banking subsectors.

Common restrictions in the professional services sector relate to the movement of people through professional licensing regulations, foreign ownership restrictions and other market entry conditions (Grosso et al. 2014a, 2014b). Foreign equity limits and restrictions on legal form are important in the financial sector (Rouzet et al. 2014). Barriers related to licensing and investment were also highlighted by study participants (AFMA, sub. 14; ANZ, sub. 23; Insurance Australia Group, sub. 10). Differences in barriers across countries for specific sectors are examined further in chapter 6 (financial services) and chapter 8 (professional and IT services).

The OECD database does not account for all potential international barriers to services trade. Two cross-cutting barriers (barriers that affect more than one service sector) not included in the database, but that have been an increasing focus for those interested in services trade, are restrictions on cross-border data flows and violation of intellectual property rights. These barriers have been brought to the Commission's attention by study participants (ANZ, sub. 23; Cox Architecture, sub. 2; FSC, sub. 20; Place Associates, questionnaire 10).

Figure 5.1 **Services trade restrictiveness by country<sup>a,b,c</sup>**

Countries in the OECD database that are in Australia's top 40 trading partners, and Australia

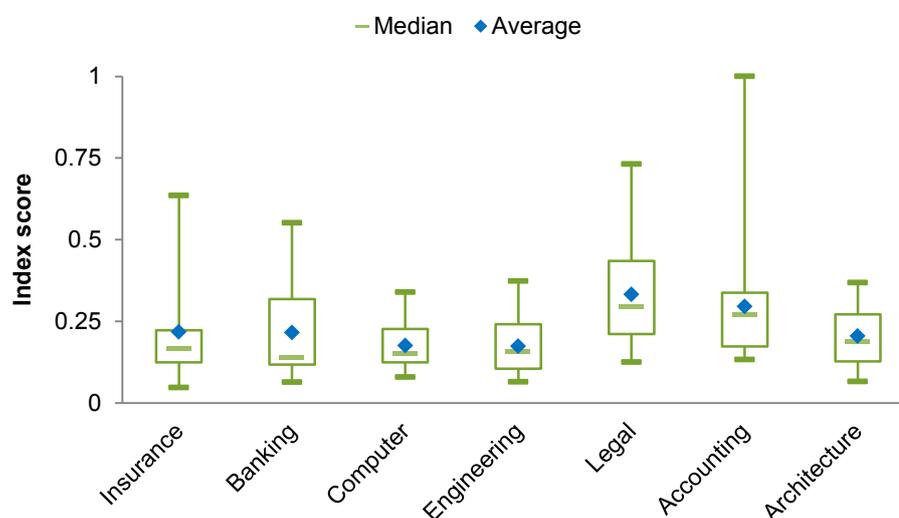


<sup>a</sup> Countries are ordered from left to right by the value of service exports from Australia in 2014. The figure displays the maximum, third quartile, average, median, first quartile and minimum subsector index scores. The maximum is given by the top whisker, the third quartile by the top of the box, the first quartile by the bottom of the box and the minimum by the bottom whisker. Index scores range from 0 to 1, where 0 indicates that a country's service sector has no barriers to foreign service providers, and 1 is completely closed to foreign service providers. To derive the quartiles, each country's index scores for all sectors are ordered from lowest to highest. <sup>b</sup> The data were collected at the end of 2013 and cover the financial (insurance, banking), professional (legal, accounting, architecture, engineering) and IT (computer) service sectors. <sup>c</sup> The index does not account for specific concessions such as bilateral and regional trade agreements or mutual recognition agreements, and does not include barriers that exclusively apply to mode 1 or mode 2 supply. The index does not account for restrictions on cross-border data flows or violation of intellectual property rights for the sectors included in this figure. Accordingly, the index may provide a distorted view of differences in barriers across countries if some countries have more barriers not included in the database than other countries.

Sources: ABS (*International Trade in Services by Country and by Detailed Services Category*, Cat. no. 5368.0.55.004, based on customised table); OECD (2015b).

The Commission has focused its analysis of cross-cutting international barriers to service exports in four areas: restrictions on cross-border data flows; violation of intellectual property rights; impediments to the movement of service providers; and investment barriers in overseas jurisdictions.

Figure 5.2 Services trade restrictiveness by subsector<sup>a,b,c</sup>



<sup>a</sup> Sectors are ordered from highest value of Australian exports (insurance services) to lowest (architecture services) using ABS data and information from Bingham (2011). The figure displays the maximum, third quartile, average, median, first quartile and minimum country index scores for each service sector. The maximum is given by the top whisker, the third quartile by the top of the box, the first quartile by the bottom of the box and the minimum by the bottom whisker. Index scores range from 0 to 1, where 0 indicates that a country's service sector has no barriers to foreign service providers, and 1 is completely closed to foreign service providers. <sup>b</sup> The data were collected at the end of 2013 and cover the 26 countries in the OECD database that are among Australia's top 40 trading partners. <sup>c</sup> The index does not account for specific concessions such as regional trade agreements or mutual recognition agreements, and does not include barriers that exclusively apply to mode 1 or mode 2 supply. The index also does not account for restrictions on cross-border data flows or for protection or enforcement of intellectual property rights for the sectors included in this figure. Accordingly, the index may provide a distorted view of differences in barriers across sectors if some sectors are more affected by barriers not included in the database than other sectors.

Sources: ABS (*Australian Outward Foreign Affiliates Trade, 2002-03*, Cat. no. 5495.0; *Balance of Payments and International Investment Position, Australia*, Cat. no. 5302.0); Bingham (2011); OECD (2015b).

## 5.2 Cross-border data flows

### The role of cross-border data flows in facilitating service exports

Exporters in all Australian service sectors rely on the internet and the movement of data across borders to export their services. Service exporters use the internet and cross-border data flows to communicate with their customers, advertise their services, process payments and settle transactions, and deliver digital products online. The United Nations Conference on Trade and Development estimated in 2009 that about 50 per cent of all traded services are enabled by the technology sector, including by cross-border data flows (ITIF 2015). The internet and cross-border data flows also enable Australian businesses to participate in global value chains by providing discrete components of a good or service, such as

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designing and electronically transmitting the design of a good that is to be manufactured or constructed overseas.

Cross-border data flows enable service providers to store and process data in other countries using data ‘hubs’, and are an integral feature of cloud computing services.<sup>1</sup> Storing data in other countries can help Australian service providers manage some types of business risk. For example, insurers maintain backup copies of insurance data in multiple locations to ensure continuity of service in the event of power outages or physical damage to data servers (USCC and Hunton & Williams 2014). Data hubs and cloud computing can result in lower data management costs for service exporters due to scale economies in storing and processing data. The Commonwealth Bank’s adoption of cloud computing technology halved its storage and application development costs, and reduced the proportion of its IT budget spent on IT infrastructure from 75 per cent to 26 per cent (Duckett 2012; Foo 2012).

## **Restrictions on cross-border data flows**

The increased use of digital technologies to trade services has seen governments impose restrictions on the flow of data across their borders. Data localisation measures require foreign and domestic businesses to store, and in some cases process, data in local data centres.<sup>2</sup> Some governments restrict their citizens’ and businesses’ use of the internet, which can inhibit the flow of data into a country. Data localisation measures often apply to all or particular industries, while internet restrictions are most commonly targeted at particular service providers (Liu 2011; Meltzer 2013).

Data localisation measures can force businesses to invest in data centres that cost tens of millions of dollars, or develop costly workarounds. There are reports that some businesses’ costs could increase by up to five times if forced to build local data centres (discussed further below). Some service providers have called for data localisation measures to be removed entirely (AIIA 2013; FSC, sub. 20; GSC 2014).

### **Forms of data localisation measures**

Governments have imposed different data localisation measures (box 5.1). Some measures apply to any personal or business data, and so can affect any service sector where businesses manage data. While some measures only require a copy of the data to be stored locally, others go further, mandating that the data cannot leave the country. Some measures

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<sup>1</sup> Cloud computing services include the provision of electronic information storage, processing power and computer programs provided over the internet through the use of computer servers that are managed by the service provider or a third party. Cloud computing is now common practice for businesses, including service exporters (National Board of Trade Sweden 2014).

<sup>2</sup> Cross-border data flows may also be impeded due to differences in technical standards across countries relating to procedures for transferring data across borders. Technical standards are considered in section 5.4.

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allow data to flow into other countries provided they meet certain standards of data protection.

#### **Box 5.1      Examples of data localisation measures**

- In Malaysia, the Personal Data Protection Act requires that data users do not transfer personal data to jurisdictions outside Malaysia unless that jurisdiction has been specified by the Minister, subject to exceptions (DLA Piper 2015).
- In India, the Information Technology Rules limit the transfer of sensitive personal data abroad to when 'necessary' or when the data subject consents to the transfer abroad (DLA Piper 2015). India has also proposed measures to require businesses to locate part of their IT infrastructure within the country (National Board of Trade Sweden 2014).
- In Russia, amendments to the Data Protection Act that came into force on 1 September 2015 require all personal data of Russian individuals to be stored and processed in local data centres (DLA Piper 2015; Duane Morris 2015).
- In Canada, the Federal Government's request for proposals for a contractor to consolidate its IT services into a single platform stipulates that the contracted company is prohibited from allowing the Government's data to leave Canada (USTR 2015a).
- In Europe, personal data can only flow to countries that the European Commission has assessed can guarantee an adequate level of data protection (EC 2015a). (In 2001 the European Commission assessed that amendments to the Australian Privacy Principles in the *Privacy Act 1988* (Cwlth) did not guarantee an adequate level of protection (EC 2001). The Australian Privacy Principles were amended in 2012.)

Some governments and regulators have introduced measures that specifically restrict financial data from being processed in other countries. In 2011, China's central bank issued a notice prohibiting banks from storing or processing financial information obtained in China offshore (USITC 2012). South Korea requires that financial institutions process data onshore unless clients provide written consent, although its trade agreement with Australia provides an exception to this requirement. Study participants highlighted restrictions on cross-border data flows in the Singapore financial sector. ANZ has argued that Singapore's data rules preclude the use of cloud computing technology (ANZ 2013).

Some Australian laws impose limits on cross-border data flows. The *Personally Controlled Electronic Health Records Act 2012* (Cwlth) prohibits the storage or processing of certain health records outside Australia. The *Privacy Act 1988* (Cwlth) outlines principles for the cross-border disclosure of personal data. The Privacy Act requires that (with certain exceptions), prior to disclosing personal data to an overseas recipient, an organisation must take steps to ensure that the recipient does not breach these principles.

Governments may introduce data localisation measures to address concerns over data security and privacy. The Explanatory Memorandum for the *Personally Controlled Electronic Health Records Act* states that allowing health information to be stored or processed outside Australia increases the risk of the information being compulsorily acquired by foreign governments (Roxon 2011). In New Zealand, the Inland Revenue

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Service provides permission to store business records offshore if doing so does not hinder its tax compliance activities (IRS 2014). Data localisation measures are also sometimes used by governments to address other objectives, such as industry protection, regional development or local employment objectives. The French Government declared its support for efforts to keep data storage and processing local to support domestic employment (Chander and Le 2014).

Governments have taken steps to reduce restrictions to cross-border data flows and the Australian Government is currently involved in an Asia-Pacific Economic Cooperation (APEC) project relating to harmonisation of standards to facilitate cross-border data flows (box 5.2). Chapter 9 includes a discussion of options for addressing unnecessary barriers to cross-border data flows.

#### **Box 5.2 Efforts to address barriers to cross-border data flows**

- Voluntary guidelines for managing data confidentiality have been developed. These efforts can help to facilitate cross-border data flows.
  - The OECD's Guidelines on the Protection of Privacy and Transborder Flows of Personal Data, adopted by all OECD member countries, encompass eight data protection principles.
  - APEC's Information Privacy Principles include nine principles for the management of personal information. Some countries, including China, have indicated that they do not intend to apply the framework (National Board of Trade Sweden 2012).
- Frameworks have been developed to directly facilitate cross-border data flows.
  - The APEC Cross-Border Privacy Rules (CBPR) system allows a CBPR-certified organisation in one participating economy to transfer personal information to a CBPR-certified organisation in another participating economy. While all APEC economies have endorsed the CBPR system, take-up has been described as slow (IIS 2015). APEC member economies and the European Union are working to harmonise the CBPR system and the analogous European 'binding corporate rules' system (Falque-Pierrotin 2015).
  - The Australian Government Treasury is, in association with Standards Australia, leading an APEC project relating to harmonisation of standards to facilitate cross-border data flows (Standards Australia, sub. 9).
- Cross-border data flows have been the subject of trade negotiations.
  - The South Korea–Australia trade agreement led to the removal of rules in South Korea that required financial institutions to process data onshore unless clients provide written consent. The United States–South Korea trade agreement contains a provision that states 'parties shall endeavour to refrain from imposing or maintaining unnecessary barriers to electronic information flows across borders'.
  - The Trans-Pacific Partnership Agreement (TPP) and Trade in Services Agreement are expected to include provisions that address cross-border data flow issues. The proposed TPP includes a commitment by the parties to allow the transfer of data across borders as well as provisions relating to the protection of personal information.

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## **The effects of cross-border data flow restrictions on service exports**

Data localisation measures can increase the upfront and ongoing costs of export operations for Australian service providers and inhibit the supply of services. Upfront costs can be increased where a service provider is required to build local data centres, either because of explicit IT infrastructure investment requirements or because existing infrastructure is unsuitable for the service provider's needs. The costs of building data centres can be in the tens of millions of dollars (Business Roundtable 2015; Chao and Trevisani 2013). If the costs of building a data centre are prohibitive, the service provider will either not supply the export market or will substitute to another supply mode, which may involve higher ongoing costs of export operations. The (United States) Business Roundtable has argued:

Choking off cross-border data flows can also force costly workarounds. When laws require data to be stored and processed in-country, companies may attempt to comply by replicating (at great cost) otherwise centralized systems, connectivity, software and even supporting data. A company that hosts back-office services at two centralized data centers (one primary, one backup for resiliency and disaster recovery) could see operating costs multiplied by a factor of three to five if forced to create regional data centers. For example, one [Business Roundtable] member company forced by law to create a small data center in Canada spends \$1 million annually on that two- to three-worker operation. (2015, p. 27)

Ongoing costs can be increased, for example, where data localisation prevents service providers from benefiting from the scale economies available from processing data in regional data hubs. Data localisation measures may also raise costs by forcing businesses to send workers to where data is generated, rather than vice versa (Business Roundtable 2015). Data localisation measures may also inhibit efficient production methods for services. The Australian Services Roundtable said that restrictions on cross-border data flows can prevent service providers from 'breaking down the value chain so as to produce various components of a service or product in different countries' (sub. 30, p. 12).

## **Costs and benefits of reducing restrictions on cross-border data flows**

Removing data localisation measures would benefit Australian service providers in a range of service sectors. The greatest benefits would likely accrue to service providers that are intensive users of data hubs and cloud computing services, such as financial service providers. Australian financial service providers such as ANZ and Westpac operate regional data hubs in Asia. ANZ (2013, p. 4) noted that restrictions on cross-border data flows 'inhibit organisations' ability to gain the full benefits of new technologies'.

Some countries with barriers to cross-border data flows have large and growing demand for financial services, including China, Malaysia and Singapore. Australian providers of cloud computing services could directly benefit from removing restrictions on cross-border data flows.

It is less clear to what extent data localisation measures have raised costs or inhibited supply — that is, it is difficult to gauge the 'height' of the barrier imposed by cross-border

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data flows (chapter 2). As noted, there are reports that some businesses' costs could increase three to fivefold if forced to build local data centres. Enabling service providers to store data offshore can also help them to better manage risks associated with managing data and to exploit the scale economies offered by cloud computing services. Greater flexibility over how and where data are stored and processed could help to promote innovation in how services are produced and supplied.

Removing data localisation measures may benefit the countries that remove such measures. Allowing local businesses to draw on cloud computing services can decrease their costs and increase their opportunities to participate in global value chains. Removing data localisation measures also increases access to global services for consumers by making it easier for foreign service providers to operate in the country. The costs that arise for countries that impose data localisation measures have been quantified in a computable general equilibrium model of world trade (Bauer et al. 2014). Estimated decreases in countries' gross domestic product from economywide data localisation measures averaged around 1 per cent.

As outlined above, some governments restrict cross-border data flows to address legitimate concerns about data security and privacy. While there is an in-principle case for policies that promote data security and privacy, it is not clear that data localisation measures will always be the best method of meeting that objective.

- Chander and Le (2014) argue that global data service providers — which are subject to global competition — are likely to develop stronger security systems than local service providers protected by data localisation measures, as global providers operate in a more competitive environment. Chander and Le also argue that data localisation measures reduce the opportunities to 'shard' data — that is, store data in separate 'pieces' in different servers around the world, making it a harder target for criminals. Castro (2013) argues that the security of data does not depend on where data are stored, only on the measures used to store data. Study participants noted during consultations that security protocols are more important than where data are stored.
- Castro (2013) also argues that data owners can rely on contracts or laws to limit data disclosures so that data stored offshore meet the required standards for data protection. In contrast, data localisation measures are a blunt policy tool that prevent data from being transferred anywhere offshore — including jurisdictions with strong protocols around data security and privacy.

If concerns about data security and privacy are not adequately addressed then removing data localisation measures could erode public trust in the internet as a place to do business. Even the chance of such a response could undermine the case for lessening data-flow restrictions. Effective measures, such as security protocols and contracts and laws, may need to be in place to preserve confidence within the community that international trade in services via cross-border supply is not undermining the privacy and security of data.

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## 5.3 Intellectual property

### The role of intellectual property in facilitating service exports

Intellectual property (IP) laws provide inventors, artists and institutions exclusive rights to produce, copy, distribute and license goods and technologies within a country. Formal IP protection measures include the enforcement of trademarks, patents and copyright. IP may also be protected by maintaining trade secrets (such as business plans and internal market analysis) and confidentiality agreements. The main rationale for providing legal protection and enforcement of IP rights is to promote innovation and creativity by enabling innovators to capture a sufficient amount of the benefits to support the initial investment of time and resources. The benefits of IP protection and enforcement must be weighed against the costs that may arise (in the form of higher prices and restricted supply) from conferring temporary monopoly power to holders of IP rights. IP rights can also impede how knowledge and discoveries are diffused through an economy, with implications for subsequent innovation and wellbeing more generally.

Service providers depend on their IP being protected and enforced in export markets. Exporters of software services that can be copied relatively easily and cheaply rely on copyright enforcement. Architects and engineers may also rely on copyright protection for their designs and drawings. Some service exporters may rely on patents. For example, Rision, an Australian human resources company, has a mobile recruitment and human resources platform that is patented in the United States.

Some service providers rely on having access to IP-protected content. Internet intermediary services such as cloud computing, search engines and trading platforms may be required to handle digital content protected by copyright. Digital content cannot be handled without being copied, so in some jurisdictions these services may be in breach of copyright (ALRC 2013). An example of an Australian business that relies on access to IP-protected content is the music intermediary Guvera, which negotiates legal access to copyright-protected music and streams this music to its subscribers online.

### Protecting and enforcing IP is more difficult in some markets

The level of IP protection and enforcement varies across countries. Some countries' IP laws may have relatively low standards of IP protection because, for example, some ideas or innovations cannot be protected, or because the minimum duration of protection is shorter than in other countries. Some countries may lack strict sanctions to enforce IP rights and deter potential violators (USTR 2015b).

Some study participants raised IP infringement as a barrier to the export of their services. Cox Architecture (sub. 2) noted instances where its designs had been used in China and Malaysia without permission or payment. Place Associates (a provider of property consultancy services) cited infringement of copyright as a barrier (questionnaire 10,

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box 5.3). The Commission heard in consultations that engineering designs can also be subject to IP infringement. In a submission to the Indonesia–Australia Comprehensive Economic Partnership Agreement, the Government of Western Australia (2011) argued that unreliable IP and copyright guidelines in Indonesia restrict trade. The Department of Foreign Affairs and Trade (sub. DR49) also stated that Australian service providers have raised difficulties relating to application and objections processes for IP rights in a number of Australia’s trading partners.

### **Box 5.3 Place Associates and intellectual property rights**

Place Associates is a professional services firm that provides property strategy and research services to clients in Australia, Singapore and the Philippines through cross-border supply. Place Associates develops property advice using an in-house methodological framework, which is underpinned by a large body of accumulated knowledge. Drawing on an established framework enables Place Associates to exploit economies of scale when developing advice for its clients. To help it win business, Place Associates shows potential clients parts of its methodological framework.

Place Associates suspects that some of its potential clients have copied the material that it has shared to illustrate its framework, then used this copied material to develop strategies themselves. For example, after making a pitch to a client in Shanghai in 2012, Place Associates suspects that the client copied the presentation materials used for illustrating the methodological framework. The client subsequently developed a strategy itself.

Place Associates estimates that unpermitted use of its intellectual property has cost it up to \$100 000 in lost revenue, and imposed costs through the time taken by senior staff to address the issue. To address this barrier Place Associates altered the way it conducted its business by selectively working with trusted businesses and clients. Place Associates also no longer seeks to win business in China or India, where it considers it would not be able to receive legal remedies if its intellectual property were used without permission.

*Source:* Place Associates (pers. comm., 20 July 2015).

Data from the International Property Rights Index (2014) suggest that, of Australia’s top 40 trading partners, the countries with the lowest levels of IP rights protection are in Asia. Focused on patent and copyright protection, the Index scores 97 countries out of 10 according to their level of protection of IP. Scores in the 2014 report ranged from 8.6 (Finland) to 2.6 (Bangladesh), with the average score 5.7. The countries among Australia’s top 40 trading partners awarded the lowest scores in 2014 were Indonesia (4.2), Vietnam (4.3) and Thailand (4.6). While China scored 5.4 overall (up from 4.5 in 2007), it scored relatively low on copyright protection (2.3). Australia achieved a score of 8, and so according to this measure provides relatively strong protection for IP.

The United States Trade Representative (USTR) reviews the state of IP rights protection and enforcement in a number of countries on an annual basis. In its 2015 report the USTR highlighted a range of concerns, including cases of trade secrets being stolen in China and India, the continuing challenges of online copyright piracy in countries such as Brazil, China, India and Russia, and the unauthorised use of licensed software (USTR 2015b).

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International efforts to persuade countries to meet their commitments to protect and enforce IP rights agreed through World Trade Organization (WTO) and World Intellectual Property Organization agreements are ongoing, with some countries yet to establish IP rights enforcement mechanisms (box 5.4).

## **The effects of IP rights violation on service exports**

Weak protection and enforcement of IP rights inhibits service exports by reducing demand for services supplied by Australian service providers. For example, an Australian service provider that developed a copyright-protected software program may see demand for licensed copies fall in countries where users can easily obtain illegal copies with little likelihood of punishment.

### **Box 5.4 International efforts to establish and enforce IP rights**

- The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), established in 1995, sets minimum IP protection standards that WTO member states must comply with. The Agreement is the first broadly subscribed multilateral IP rights agreement subject to mandatory dispute settlement provisions. Some signatories, including India and Indonesia, are yet to establish IP rights enforcement mechanisms. The APEC Intellectual Property Experts Group is implementing a work program that aims to fully implement TRIPS among its members.
- Following TRIPS, IP obligations have been included in trade agreements and multilateral arrangements such as the Anti-Counterfeiting Trade Agreement (involving Australia but yet to be brought into force). IP provisions in trade agreements may provide stronger protection for rights holders than TRIPS.
- The World Intellectual Property Organization administers the Copyright Treaty and Performances and Phonograms Treaty. These treaties seek to establish protection for creative works on the internet. The Copyright Treaty extends IP rights to broader subject matter than TRIPS and clarifies rights of authors to control the communication of their works.

*Sources:* Maskus (2008); USTR (2015b).

Weak protection and enforcement of IP rights may also increase Australian service providers' upfront and ongoing costs of export operations. For example, a service provider may set up its own commercial operations in an export market (either as a sole or joint venture) to avoid having its IP rights violated, increasing the upfront and ongoing costs of export operations relative to the costs of licensing a third party to sell the service. A Canadian business that designs household products resorted to establishing its own manufacturing facilities in China to help avoid IP infringement there (Smith 2015).

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## **Costs and benefits of greater protection and enforcement of IP**

Some Australian service providers would benefit from other countries better meeting their commitments to protect and enforce IP rights agreed through the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Better enforcement of IP rights in other countries could be particularly helpful in reducing barriers to exporting architectural, engineering and software services. Violation of IP rights in these sectors is likely to impose a restriction on some service providers' ability to export services, as violations may reduce demand for their services and/or increase the upfront and ongoing costs of export operations.

Against this, there is evidence that, as a net importer of IP, Australia has likely incurred net costs from the inclusion of provisions in trade agreements that go beyond the IP rights agreed through TRIPS. Two of Australia's bilateral trade agreements (with Chile and the United States) involved an increase in protections for IP beyond the levels required by the TRIPS and other bilateral trade agreements. Analysis indicates that extensions in the duration of copyright protection under the Australia–United States trade agreement (which extended the term of copyright to the life of the author plus 70 years, compared with life plus 50 years under TRIPS) imposed net costs on Australia through increased royalty payments (PC 2010a).

Hence, while better enforcement of IP rights as they apply under TRIPS would provide benefits to some Australian service providers, this should not be considered justification for extending the coverage of IP in negotiations.

The Commission is currently undertaking a separate inquiry into Australia's IP arrangements. This inquiry will consider issues associated with enforcement of IP rights, as well as Australia's international arrangements, including Australia's IP obligations under bilateral, multilateral and regional trade agreements.

## **5.4 Impediments to the movement of service providers**

Some impediments to service exports relate to measures that apply to the movement of people across borders, such as overly burdensome licensing and standards regulations and visa arrangements.

### **The role of licensing and standards regulations**

Governments, professional bodies and regulators (both in Australia and overseas) use professional licensing and technical standards to regulate a broad range of service sectors.

- Professional licensing, and other forms of regulation such as registration, certification and recognition of qualifications, enable regulators and professional bodies to authorise

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who can supply services.<sup>3</sup> Licensing regulations are commonly applied in the professional service sector, including the legal, accounting, engineering and architectural professions, and in the human services sector, including for medical and education services.

- Technical standards may be applied to the procedures used to produce a service. The International Organization for Standardization (ISO) and International Electrotechnical Commission have established standards in a number of sectors, including the financial and IT sectors (Standards Australia, sub. 9). In the financial sector the ISO and other international organisations (such as the Basel Committee and the International Financial Reporting Standards Foundation) develop operating and reporting standards. The International Civil Aviation Organization develops standards and recommended practices to manage aviation safety risks. Standards can also apply to procedures for cross-border data flows and the settlement of financial transactions.

Governments, professional bodies and regulators use licensing and standards regulations to address consumer protection, quality and safety concerns that arise due to asymmetric information between service providers and consumers. Consumers often have insufficient information to judge the quality and safety of a service, or can only do so once the service has been provided. Even where quality and safety can be assessed by consumers, screening costs may be significant. Regulating professional services can help to ensure safety and a minimum quality of service, reducing the potential for consumer harm and lowering the transactions costs to consumers of selecting a service provider.

## **Licensing and standards regulations can inhibit service exports**

Licensing and standards regulations that go beyond what is required to address asymmetric information between service providers and consumers impose a barrier to service exports (box 5.5).

Some licensing regulations have requirements relating to nationality, citizenship and residency — these requirements are unlikely to influence the quality of a provider or the safety of the service, and so will unnecessarily restrict service exports. Such is the case in India where certain legal services can only be provided by Indian citizens. Licensing regulations increase the upfront costs of establishing export operations where they, for example, require service providers to establish a local presence. Extra upfront costs of meeting licensing regulations could result in a service provider not supplying the export market at all.

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<sup>3</sup> This report generally uses the term ‘licensing’ to refer to all of the different forms of authorisation for providing a service (these can apply to individuals and businesses). Terms such as registration, certification and licensing are often used interchangeably to denote occupational regulation (PC 2015h). Regulations that apply to establishing a branch of a business are considered in section 5.5. Registration and licensing requirements for managed investment schemes are discussed in chapter 6.

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**Box 5.5 Examples of barriers arising from licensing and standards regulations**

- In India foreign lawyers can only practice on a fly-in/fly-out basis, and then only to advise on foreign law or to participate in international arbitration proceedings. Foreign lawyers may only be admitted as a local lawyer if they are an Indian citizen (Law Council of Australia 2015). In Indonesia there are no rules allowing temporary practise by foreign lawyers (Law Council of Australia, sub. 26). In Thailand, foreign law firms or individuals are only allowed to provide legal services via a Thai majority-owned joint venture company or secondment to a Thai majority-owned law firm (Law Council of Australia, sub. DR46).
- In some Asian countries accountants need to be living in the country to provide services. Regulations can also require local accreditation to sign off on jobs. In China foreign accountants cannot take a lead role in projects and are limited to providing technical support and expertise (Professional Services Industry Taskforce 2012).
- A survey of Australian engineers showed that, for both engineering companies and individual engineers, the non-recognition of Australian standards and the inability to become licensed to practice in overseas countries are among the key problems when attempting to undertake work overseas (Engineers Australia 2009).
- Cox Architecture (sub. 2) said that there can be onerous residency requirements in the architectural profession that can be a barrier to receiving registration to work in other countries.
- Singapore, Thailand and the Philippines have policies that impede medical service professionals from supplying services on a fly-in/fly-out basis (Dee 2014). In some countries foreign education providers are prohibited from teaching certain subjects (DFAT, sub. 31).

More generally, slow procedures for obtaining a license to practice in another country can impose costs, including in the form of foregone sales. For example, the Law Council of Australia (sub. DR46) stated that in China, there are instances where the initial registration of individual lawyers has taken up to 18 months, with 6 to 12 months not being unusual.

Australian service providers may be unable to provide a service if their qualifications are not recognised. Studies have found that education authorities in some countries (such as Indonesia and Mexico) did not recognise online education courses (Institute for International Trade 2009). Universities Australia (sub. 17) said that the failure of foreign governments to recognise Australian qualifications for further study or for employment is a barrier to service exports. Whether non-recognition of Australian degrees is an unnecessary barrier to trade depends on the extent to which degrees obtained in different countries or from different institutions are equivalent. There may be reasons why degrees obtained in different countries are not substantially equivalent, for example where they are tailored to the laws or standards of a particular country.

Service exports may also be inhibited where a country has decided not to adopt internationally recognised standards. Unique national standards can raise the upfront costs of establishing export operations. In the financial service sector, national standards for risk management procedures that differ from internationally recognised standards may require

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financial service providers to tailor their client software to operate in the importing country of supply, increasing upfront (and potentially ongoing) costs.

Determining whether licensing and standards regulations are overly burdensome, and therefore unnecessarily impede the ability of Australian service providers to export services, is extremely difficult. There is a policy rationale for licensing and standards regulations to address asymmetric information between consumers and service providers, where the costs of regulation are outweighed by the benefits to the community from ensuring a minimum level of quality and safety. However, community and government expectations about quality and safety can differ across countries, particularly where countries are in different stages of development.

### **Initiatives to address barriers relating to licensing and standards**

Governments, professional bodies and regulators have developed mutual recognition agreements (MRAs) that recognise the substantial equivalency of participating countries' licensing regulations and standards. MRAs have been negotiated in a number of professional service sectors.

- The Washington, Sydney and Dublin Accords respectively recognise the accredited engineering courses for professional engineers, engineering technologists and associate engineers of member countries (Engineers Australia, sub. 3).
- Australia is a signatory to MRAs in the architectural profession, including trilateral agreements between Australia, New Zealand and Singapore; and Australia, Canada and New Zealand (AACA 2015).
- CPA Australia (a professional accountancy body) has MRAs with professional accountancy bodies in a number of jurisdictions, including Canada, Europe, India, Hong Kong and Singapore (CPA Australia 2015).
- The Trans-Tasman Mutual Recognition Arrangement between Australia and New Zealand covers a range of occupations, including legal professionals such as barristers and solicitors.

Governments have used trade agreements and international forums to help facilitate mutual recognition. Australia has provisions related to mutual recognition in trade agreements, including those with China, Japan, New Zealand, South Korea and the United States. Mutual recognition provisions in trade agreements do not in themselves establish mutual recognition, but typically include a framework for progressing MRAs (chapter 9). APEC initiatives used to facilitate mutual recognition include the APEC Engineer Scheme, the APEC Legal Services Initiative, the APEC Architect Framework and the Non-Binding Guidelines for the Regulation of Foreign Accountancy Professionals.

International standards organisations are pursuing greater harmonisation in standards across countries. The Pacific Area Standards Congress, a regional grouping of national standards bodies, is identifying and prioritising actions that Pacific Area Standards

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Congress member countries (including Australia) can take to further support growth in services (Standards Australia, sub. 9). The APEC Sub-Committee on Standards and Conformance aims to reduce the negative effects that differing standards arrangements have on trade and investment flows, including by encouraging greater alignment of APEC member economies' standards with international standards (APEC 2015a). As noted in section 5.2, the Australian Government Treasury and Standards Australia are involved in an APEC project that is seeking to harmonise standards to facilitate cross-border data flows.

### **Costs and benefits of further reform to licensing and standards**

The potential benefits from reducing barriers due to licensing and standards regulations will vary across sectors and countries. The benefits will depend on how restrictive the barriers are and the size of the sector in the importing country. The Commission has not sought to quantify which countries' licensing or standards regulations, if reformed, would provide the largest potential gains. Legal associations have highlighted the size of the Indian legal sector and the opportunities this could provide Australian legal service providers if licensing regulations that discriminate against foreign providers were removed (ILSAC 2008; Law Council of Australia 2012). APEC economies are important destinations for Australian service exports, particularly financial services, so even small improvements in harmonising standards relating to cross-border data flows could generate economic benefits.

There may also be substantial benefits to the importing country from reducing barriers due to licensing and standards regulations. Enabling internationally competitive legal firms to provide services in the country could help to improve the performance of local businesses that compete against, and use, those services. More generally, increased competition from foreign service providers could put downward pressure on domestic prices, providing benefits to consumers.

As discussed in chapter 9, negotiating and establishing MRAs can be time consuming and costly, so these costs need to be weighed against the benefits from reducing barriers associated with licensing and standards.

### **The effect of visa arrangements on the movement of service providers**

Even where Australian service exporters can meet other countries' licensing and standards regulations, they may be impeded from moving people across borders by other factors, such as visa processes and work permit requirements (DFAT, sub. 31). Cox Architecture (sub. 2) said that client demand for instant attendance can be disrupted by the time it takes to obtain a visa in some jurisdictions. Universities Australia (sub. 17) said that the delivery of offshore education services often involves the need to move academics to students overseas and that barriers to this type of service emerge because of difficulties in obtaining appropriate visas for academics. Difficulties obtaining a visa may dissuade service

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exporters from operating on a fly-in/fly-out basis and can also impose costs on providers. These costs can include foregone sales if providers cannot meet clients' needs for timely face-to-face service.

Initiatives such as the APEC Business Travel Card (box 5.6) — designed to expedite travel and border entry between participating APEC member economies — can remove the need for frequent business travellers to apply for visas or entry permits (Corrs Chambers Westgarth, sub. DR34).

#### **Box 5.6      APEC Business Travel Card**

The APEC Business Travel Card (introduced in 1997) offers business travellers short-stay, multiple entry to 21 participating APEC economies and expedited access at airport immigration checkpoints for three years. In-principle agreement to extend the validity of the card to five years was reached in 2014. The APEC Policy Support Unit found that the travel card reduces the costs of cardholders' travel between APEC economies by 38 per cent, and cuts application fees by 28 per cent and immigration processing time costs by 52 per cent.

A 2014 review of the scheme identified a number of operational weaknesses, including lengthy pre-clearance processing times for some member economies, cumbersome card renewal requirements, and poor communication between certain economies. Corrs Chambers Westgarth (sub. DR34, p. 5) stated that 'making APEC Cards easier and faster to obtain, and in particular, to renew, would facilitate the competitive export of Australian legal services to APEC member countries'. The APEC Business Mobility Group is investigating ways to address these issues through capacity-building initiatives including options for online application lodgements and sharing best practice processing experiences.

*Sources:* APEC (2014c, 2014d).

## **5.5      International investment barriers**

Barriers to foreign investment can take many forms. Barriers to international investment can be separated into:

- limits on foreign equity
- investment screening and approval processes (approval required for new foreign direct investments or acquisitions, as in the Australian foreign investment review framework)
- restrictions on key foreign personnel or requirements to engage local directors
- restrictions on the form of commercial presence, such as requirements for joint ventures with domestic investors
- other restrictions, including restrictions on establishment of branches, local incorporation requirements, restrictions on acquisition of land, and reciprocity requirements (whereby foreign companies are only allowed to invest in a particular sector if an agreement exists with the foreign company's host country) (based on Kalinova, Palerm and Thomsen 2010).

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Some restrictions to foreign investment are based on national security concerns. The OECD has recognised the right of countries to restrict foreign investment based on national security concerns and developed guidance to help countries to design and implement policies that are narrowly focused on the achievement of national security goals, with the smallest possible effect on investment flows (OECD 2009b). Ownership of key infrastructure, telecommunications, defence-related assets and technology may raise national security concerns (Kirchner 2014). For example, in 2013 the Canadian Government rejected Egyptian investment group Accelero Capital's proposed takeover of the Allstream division of Manitoba Telecom Services on the basis of national security concerns from foreign ownership of a national fibre optic network that provided critical telecommunications services (Frigon 2014).

In many cases, concerns that lead to investment barriers could be addressed in a more direct manner. Foreign education institutions, for example, were not allowed to establish a commercial presence in Indonesia before 2012, due in part to concerns about quality assurance (Institute for International Trade 2009). Concerns about issues such as quality assurance would be better addressed more directly by non-discriminatory measures that apply equally to foreign and domestic providers. This may require capacity building to strengthen domestic regulation (chapter 9). Where national security concerns are a relevant consideration, these can be addressed through targeted measures, such as screening and approval of foreign investments.

Analysis in this section is limited to barriers to establishing a commercial presence in another country. Restrictions on licensing and standards (which often apply to individuals as well as businesses) are considered in section 5.4.

## **The effect of investment barriers on service exports**

Investment barriers can prevent firms from entering particular markets altogether or impose costs through constraining how service providers operate. For Australia, the majority of financial service exports occur via establishing a foreign commercial presence, and such a presence is also important to some other service exports, including education, professional services and health (chapter 3).

In some cases, stringent foreign equity limits or outright bans on foreign investment severely restrict the provision of service exports or preclude outward foreign investment altogether. For example, the provision of accounting and auditing services using a foreign affiliate is not permitted in India (World Bank 2015a). Indonesia prohibits foreign ownership for health research centres, private maternity hospitals, and general or public hospitals (but does allow foreign ownership of private specialist hospitals) (USTR 2015a). Insurance companies are not allowed to establish branches in several countries, including India, Indonesia and Russia (Rouzet et al. 2014).

ANZ (sub. 23) stated that foreign equity limits are the primary barrier to accessing Asian banking markets. Foreign equity limits and related regulation restricts ANZ from acquiring

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full ownership of established domestic banks in countries such as China, Indonesia and Malaysia. This affects the opportunity for competing and growing in these countries. Partial ownership also creates additional costs through duplication of functions and systems, and additional capital requirements (ANZ, pers. comm., 23 July 2015).

In some cases there might be potential to get around investment barriers by exporting through a different mode. For example, an education provider may respond to barriers to establishing schools or other education institutions in a foreign country by delivering courses to students from that country online or within Australia. In countries where regulations preclude them from establishing branches, insurance providers might offer services through cross-border supply, which will limit the extent to which they can engage directly with their customers. The Law Council of Australia (sub. DR46) stated that because only those practicing local law in India are entitled to establish law firms, foreign legal service providers use the workaround of providing legal services on a fly-in/fly-out basis. It further stated that the restriction on establishing a commercial presence undermines the effective and efficient practice of foreign law in India. As these examples suggest, delivering services through different modes has the potential to lead to markedly different business models and costs.

Requirements to establish a joint venture can cause substantial costs if this imposes a non-preferred business model. Insurance Australia Group (sub. 10) highlighted mandatory joint ventures as the main restriction on foreign investment in China.

In other cases, requirements to establish a joint venture or to have local representation on the board of directors might not have a substantial effect on costs if a business would have done something similar anyway. There can be good commercial reasons for entering into joint ventures with foreign partners in order to overcome foreign investment challenges. For example, the Royal District Nursing Service has found a joint venture to be a valuable way to export services to China (chapter 7).

### Investment barriers are particularly high in several developing Asian countries

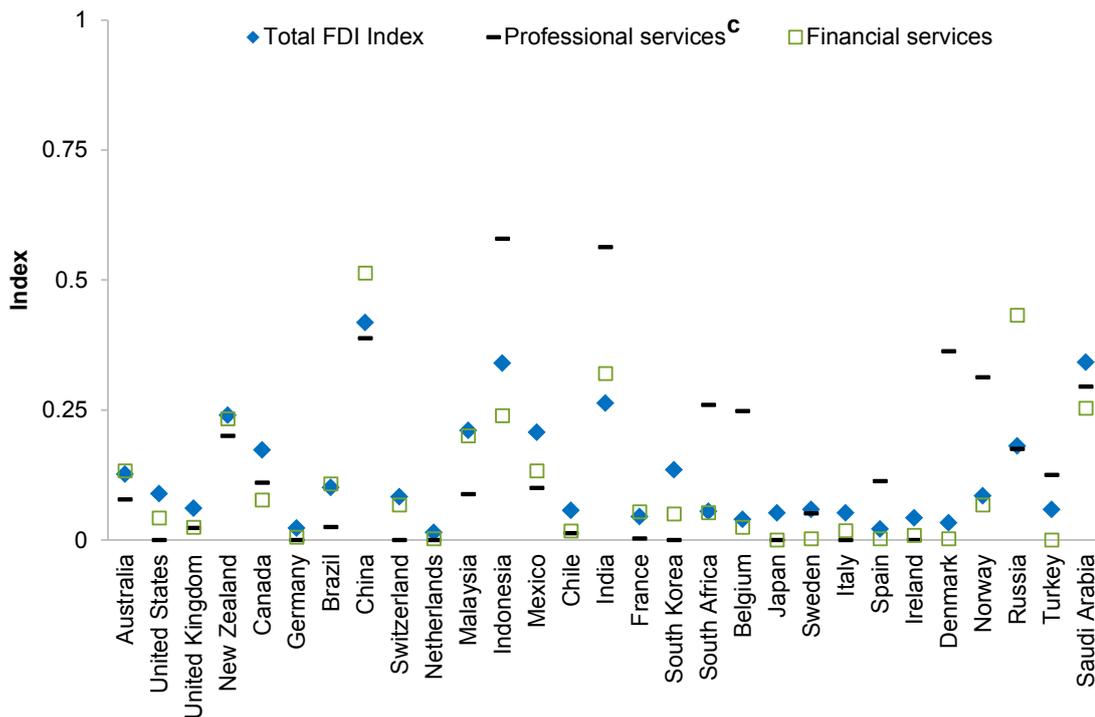
Many barriers to investment are behind-the-border measures and, as such, information on investment barriers across countries lacks transparency and is difficult to compile. For example, the General Agreement on Trade in Services (GATS) schedules provide an incomplete picture of barriers to investment in service sectors. ANZ (sub. 23) noted that behind-the-border limitations on the number of products approved, or the time in which they are approved, restrict the ability of a financial institution to access new or different sectors of a foreign market in a short timeframe.

The OECD index of restrictions on foreign direct investment (figure 5.3) and information underlying the World Bank index of restrictions on establishing a commercial presence (World Bank 2015a) both indicate that, in general, investment barriers tend to be more restrictive in developing countries. These indexes should not be used in isolation — in particular because they have limited sectoral coverage, do not incorporate the effects of

preferential trade agreements and require significant assumptions to combine different investment barriers into a single index — but do provide a heuristic approach by which differences in investment barriers across countries can be analysed.

Barriers to investment are particularly high in several large Asian developing countries, most notably in China, India and Indonesia. International data suggest that this is true for financial services, professional services and foreign direct investment more generally (figure 5.3). China, India and Indonesia are key markets for Australian service exporters, due to their size and the potential for continued economic growth within Asia to drive future growth in demand for service exports (chapter 3). Examples raised by participants in this study underscore the significance of investment barriers in these countries across the education, financial and professional service sectors (box 5.7).

**Figure 5.3 OECD index of restrictions on foreign direct investment<sup>a,b</sup>**  
Countries in the OECD database that are in Australia's top 40 trading partners, and Australia



<sup>a</sup> Countries are ordered using a five year average of the level of Australian direct investment in each country, based on ABS data. Separate estimates are not available for the other four sectors that are the focus of this study (education, health, IT and tourism). <sup>b</sup> The index does not account for specific concessions such as bilateral and regional trade agreements or MRAs. <sup>c</sup> Includes legal, accounting, architectural and engineering services.

Sources: ABS (*International Investment Position, Australia: Supplementary Statistics, 2014*, Cat. no. 5352.0); OECD (2015a).

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By comparison, barriers to investment into Australia are lower than in these developing Asian countries, but relatively high compared with other developed countries. Australia has the 6th highest level of restrictions on foreign direct investment of 34 OECD countries, primarily due to screening processes under Australia's foreign investment framework (Kalinova, Palerm and Thomsen 2010; OECD 2015a).

## **Initiatives to address investment barriers**

Investment barriers have predominantly been addressed as part of international agreements — on a multilateral basis through the GATS and on a preferential basis through bilateral and regional agreements (chapter 9). Investment has traditionally been dealt with in separate bilateral investment treaties,<sup>4</sup> but is increasingly being incorporated into preferential trade agreements (Miroudot 2011). The GATS explicitly covers investment barriers, but in practice the effect of the GATS on investment barriers has been small. Countries have excluded many sectors and, even where commitments were made, restrictions on market access or national treatment for commercial presence were frequently listed as unbound or exempt (Hardin and Holmes 1997). Almost two decades have passed since commitments were made under the GATS and in many cases policies now in place are significantly less restrictive than commitments under the GATS (OECD 2014b).

There are also examples where investment barriers have been reduced unilaterally. South Korea rapidly liberalised its foreign investment policies during the 1990s, in particular in the finance sector — for example, foreign equity limits were increased from 3 per cent to 20 per cent and later removed altogether, with full foreign ownership of South Korean banks allowed from 1999 (Nicolas, Thomsen and Bang 2013). In 2012 the Indonesian Parliament passed a bill allowing foreign higher education institutions — operating in partnership with an approved Indonesian higher education institution — to deliver higher education in Indonesia (DET 2012).

## **The effect of Australian trade agreements on investment barriers**

Australia has completed trade agreements with many of the countries that OECD summary data suggest have the highest generally applicable barriers to foreign direct investment, in particular China and New Zealand (through bilateral agreements), and Indonesia and Malaysia (through the ASEAN–Australia–New Zealand Free Trade Agreement). Trade agreements can go some way to addressing barriers to Australian investment in these countries (discussed in chapter 9).

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<sup>4</sup> Australia is party to bilateral investment treaties with 21 countries (DFAT 2015a).

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**Box 5.7      Examples of investment barriers faced by Australian service providers**

- Australian life insurance providers face caps on foreign equity participation (which also apply to funds management providers) and nationality requirements in Thailand, and foreign direct investment approvals in Japan. Thailand and Japan are two key markets for the Australian wealth management industry (FSC, sub. 20). (Australia has trade agreements with both of these countries.)
- Foreign equity caps exist in many forms across the Asia-Pacific region, and vary in their effect. For example, in China, there is a 20 per cent cap on foreign ownership of a domestic bank and foreign banks can only hold an interest in up to two domestic banks. Indonesia implemented a 40 per cent cap for ownership by a single foreign bank in 2012, unless the foreign bank is deemed to be 'fit and proper'. Countries often apply a limit on the number of new branches for which a foreign bank may apply (ANZ, sub. 23).
- In the United Arab Emirates, substantial fees can be required to establish an architectural practice and an Australian business is required to be sponsored by another party to establish a business, adding another cost (Cox Architecture, sub. 2).
- South Korea has proposed that foreign law firms must establish joint venture law firms under Phase 3 of its free trade agreements. A joint venture law firm would be a new legal entity, similar to a law firm but requiring the principals to be foreign and South Korean law firms, not individual partners (Law Council of Australia, sub. 26).
- There are significant barriers to Australian law firms establishing a commercial presence in India, Indonesia, Malaysia and Singapore (Law Council of Australia, sub. DR46).
  - There is no scope for Australian law firms to establish a commercial presence in India.
  - Under Indonesian law, Australian lawyers are not able to enter into partnerships, joint ventures or other forms of commercial association with Indonesian law firms. This framework prevents Australian law firms from establishing firms to exclusively practice Australian law or enter into joint ventures with Indonesian lawyers.
  - Indonesia, Malaysia and Singapore are examples of countries that have restrictions on the number or percentage of foreign lawyers who may be employed by a local law firm or in special joint venture structures.
- In China, the Ministry of Education places quantitative limits on the number of joint ventures for each foreign provider of vocational education and training (Melbourne Polytechnic, pers. comm., 22 September 2015; Box Hill Institute, pers. comm., 9 September 2015). Foreign providers of vocational education and training have also faced quantitative limits on the number of courses per campus and the number of repeats of the same course across campuses, quotas on student enrolments in international programs, and regulation at both the national and provincial level (Box Hill Institute, pers. comm., 9 September 2015). These restrictions have constrained Australian exports of education services via commercial presence abroad through:
  - the inability to proceed with new projects where a provider is already at the quantitative limit (Melbourne Polytechnic, pers. comm., 22 September 2015)
  - reductions in the number of Australian joint venture campuses in China and stalled investment in new campuses because the quantitative limits impose inefficient operations on education providers (Box Hill Institute, pers. comm., 9 September 2015).

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**Box 5.7** (continued)

Joint venture requirements and restrictions on key foreign personnel are common in developing countries in Asia. For example:

- banks in India must have a minimum of 50 per cent Indian nationals on the board of directors (World Bank 2015a)
- foreign higher education institutions in China must be established as a joint venture where the head of the institution holds Chinese citizenship and at least half of the members of the administrative council, board of directors or joint management committee must come from the Chinese parties (NDRC and MOFCOM 2015; State Council of the People's Republic of China 2003)
- foreign higher education institutions in Indonesia must operate in partnership with an approved Indonesian higher education institution (DET 2012).

However, the FSC (sub. 20) has suggested that trade agreements do little to alleviate regulatory impediments associated with establishment and operation in the market for financial services, and barriers to investment still remain in countries with which Australia has trade agreements (box 5.7). Similarly, Melbourne Polytechnic noted that the China–Australia Free Trade Agreement is not expected to address the barriers that they face in supplying education services in China (these barriers are noted in box 5.7) (Melbourne Polytechnic, pers. comm., 22 September 2015).

### **Costs and benefits of reducing investment barriers**

Reducing investment barriers in foreign countries would have benefits for Australian firms that export, or seek to export, by establishing a commercial presence in another country. Investment barriers are particularly costly for exporters of financial services, as the majority of financial services trade occurs via commercial presence abroad and there are substantial restrictions to financial services investment in potentially large markets such as China, India and Indonesia (Rouzet et al. 2014).

There can also be benefits for importing countries from reducing investment barriers. Through increasing capital stocks, supporting access to foreign technology and promoting competition, foreign investment can deliver economywide benefits (chapter 4).

Costs of reducing unnecessary investment barriers are likely to be small in comparison and largely short term. Costs for Australia will primarily relate to negotiating greater market access through trade agreements, and there could be administrative costs in foreign markets from creating new regulatory regimes that more directly address any national security concerns relating to foreign investment (chapter 9).

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## 6 Financial services

### Key points

- There are likely to be opportunities to grow Australia's financial service exports. Policy changes, including some already underway, could facilitate growth in financial exports.
  - To the extent that there is demand for Australian managed investment schemes overseas, the Asia Region Funds Passport will increase export opportunities for financial service providers offering an interest in Australian managed investment schemes and reduce the costs of offering managed investment schemes internationally.
  - A broader range of collective investment vehicles has the potential to provide significant benefits for the financial services sector, as the new vehicles increase the flexibility of fund managers to meet investor demands.
  - The multitude of different tax rates under Australia's regime of withholding taxes creates distortions between groups of investors and between investment activities, affecting demand for financial service exports. Simplification should be pursued through greater uniformity in the rates applying to different types of investment, a reduction in the range of domestic exemptions available and the negotiation of more consistent withholding tax rates in tax treaties.
  - The 2014 Financial System Inquiry recommended regularly reviewing the state of competition in the financial sector, including identifying barriers to the cross-border provision of financial services. The Australian Government has committed to implement this recommendation, which will help to identify any barriers to financial service exports imposed by prudential regulation.
- In some other areas, further information and/or broader analysis is required to assess potential policy changes.
  - Determining the optimal rate for withholding taxes is complex and requires detailed empirical consideration of the economywide effects — an analysis best undertaken during the Tax White Paper process.
  - Australia's system of dividend imputation produces biases against foreign investment, but changes to dividend imputation to increase service exports would reduce the integrity benefits of the dividend imputation system and decrease taxation revenue. Changes to dividend imputation should be examined in the broader context of the Tax White Paper.
  - There are likely to be benefits from providing clarity on the level of taxation faced by foreign managed funds investing in Australia through the Investment Manager Regime, but it is too soon to assess the effectiveness of the Regime. The Board of Taxation should review the Regime no later than 2020.

The provision of financial services was Australia's largest service sector in 2014-15 — contributing almost \$140 billion (gross value added) to the Australian economy (ABS 2014b). The sector was also a substantial contributor to Australia's total exports in 2009-10, predominantly through commercial presence abroad — the financial services

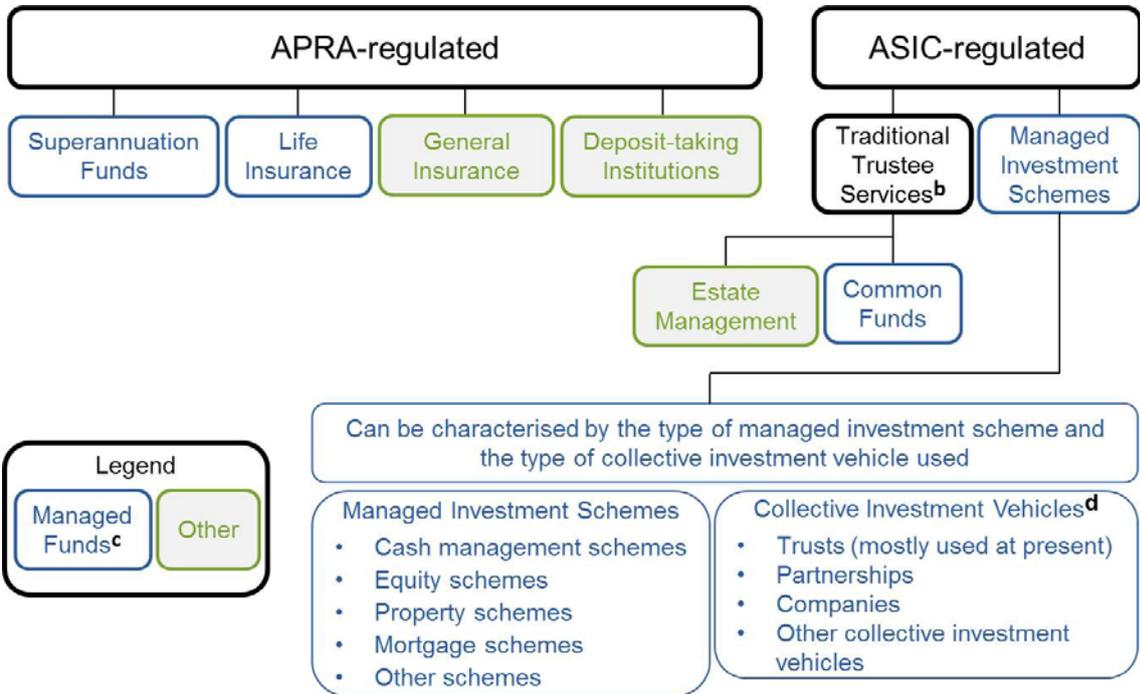
sector exported over \$35 billion via commercial presence abroad in 2009-10 (chapter 3). Its large domestic footprint, coupled with the importance of commercial presence abroad, mean the financial services sector is heavily influenced by regulatory settings in Australia and in the jurisdictions where commercial operations are undertaken. These regulatory settings constitute a barrier to service exports where they are not the least cost way of meeting objectives such as the stability of the financial system.

In 2009-10, the largest exporters from the financial services sector were insurance companies, which accounted for almost half of Australia’s financial service exports. Exports from deposit-taking institutions (such as banks) were also large, particularly through margins on borrowing and lending money (chapter 3). The Financial Services Council (FSC) (sub. 20) identified exports of services relating to managed investment schemes as a potential area for growth (section 6.1).

Barriers to financial service exports can constrain the ability of the sector to take advantage of opportunities for growth. Barriers identified in this chapter affect a range of the financial services provided by the sector (figure 6.1).

**Figure 6.1 Simplified overview of the financial services sector**

Parts of the financial services sector considered in this chapter<sup>a</sup>



<sup>a</sup> This diagram does not include all types of financial services, as sector-specific barriers were not identified in some parts of the sector. Other types of financial services include friendly societies, brokerage services and merchant banks. <sup>b</sup> Traditional trustee services are also regulated by state and territory governments. <sup>c</sup> Managed funds are as defined in ABS, *Managed Funds, Australia, Mar 2015* (Cat. no. 5655.0). <sup>d</sup> Trusts are the most common type of collective investment vehicle used. Partnerships, companies and other collective investment vehicles are rarely used to supply managed investment schemes.

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This chapter examines domestic barriers to export, including in relation to managed investment schemes (section 6.1), trust law (section 6.2), prudential regulation (section 6.3) and taxation arrangements (section 6.4). International barriers to the export of financial services are examined in chapter 5, with two exceptions that are covered here — barriers to the cross-border marketing of managed investment schemes and the effect of international prudential regulation on Australian financial service exports.

Domestic policy should be guided by whether it generates a net benefit to the Australian community overall, not its effects on service exports alone (chapter 2). A focus in this chapter is on policy changes that can facilitate financial service exports by increasing the opportunities for the sector to respond to changes in global demand for those services. In assessing potential policy changes, the Commission is mindful that changing the regulatory arrangements for financial services would have implications that are broader than service exports. Regulations enforced by the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC), for example, are intended to ensure the stability of the financial sector, and provide protection for consumers (APRA 2014b; ASIC 2015). Similarly, any consideration of changes to taxation arrangements should give due weight to the need for governments to impose taxes as a means to fund expenditure.

## **Barriers to financial service exports by country**

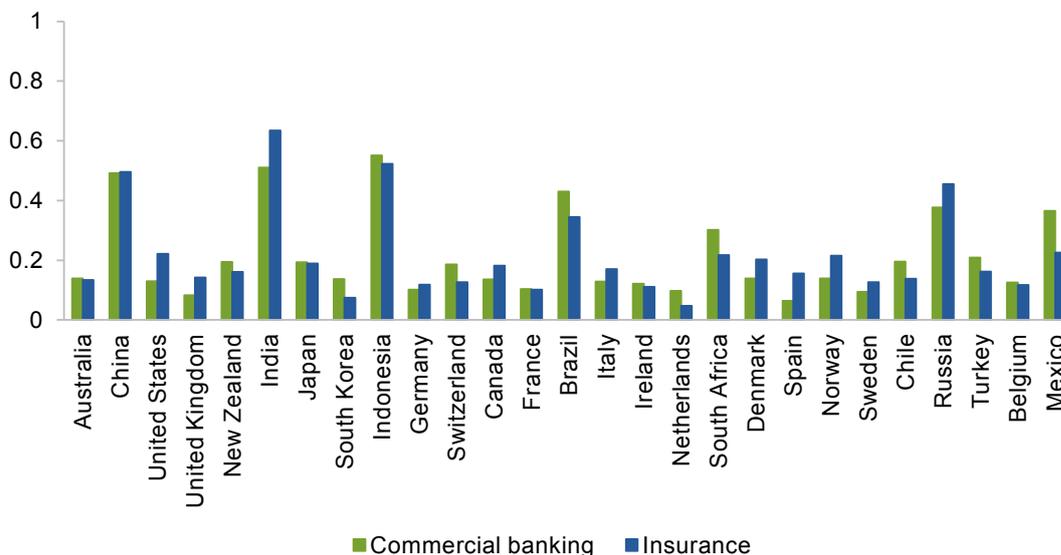
There is considerable variation in the level of restrictions to trade in banking and insurance services across countries (figure 6.2). The OECD Services Trade Restrictiveness Index indicates that restrictions to trade in banking and insurance are relatively low in Australia, comparable in magnitude to those in other developed countries such as the United States and the United Kingdom. Developing countries such as China, India and Indonesia, have higher barriers to trade in banking and insurance services. These countries impose substantial restrictions on foreign businesses establishing a commercial presence in their country (chapter 5), which is the predominant mode of export for Australian financial services (chapter 3).

### **6.1 Managed investment schemes**

Managed investment schemes cover a variety of collective investments, including cash management schemes, equity schemes and property schemes (figure 6.1). Managed investment schemes are regulated by ASIC under chapter 5C of the *Corporations Act 2001* (Cwlth) (the Act). Managed investment schemes do not include other managed funds such as superannuation funds and life insurance corporations that are regulated by APRA.

**Figure 6.2 Barriers in the commercial banking and insurance subsectors<sup>a</sup>**

Countries in the OECD database that are in Australia's top 40 trading partners and Australia



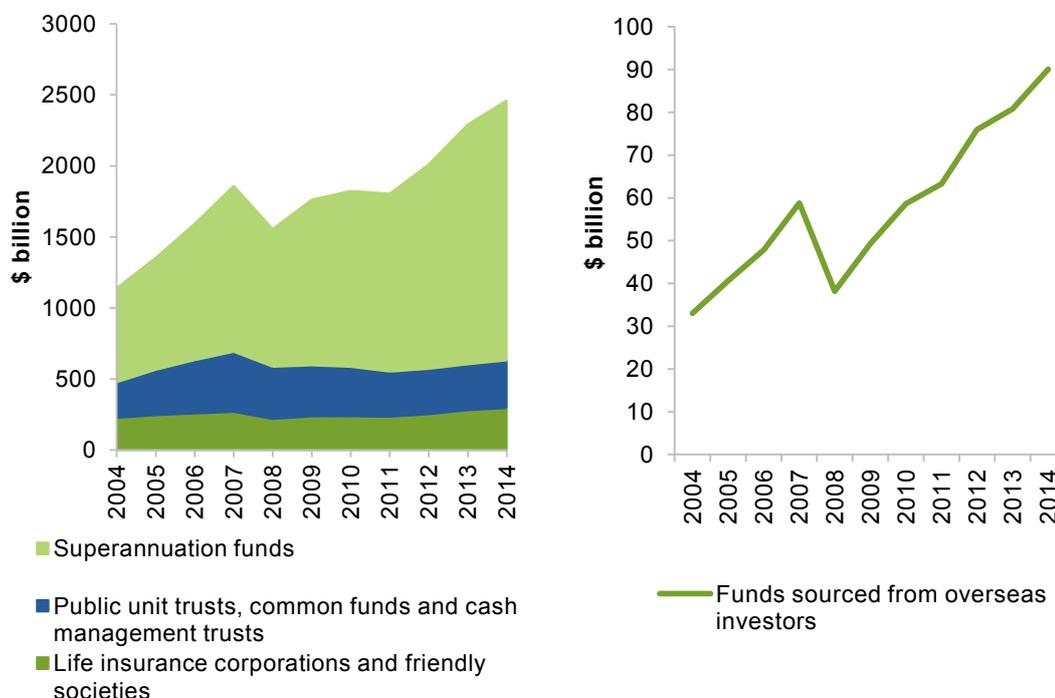
<sup>a</sup> Countries are ordered from left to right by the value of service exports from Australia. Index scores range from 0 to 1, where 0 indicates that a country's service sector has no barriers to foreign service providers, and 1 is completely closed to foreign service providers. The index does not account for specific concessions such as regional trade agreements or mutual recognition agreements, and does not include barriers that exclusively apply to mode 1 or mode 2 supply. The index also does not account for restrictions on cross-border data flows or protection or enforcement of intellectual property rights for the subsectors included in this figure. Accordingly, the index may provide a distorted view of differences in barriers across countries if some countries have more barriers not included in the database than other countries. The data were collected at the end of 2013.

Source: OECD (2015b).

## The size of Australia's managed fund sector

The value of funds in Australian managed funds, which include managed investment schemes as well as superannuation funds and life insurance corporations, has more than doubled since 2004, in large part driven by the increase in the value of domestic assets managed by superannuation funds. There has also been strong growth in the value of foreign funds in managed funds domiciled in Australia, which has almost tripled since 2004 to about \$90 billion in 2014 (about 3.7 per cent of total funds in Australia's managed funds) (figure 6.3). About 14 per cent of foreign funds under management were from retail investors as at 31 December 2013 — the remainder was from wholesale investors, such as pension funds (Perpetual and Financial Services Council 2014). The ABS does not provide data that separate foreign funds under management in Australian managed investment schemes from other managed funds.

**Figure 6.3 The size of Australia's managed fund sector and funds sourced from foreign investors**  
Funds under management



Source: ABS (*Managed Funds, Australia, Mar 2015, Cat. no. 5655.0*).

Participants in this study, and previous studies, have noted that Australia has a small proportion of funds sourced from foreign investors, relative to jurisdictions such as Hong Kong, Singapore and the United Kingdom (AFCF 2009; FSC, sub. 20; Deloitte Access Economics 2014b).

- As at December 2014, foreign investors around the world held about HK\$9.1 trillion (A\$1.4 trillion) (72 per cent) of assets in Hong Kong's managed funds (SFC 2015).
- As at December 2013, foreign investors around the world held about S\$1.4 trillion (A\$1.2 trillion) (77 per cent) of assets in Singapore's managed funds (MAS 2014).

### There are opportunities for Australian service providers

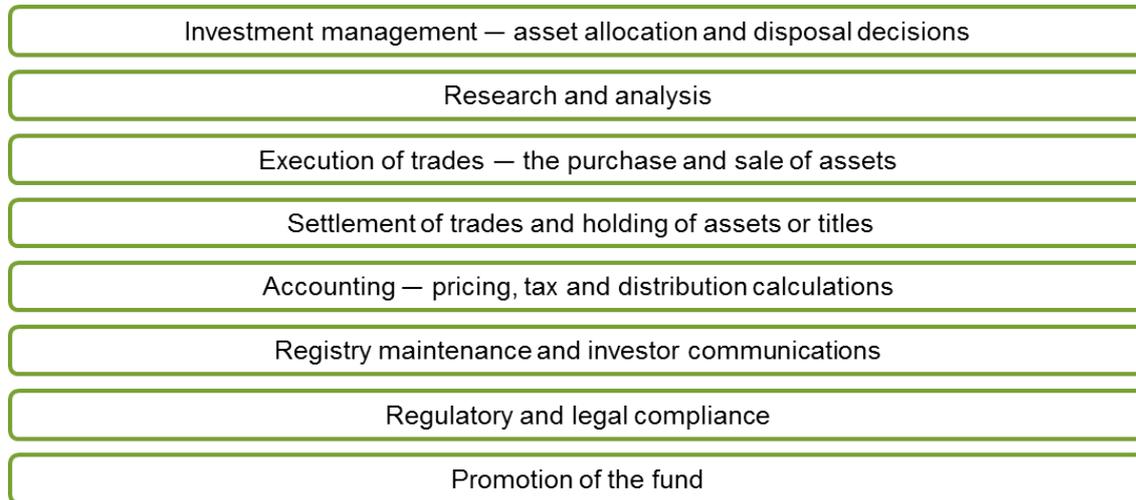
Increases in foreign funds under management provide opportunities for Australian fund managers to export their services. The Financial Services Council (sub. DR43) highlighted the services that can be provided if funds are domiciled in Australia (figure 6.4). Deloitte Access Economics (2014b) estimated that, for every \$100 of foreign funds under management in Australia, fund managers receive about \$0.60 in annual revenue from the services they provide. Based on the level of foreign funds under management in June 2013

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(\$74 billion), funds management service exports were estimated to be about \$442 million for that year (Deloitte Access Economics 2014b).

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**Figure 6.4 Funds management value chain**



Source: Adapted from FSC (sub. DR43).

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Growing levels of wealth in Asia will lead to opportunities for fund managers to increase their foreign funds under management (chapter 3). Asia's share of global GDP has grown from about 30 per cent in 2000 to just under 40 per cent in 2012 (APEC Policy Support Unit 2014). The Asia–Pacific financial system remains underdeveloped — as of 2015 it held under 15 per cent of global funds under management — but is expanding its share of the region's GDP (Auster and Foo 2015).

There is strong competition to provide financial services to investors in Asia, particularly from providers of exchange-traded funds (funds that are traded on a stock exchange) from the United States (EY 2014) and Undertakings for Collective Investments in Transferable Securities (UCITS) schemes domiciled in the European Union (Luxembourg and Ireland in particular) (box 6.1). UCITS schemes are heavily used in Asia. In 2011 there were about \$490 billion of funds from investors in Hong Kong, Singapore and Taiwan in UCITS schemes. This is an order of magnitude larger than an estimate of about \$44 billion in Australian managed funds sourced from the entire Asia–Pacific region in 2013.<sup>1</sup>

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<sup>1</sup> Productivity Commission estimate based on 55 per cent of foreign funds in managed investment schemes being sourced from the Asia–Pacific region (Perpetual and Financial Services Council 2014), and ABS data on the total amount of foreign funds under management in Australia.

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### Box 6.1 UCITS funds are widely used in Europe and Asia

The UCITS scheme establishes a regulatory structure that allows for retail and wholesale managed funds to be offered in countries across the European Union on the condition that the fund is assessed as meeting the UCITS rules by the regulatory authority in its home member state.

Following an initial EU directive in 1985, take-up of the UCITS scheme was slow. It was not until 1988 that the first country (Luxembourg) adopted the initiative and the first UCITS fund was established. Six of the (then) twelve countries in the European Union had adopted the directive by the time the deadline was reached in 1989 (UCITSXXV 2013).

Varying regulatory arrangements across member states and a limited range of asset classes prevented UCITS funds from benefiting from the full range of investments in the market (BlackRock 2010). A second directive, UCITS II, designed to fix these issues was scrapped after agreement could not be reached between member states. Despite this, growth in UCITS funds was strong in the 1990s and, by 1999, UCITS funds held about \$4.6 trillion in assets (UCITSXXV 2013).

A further UCITS directive, UCITS III, was adopted in 2001, and this was followed by UCITS IV and UCITS V. There has continued to be strong growth in UCITS funds. As at February 2015, over 70 per cent of funds under management in the European Union were in UCITS funds — about \$13 trillion in assets (EFAMA 2015a). Over 50 per cent of UCITS funds were in funds domiciled in Luxembourg or Ireland as at March 2015.

UCITS is unilaterally recognised in some Asian countries, where it has a substantial presence. As of July 2012, about 5300 UCITS funds were registered in Asia. Investors in Hong Kong, Singapore and Taiwan held about \$490 billion in UCITS funds in 2011 (APEC Policy Support Unit 2014).

Given this competition, Australian managed investment schemes will need to continue to increase their attractiveness to investors in Asia (and in other countries). Fund managers will need to take advantage of opportunities to increase economies of scale and improve productivity. Fund managers will also need to offer products that are attractive to overseas investors. Perpetual and Financial Services Council (2014) suggest that overseas investors have typically invested in a broad mix of asset types in Australia — about a third of cross-border investments into Australia are invested into overseas assets, while about 20 per cent are invested into each of Australian shares, Australian fixed interest assets, and Australian property.

Strong competition and the growing levels of wealth in Asia mean that barriers to financial service exports from Australia will be particularly costly. There are regulatory barriers that are impediments to the growth of exports from the managed fund sector in Australia (in particular, from managed investment schemes), which are discussed below. Taxation arrangements also have implications for international investment in managed funds (section 6.4).

The low proportion of foreign funds under management in Australia is not, of itself, a policy concern unless the Australian financial sector is unnecessarily impeded in its ability

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to play a larger role in exporting funds management services to overseas markets. Policy settings should not be solely geared toward increasing foreign funds under management. Unlike major destinations for foreign funds such as Luxembourg and Ireland, Australia has a large domestic funds management sector. As a result, factors such as the protection of domestic consumers and the integrity of the domestic market are particularly important when developing policy for managed funds. Care must also be taken to ensure that any changes to taxation arrangements do not have unintended consequences for government revenue (section 6.4).

### **There are restrictions on the cross-border marketing of managed investment schemes**

To offer interests in a retail managed investment scheme in another country, schemes offered by Australian service providers must first meet the requirements to be registered in that country (AFCF 2009; FSC 2014). For example, to offer interests in a foreign managed investment scheme to a Singapore investor, the scheme must meet the registration requirements of the Monetary Authority of Singapore, and meet other requirements such as being registered in a jurisdiction that offers investors protection at least equivalent to that in Singapore (Securities and Futures Act (Sing), s. 287).

If a country's registration requirements are not the least cost way of meeting its consumer protection objective, they can increase the costs of exporting financial services associated with managed investment schemes, or prevent Australian fund managers from offering their product in that jurisdiction.

Similar registration requirements exist in Australia for the operation of foreign retail managed investment schemes, although ASIC has the ability to grant relief from the requirement for a foreign managed investment scheme to register in Australia (box 6.2). These arrangements can be useful for Australian service providers with overseas businesses. Westpac (pers. comm., 4 August 2015) was supportive of mutual recognition arrangements between financial regulators in Australia and the other jurisdictions in which it operates. Westpac is of the view that these arrangements, and the application of consistent regulatory standards and requirements, can make a big difference to the bank's operations by allowing more streamlined global structures to better utilise these mutual recognition arrangements.

### **Initiatives are underway to address restrictions on cross-border marketing of managed investment schemes**

The Australian Government has negotiated, or is in the process of negotiating, agreements to address restrictions to the cross-border marketing of managed investment schemes. This includes two bilateral mutual recognition agreements (MRAs) — one signed between ASIC and the Hong Kong Securities and Futures Commission in 2008, and another with New Zealand.

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The Australian Government is also negotiating the Asia Region Funds Passport (ARFP) with a group of countries — Australia, Japan, New Zealand, the Philippines, South Korea, and Thailand have signed a statement of understanding to implement the ARFP, and Singapore is part of the ARFP working group. The Government intends to legislate to give effect to the ARFP in the second half of 2016 (Australian Government 2015e). The ARFP will allow fund managers to market retail managed investment schemes in the other passport countries where they meet both the rules and regulations required to be registered as a scheme in their home country, and the passport rules (as determined by the regulator where the scheme is domiciled) (APEC 2015c). (Funds must also meet any additional regulations imposed by the host country in relation to dealing with investors, such as annual reporting requirements (APEC 2015d).)

**Box 6.2      Registration requirements for foreign managed investment schemes in Australia**

Foreign retail managed investment schemes that operate in Australia are subject to the same regulatory requirements as Australian schemes. ASIC has the power to grant relief for foreign investment schemes for any or all of the requirements to be registered, licensed or to disclose information where:

- the overseas regulatory regime is substantially equivalent to the Australian regulatory regime for managed investment schemes
- there are cooperation arrangements between ASIC and the overseas regulatory authority
- adequate rights and remedies are available to Australian investors
- the operator meets a range of other conditions for relief.

Relief can be granted on an individual operator or class order basis. ASIC has issued class orders granting relief for schemes regulated in Hong Kong, Jersey, New Zealand, Singapore and the United States.

*Source:* ASIC (2012).

The costs and benefits of reducing restrictions on the cross-border marketing of managed investment schemes

*Mutual recognition agreements have had mixed results at facilitating cross-border marketing*

The success of MRAs in facilitating cross-border marketing of managed investment schemes is mixed. The Hong Kong–Australia MRA has not been used in either market in the five or so years since its implementation (FSC, sub. 20). The FSC stated that Australian funds have not used this agreement as some provisions to meet Hong Kong investment requirements are more restrictive than those in Australia. In the FSC’s view, tax arrangements, particularly the absence of a double tax agreement, have undermined the ability for Hong Kong managed funds to access the Australian market (FSC, sub. 20).

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Conversely, the Australia–New Zealand MRA has been heavily used. There were over 1000 Australian offers made in New Zealand through this scheme between June 2008 and November 2013 (this number also includes offers of products such as shares and debentures) (IOSCO 2014).

The mixed results of MRAs highlight the importance of ensuring that provisions in the agreement maintain consumer protection arrangements, but at the least possible cost. Consultation with industry stakeholders can be used to highlight provisions of the agreement that may affect its use by industry. Decisions about whether to alter or proceed with an MRA should be based on an economywide assessment of the benefits and costs of the agreement (chapter 9).

*The Asia Region Funds Passport is likely to have net benefits for Australia*

Participants in this study were supportive of the ARFP. The Australian Financial Markets Association stated that the ARFP provides a ‘practical template for cooperation in the Asian region’ (AFMA, sub. 14, p. 23). ANZ (sub. DR45, p. 2) stated that the ARFP would ‘help create jobs and investment for Australian companies’. The FSC noted that the ARFP was its ‘preferred mechanism for cross border trade in funds management, alongside bilateral and multilateral free trade agreements’ (sub. 20, p. 14). The FSC also noted that taxation regimes, both in Australia and overseas, were complex (sub. 20), and that ‘Australia will not be a successful participant in [the ARFP] unless accompanying domestic reforms are undertaken ...’ (sub. DR43, p. 5).

To the extent that there is demand for Australian managed investment schemes overseas, the ARFP will increase export opportunities for financial service providers offering an interest in Australian managed investment schemes and reduce the costs of offering managed investment schemes internationally. The magnitude of the potential benefits due to the ARFP will depend on the size of the market for managed investment schemes in ARFP countries, the extent to which the ARFP is able to reduce the regulatory requirements to export managed investment schemes, and the competitiveness of Australian providers of managed investment schemes. Australian fund managers will need to continue to increase their attractiveness to overseas investors to maximise the benefits of the ARFP.

The benefits resulting from the ARFP will not be spread evenly across participating countries. Drawing on the UCITS experience, over 50 per cent of the value of the assets were held in UCITS funds domiciled in either Luxembourg or Ireland as at March 2015. Of the 14 jurisdictions registered for the UCITS scheme had less than 1 per cent of the value of UCITS assets in funds domiciled in their jurisdiction (EFAMA 2015b). The UCITS experience also suggests that it may take some time (and refinements to the ARFP) for the benefits to be fully realised.

Regulatory factors, such as taxation arrangements, can influence the overseas demand for Australian managed investment schemes (section 6.4). For example, Australian financial

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service providers will be competing with providers in ARFP jurisdictions that have more favourable tax arrangements, including those with lower rates of withholding tax for international investors.

In addition to the potential benefits for Australian fund managers, there are likely to be benefits for Australian investors resulting from greater competition in the Australian market for managed investment schemes and increased access to managed investment schemes domiciled overseas. Based on assumptions about increases in economies of scale, the APEC Policy Support Unit has estimated that the benefits from the ARFP could be US\$20 billion annually across the Asia region (APEC Policy Support Unit 2014). Competition is also expected to lead to increased pressure for innovation and efficiency in the sector, leading to higher quality services being offered in Australia. There is also likely to be an increase in choice and diversity in managed investment schemes offered in Australia (APEC Policy Support Unit 2014) (although diversification opportunities already exist for Australian investors, such as through exchange traded funds).

Given the likely benefits to Australian (and other) investors and the potential benefits to Australian fund managers, the Commission considers that there would be net benefits in the Australian Government continuing to progress the ARFP and, through work in international forums, encouraging other jurisdictions to participate in the ARFP.

**RECOMMENDATION 6.1**

The Australian Government should continue to progress the Asia Region Funds Passport and, through work in international forums, encourage other jurisdictions to participate in the Passport.

## **Separation of the trustee and asset manager**

Changes were made to the regulatory structure of managed investment schemes in 1998. Previously, managed investment schemes were required to have a trustee that was separate to the asset manager. The trustee was responsible for holding scheme assets and had a fiduciary duty to act in the best interests of scheme members.

Amendments to the then Corporations Law (now the Corporations Act) in 1998 removed the requirement to separate the trustee from the asset manager, and instead legislated a single responsible entity that would be responsible for scheme assets. This change was made to address concerns regarding confusion over responsibilities between the asset manager and the trustee (Costello 1997).

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## The effect of managed fund structures on managed investment scheme exports

AFMA (sub. 14) argued that the requirement to have a single responsible entity for Australia's managed investment schemes limits the flexibility of asset managers, and that overseas jurisdictions are apprehensive about recognising the validity of the single responsible entity structure. Similarly, The Trust Company has noted that:

The single responsible entity model is a source of, at a minimum, consternation, if not strong aversion from many overseas institutional investors, especially in the UK and Europe. Even when the scheme sponsor possesses an excellent pedigree, many institutional investors from these jurisdictions will not invest in any vehicle that does not have an independent trustee. The potential for conflict in the single responsible entity regime is perceived to be unacceptable by many foreign investors and the regime flies in the face of what is regarded as internationally accepted investment standards. (2011, p. 3)

AFMA (sub. 14) and the Corporations and Markets Advisory Committee (CAMAC 2014) noted that Australian managed funds cannot use UCITS-like structures as UCITS does not recognise Australia's single responsible entity regime. To the extent that Australia's regulatory structure, including the inability for Australian funds to adopt UCITS structures, affects the willingness of international investors to invest in Australian funds, this will reduce the demand for exports of financial services associated with managed investment schemes domiciled in Australia.

There is flexibility in the legislation requiring a managed investment scheme to appoint a responsible entity. A responsible entity is able to appoint a delegate to undertake any of its duties — although the entity remains ultimately responsible for the actions of its delegate (s. 601FB of the Act). For example responsible entities can (and often do) appoint custodians to hold scheme assets. CAMAC (2014) noted in a discussion paper into Australia's regulatory arrangements for managed investment schemes that custodians do not have the same supervisory role that a trustee would. A responsible entity can also appoint an external asset manager and operate in some respects as a separate trustee and asset manager would.

Some studies have raised concerns that combining the roles of asset manager and trustee has the potential to create conflicts of interest for responsible entities. For example, Bianchi stated:

It is abundantly clear that severe conflicts exist between the functions of the trustee and investment manager roles within a [single responsible entity]. In a poorly performing managed investment scheme, does the [single responsible entity] act in the best interest of its unit holders ... and terminate its mandate as investment manager ... or, alternatively, does the [single responsible entity] act in its own best interest and avoid termination to continue receiving management fees? (2010, p. 26)

Similarly, Brown, Trusler and Davis (2010) suggested that it is worth examining whether alternative models would provide greater oversight and better resolve conflicts of interest.

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In a Parliamentary Joint Committee inquiry into the collapse of Trio Capital, most participants were supportive of the single responsible entity regime, noting the clean lines of accountability under the regime. The Committee noted that the system can fail when the responsible entity ‘stalls and deceives’ and that there were weaknesses in the roles of regulators, auditors, custodians, research houses and financial advisors. The Australian Government accepted the Committee’s recommendations to address these weaknesses, including greater disclosure of the assets of managed investment schemes, and improving the operation of compliance plans and compliance committees (Australian Government nd; PJCCFS 2012). The Government has committed to examining governance issues in managed investment schemes further in its response to the Financial System Inquiry (discussed later).

### The costs and benefits of greater structural flexibility for managed investment schemes

There is limited evidence regarding the effects of the single responsible entity regime on financial service exports. Other factors, such as taxation arrangements and the expertise, scale, expected returns and costs of funds are likely to be more significant factors for investors considering whether to take an interest in a scheme domiciled in Australia. It is unclear whether the benefits for financial service exports of allowing firms the flexibility to adopt alternative structures would outweigh the regulatory costs of the change.

Whether conflict of interest concerns warrant a change to require a separate trustee and asset manager is primarily an issue for the domestic market for managed investment schemes and is beyond the scope of this study. The Commission notes that, in its response to the Financial System Inquiry, the Australian Government has committed to examining further the findings of the CMAC discussion paper into managed investment schemes (Australian Government 2015e), which includes discussion of whether the single responsible entity model has been an issue for international investors in Australian managed investment schemes. Consideration could also be given to whether alternative regulatory structures, such as a separate trustee and asset manager, could be used in alternative collective investment vehicles (section 6.4).

## 6.2 Trust law

Trusts are commonly used in Australia, including for traditional trustee services such as estate management and common funds, and for managed investment schemes. Trusts are subject to a range of regulations, including Commonwealth legislation under the Corporations Act, state and territory-based acts, and common law established through the courts. Participants in this study, including the Financial Services Council (sub. 20, sub. DR43), and Chaikin and Brown (sub. DR50) stated that trust law in Australia imposed a barrier to the export of services using trusts, in particular traditional trustee services, but also potentially services in relation to managed investment schemes.

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## Is there an export market for traditional trustee services?

Traditional trustee services are commonly provided through trustee corporations licensed under chapter 5D of the Corporations Act. The value of assets managed by trustee corporations in Australia is substantial — in 2010, licenced trustee corporations held about \$500 billion in assets<sup>2</sup> (FSC 2012). About half of this related to securitisation programs, and about a quarter related to a trustee corporation acting as a custodian for a managed investment scheme or superannuation fund.

A potential export market for trustee corporations may be the provision of private trusts for wealth and estate management services in Asia. Australian trustee corporations held about \$25 billion of assets in relation to wealth and estate management services in 2010, but the share of these assets held for foreign investors is unknown (FSC 2012). The market for private trusts in Asia is expected to continue to grow — there has been growth in the number of ultra-high net worth individuals (chapter 3). KPMG has noted that ‘the growth [in wealthy individuals in Asia], and in China especially, has seen a surge in the demand for wealth and estate planning services which are supported by advisors who specialise in private trusts’ (2013, p. 51).

Attracting private trusts has been one of the motivators for other countries to reform their trust regulation. Since 2000, Hong Kong, Singapore and the United Kingdom reviewed and updated their trust law, and New Zealand reviewed its trust law in 2013 (box 6.3). Prior to reforms to Hong Kong’s trust law in 2013, KPMG (2013) stated that the out-dated nature of Hong Kong’s trust law contributed to a preference for offshore private trusts by Hong Kong settlors.

While New Zealand has not updated its trust law, it has established a foreign trust industry (Prebble 2012), in large part via tax arrangements for foreign trusts — New Zealand does not tax foreign source income in trusts established in New Zealand for non-residents. Between 2006 and 2012 there were about 8000 foreign trusts registered in New Zealand (Law Commission 2013) and in 2009, when there were about 4500 foreign trusts registered in New Zealand, trustee corporations earned about NZ\$20 million (A\$16 million) in fees from foreign trusts (IFSDG 2011).

## Is Australia’s trust law antiquated?

The FSC (sub. 20, sub. DR43) and Chaikin and Brown (sub. DR50) raised concerns about the application of trust law to trustee services. The FSC (sub. 20) stated that Australia’s trust law is out dated, and results in undesirable outcomes for settlors and investors. The concerns predominantly arise from the fact that trust law in Australia has not been

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<sup>2</sup> Some services provided by entities licenced under chapter 5D of the Act are covered under other Commonwealth legislation. For example, services relating to acting as a responsible entity for a managed investment scheme are regulated under chapter 5C of the Act, and superannuation funds are regulated under specific superannuation legislation.

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reviewed for many years (except in Queensland), and the way that trusts are used has changed over time.

### **Box 6.3      Review of New Zealand's trust law**

In 2013, the New Zealand Law Commission released a review of New Zealand's trust law. It noted that there was a strong case for a new trust act in New Zealand, as the current Act is inaccessible, contains inapplicable provisions and is out of date. The review recommended a range of new provisions in the Act, including on:

- clarifying the duties of the trustee, the indemnity rights of the trustee and the information required to be retained by the trustee
- the information required to be provided to beneficiaries
- the administrative powers of trustees, and their powers to appoint custodians, agents, delegates and investment managers
- the appointment and removal of trustees
- the ability for beneficiaries or courts to revoke or vary a trust
- insolvency provisions
- the maximum duration of trusts.

The New Zealand Government agreed with the recommendation that a new trust act was needed. It noted that more work was required to implement the detail of the act.

*Source:* New Zealand Law Commission (2013).

Participants in this and previous studies have raised issues with Australia's trust law.

- Much of Australia's trust law relies on common law and is not codified, including in relation to the powers and duties of trustees. Chaikin and Brown (2014b, sub. DR50) noted that this makes Australia's trust law inaccessible to non-experts, and considered that codifying trust law would provide legal advisors with greater clarity as to the content of the law. Other jurisdictions, including Hong Kong and the United Kingdom, have codified the powers and duties of trustees in statute (FSTB 2012; Law Commission 2013).
- Chaikin and Brown (sub. DR50) noted that settlors have a limited involvement in Australian trusts, which is a deterrent for international investors.
- In its submission to the Commission's inquiry into business set-up, transfers and closures, the Australian Restructuring, Insolvency and Turnaround Association noted that there is not a comprehensive regime for dealing with the insolvency of trusts (ARITA 2015). Similarly, Chaikin and Brown (sub. DR50) note that there have been difficulties in applying trust law to managed investment schemes when a scheme becomes insolvent.

To the extent that the above issues are concerns for international consumers of financial services provided through Australian trusts, Australia's current trust law could result in

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Australia's trustee sector not being able to offer products that consumers prefer, reducing the demand for services provided through Australian trusts.

Trust law is only a barrier to the export of certain types of trustee services, including traditional trustee services. Chaikin and Brown (2014a) noted that, in relation to securitisation arrangements, Australian lawyers have avoided problems with Australia's trust law by negotiating innovative trust deeds. Chaikin and Brown stated that any revision to Australia's trust law 'should be sensitive to the market practices that have been developed in relation to commercial uses of trusts', such as those developed for securitisation arrangements (2014a, p. 14).

Participant's views varied as to whether the above issues imposed a barrier for the export of services relating to managed investment schemes (section 6.1). Chaikin and Brown (sub. DR50) stated that trust law reform is critical for collective investment vehicles such as managed investment schemes, and considered that a new trust regime would operate alongside alternative collective investment vehicles (CIVs) being considered by the Government (section 6.4). The FSC (sub. DR43) stated that a new trust law regime should not apply to managed investment schemes.

### **Should Australia's trust law be updated?**

The FSC (sub. 20, sub. DR43) and Chaikin and Brown (sub. DR50) proposed an alternative trust act to provide fit for purpose legal infrastructure for Australian trusts. The FSC considers their proposed act would modernise and codify Australia's trust law, be a Commonwealth act (and so consistent across jurisdictions) and address the shortcomings with the current system of trust law. The FSC noted that their proposed act would operate as an alternative regime to the current system of trust law, on an opt-in basis. An alternative option may be to review and update the existing state and territory-based trust acts.

The effects of Australia's system of trust law on the export of traditional trustee services is unclear. There is limited evidence on the potential size of the export market for Australian traditional trustee services. Nor has the Commission found sufficient evidence to identify the 'height' of the barrier imposed by Australia's system of trust law — there are other factors that settlors consider, aside from the regulation of trusts, when deciding on the jurisdiction in which to domicile a trust. These other factors include taxation arrangements and the competitiveness of the trust management services offered by domestic financial providers.

While some overseas jurisdictions that have amended their trust law have seen an increase in financial service exports, these jurisdictions also amended other laws at the same time. For example, Singapore, which saw strong growth in its asset management industry following trust law reform, amended its tax laws for foreign investors at the same time (Chaikin and Brown, sub. DR50). As a result, the relative importance of each of the factors that investors consider when choosing a jurisdiction to domicile a trust is unclear.

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In relation to managed investment schemes, the Commission considers that other reforms are a higher priority for financial service exports at this stage. In particular, although the introduction of alternative CIVs (section 6.4) would be unlikely to completely alleviate the issues for managed investment schemes caused by trust law, a broader range of CIVs will reduce the reliance of fund managers on trusts, and provide alternatives for international investors that do not wish to use Australian trusts.

Due to the uncertain effect of trust law reform on service exports, particularly the export of traditional trustee services, and the progression of other reforms for managed investment schemes, the Commission is not recommending that Australia's system of trust law be updated at this stage. The Commission notes that trust law is a broader issue than the export of financial services. While trust law reform may be justified due to benefits for domestic investors in trusts, full assessment of these benefits (and costs) is beyond the scope of this study.

### **6.3 Prudential regulation**

The majority of the value of Australia's financial service exports are banking and insurance services (chapter 3), which are subject to prudential oversight by APRA. APRA supervises deposit-taking institutions and insurance companies with the intent of promoting financial system stability and protecting consumers of financial products. This regulatory framework is being increasingly driven by international standards (FSI 2014b) (box 6.4). Prudential regulation can include:

- minimum capital adequacy requirements — a regulated institution must maintain a minimum ratio of capital to its total risk-weighted assets
- risk management frameworks — for example, regulated institutions must maintain a board-approved risk appetite statement and risk-management strategy, and must notify APRA of any significant breaches of its risk-management framework
- governance frameworks — for example, regulated institutions must meet specific requirements in regard to board size and composition, and must have an independent chairperson.

Deposit-taking institutions, and life and general insurers, are also subject to a range of general barriers to export, such as restrictions on establishing a commercial presence abroad (chapter 5).

#### **Stringency of Australia's prudential standards**

The FSC (sub. 20, sub. DR43), the Insurance Council of Australia (sub. 12) and Insurance Australia Group (IAG, sub. 10) raised concerns with APRA's approach to setting Australia's prudential regulation framework, including in relation to:

- capital adequacy requirements for insurers in Australia. Participants noted that APRA has set capital adequacy requirements that are higher than those for Australia's competitors
- a requirement that an Australian life insurance provider that operates outside Australia must have a separate statutory fund for its overseas business.

## Box 6.4 International standards for prudential regulation

### Basel Committee on Banking Supervision

The Basel standards on the prudential regulation of banks were first agreed in 1988 (Basel I) and are currently being updated through the Basel III standards. The Basel standards include standards for banking regulation in relation to:

- minimum capital requirements
- supervisory review processes
- measurement of risks in relation to securitisation and trading book exposures
- liquidity requirements
- frameworks for 'systemically important' banks.

The Basel committee published a report on 28 of its member jurisdictions (including Australia), which indicated that all have adopted the standards (to varying degrees) (Basel Committee on Banking Supervision 2015). The Basel standards have also been implemented by many countries (also to varying degrees) that are not members of the Basel Committee (FSI 2015).

### International Association of Insurance Supervisors

The International Association of Insurance Supervisors (IAIS) was established in 1994 and represents insurance supervisors in nearly 140 countries. The purpose of the IAIS is to promote effective and globally consistent regulation of the insurance industry, and contribute to global financial stability.

The IAIS has standards across 26 areas of insurance regulation. The adoption of these standards by member countries varies.

- Insurance Core Principle (ICP) 1 relates to the objectives, powers and responsibilities of the supervisor — including that the responsible authority and its objectives are clearly defined in legislation, and that these objectives promote a fair, safe and stable insurance sector. Of 82 jurisdictions surveyed in 2013, all observed or largely observed this standard.
- ICP 2 relates to ensuring that the supervisor is independent and transparent, has adequate resources and meets high professional standards. Of 82 jurisdictions surveyed in 2013, all either largely observed or partly observed this standard.
- ICP 23 requires that the supervisor supervises insurers on a group-wide basis. Most jurisdictions surveyed in 2013 either partly observed or did not observe this standard (IAIS 2013).

In 2012 the International Monetary Fund noted that Australia had, in general, a high level of conformance with the IAIS principles. The Fund made several recommendations designed to increase Australia's conformance with the principles, such as restricting the ability of Government ministers to give directions to APRA or ASIC on supervisory policy (IMF 2012b).

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The FSC (sub. 20) recommended that APRA should regularly review capital requirements in the context of promoting international competitiveness. Similarly, IAG (sub. 10) recommended that regulators should be encouraged to take a global view in their considerations. IAG noted that one instance where competitiveness is not adequately considered is in relation to APRA's view of joint venture investments in Asia, where it excludes almost all the economic value of joint venture investments in its capital adequacy calculations. IAG stated that this decision made expansion financially difficult for Australian insurance companies relative to EU and US companies. Similarly, Rodney Maddock (sub. DR35) stated that banks must fund minority stakes in overseas banks from tier 1 capital, which makes overseas expansion difficult.

### The costs and benefits of modifying Australia's prudential regulation arrangements

As noted by the IAG (sub. 10) there are tradeoffs when balancing the objective of promoting financial integrity against the need to minimise any adverse effects on competition and efficiency. For example, APRA's requirements for capital adequacy are in place for financial stability reasons, while the separate statutory funds for international life insurance funds were put in place to protect policy holders by having business of a similar risk profile grouped together (Willis 1994). APRA indicated that the requirement to have a separate statutory fund, that largely relates to record keeping and administrative obligations, is an important prudential control (pers. comm., 6 October 2015). Changes to prudential regulation to address concerns about international competitiveness would have ramifications that are broader than those specific to service exports and should be assessed in a manner that gives appropriate consideration to communitywide effects. For this reason, and because prudential regulation was considered in the Financial System Inquiry in 2014, the Commission has not made any recommendations or findings regarding prudential regulation in this study.

The costs of complying with regulation should be a consideration for APRA when setting prudential regulation, alongside other factors such as the benefits arising from the stability of the Australian financial system and consumer protection. APRA has a conservative approach to prudential regulation, which it considers has helped to maintain the stability of the Australian financial system, including in relation to the global financial crisis.

... as APRA sees it, its most enduring contribution to the resilience of regulated institutions during the [global financial] crisis came from its efforts to promote their financial health prior to the crisis. Tough decisions were taken in good times, including establishing more conservative ... capital requirements relative to overseas peers, developing a risk-based capital framework for general insurers consistent with leading practice globally, and introducing meaningful governance requirements. (APRA 2014a, p. 20)

The International Monetary Fund (2012a) has also noted that a proactive response to financial supervision in Australia has helped to maintain financial stability.

There may be scope to improve prudential regulation in ways that could reduce the regulatory burden on Australian firms, while meeting policy objectives such as maintaining

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the stability of the financial system. The Financial System Inquiry concluded that there was no evidence to suggest that Australia's compliance burden is larger than in comparable jurisdictions overseas, but made recommendations to improve Australian regulatory processes. Of most relevance to financial service exports, the Inquiry recommended that the state of competition in the financial sector should be reviewed externally every three years, including identifying barriers to cross-border provision of financial services. The Inquiry considered that the effects of regulatory proposals on competition should be explained explicitly in consultation documents and annual reports (FSI 2014a). The Government has committed to implementing this recommendation (Australian Government 2015e), which will help to identify any barriers to financial service exports imposed by prudential regulation.

## **Differences in prudential regulation across countries**

As noted above, there are international standards in place for the regulation of financial services but the adoption of these standards can vary. Many jurisdictions, particularly in Asia, set higher minimum capital standards than is required under the Basel framework (Byres 2013). In assessments of the implementation of the Basel III capital adequacy requirements, the Basel Committee noted that there were material deviations from the Basel requirements in several countries including the United States and countries in the European Union (Basel Committee on Banking Supervision 2014a, 2014b).

### **Differences in prudential regulation can impede service exports**

Submissions to this study, and previous reports, have stated that differences in prudential regulations add to the costs of doing business for financial services firms.

- AFMA (sub. 14) stated that inconsistent regulation of financial services is a barrier to service exports, and highlighted the need for greater regulatory harmonisation. Similarly, APEC (2012) stated that inconsistent regulation of financial services can impose onerous costs on businesses with cross-border operations.
- ANZ (sub. 23) noted that prudential standards vary greatly across jurisdictions in the Asia region, which can restrict market entry and, in some cases, entrench existing domestic banks' positions.
- The Australian Bankers' Association (2014) has highlighted the Dodd–Frank reforms in the United States (box 6.5) as adding to compliance costs — in particular, it highlighted the 'Volcker rule' as having considerable compliance costs and burdens for Australian banks.
- Byres (2013) noted that regulatory consistency can have benefits, including supporting cross-border trade by promoting international financial markets. He also noted that moves toward ring fencing risk introducing a degree of fragmentation in global markets. For example, the United Kingdom has implemented reforms to ring fence banks whose interruption would have a significant effect on the local economy.

- the Financial System Inquiry stated that divergent international regulatory requirements can ‘increase compliance costs [and] create legal risk ... ’ (FSI 2014b, pp. 4–93).
- The FSC (2015) has noted that changes to the way unit link insurance products (products where the premium paid covers both insurance and investment in debt and equity instruments) are regulated in India have detrimentally affected the life insurance market. The FSC (sub. DR43) also noted that several governments have restricted overseas reinsurance business.

### Box 6.5 **Dodd–Frank reforms**

The Dodd–Frank Wall Street Reform and Consumer Protection Act was adopted in the United States in 2010, and contained several reforms designed to prevent another financial crisis. These reforms included creating a new independent authority with a consumer protection role, creating a council to identify and address systemic risks imposed by large companies, reforming corporate governance arrangements and increasing transparency for ‘exotic instruments’.

The Dodd–Frank reforms led to a rule requiring foreign firms with substantial operations in the United States to establish a US intermediate holding company. This rule was approved by the Federal Reserve in 2014. These holding companies are required to comply with US risk and capital standards established through the Dodd–Frank reforms, including requirements:

- to employ a US risk officer and risk committee
- for entities to have a debt to equity ratio of no more than 15 to 1 if they are considered to be a grave threat to US financial stability
- in relation to capital adequacy, risk management and liquidity, and to conduct liquidity stress tests.

Foreign banks must also comply with the ‘Volcker rule’, which was included in the Dodd–Frank reforms. This rule prohibits commercial banks (with some exceptions) in the US from trading and investing in hedge funds and private equity funds.

*Source:* Code of Federal Regulations (US), part 252.

## Costs and benefits of greater consistency in prudential regulation across countries

The key potential benefit of addressing regulatory inconsistencies in prudential regulation across countries would be a reduction in costs (both upfront and ongoing) for financial service providers. In addition, to the extent that simplifying cross-border regulation leads to a greater international presence for Australian financial service providers, there may also be benefits for other Australian exporters that require financial services to support their activities (FSI 2014b).

In some cases there are legitimate reasons for prudential frameworks to differ across jurisdictions — full regulatory consistency is unlikely to be optimal. For example, as noted above, Australia’s more conservative approach to financial regulation was cited as beneficial in the context of the global financial crisis. Byres (2013) noted that: variation in prudential regulation can be optimal as different financial systems are at different stages of

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development; financial regulation needs to be blended with tax, accounting and legal frameworks; and there is a need to adjust regulatory arrangements to account for different risks across jurisdictions.

There are limited policy tools available to the Australian Government to achieve greater regulatory harmonisation (FSI 2014b). Where possible, there would be benefits in the Australian Government working in relevant international forums to achieve greater regulatory consistency, while being mindful of the need for jurisdictions to tailor prudential regulation. General approaches to achieve greater regulatory consistency are considered in chapter 9.

## 6.4 Taxation arrangements for financial services

Taxation primarily acts as a barrier to financial service exports by taxing the returns to investment for foreign investors. This reduces the expected returns of financial products supplied by Australian financial institutions in international markets and reduces demand for the associated service exports.

Not all taxation is a barrier to service exports — in the sense that it *unnecessarily* impedes the ability of businesses to export services (chapter 1) — as there is a need for governments to fund their expenditure through taxation. The Commission has analysed taxation arrangements in a manner that takes into account the broader goals of the taxation system, based on applying the following widely accepted tax policy design principles (Board of Taxation 2003).

- *The efficiency principle* — in raising revenue, a tax system should seek to minimise the costs to the broader community.
- *The neutrality principle* — a tax system should reflect the objectives of:
  - capital export neutrality, whereby residents' income is taxed the same regardless of whether it is earned domestically or internationally
  - capital import neutrality, whereby the income from domestically-owned capital is taxed the same as that from foreign inward investment.
- *The simplicity principle* — a tax system should be transparent, easily understood and seek to minimise administrative and compliance costs.
- *The equity principle* — a tax system should reflect community concerns about fairness.

### Withholding taxes on foreign investment

Like most other governments, the Australian Government imposes taxes on the income earned in Australia by foreign investors — this includes withholding taxes that apply to Australian payments of interest, dividends, royalties and payments from managed funds

(table 6.1). Withholding tax on interest payments represents the bulk of withholding taxes levied on foreign investment in Australia (figure 6.5).

International comparison of the headline rates of withholding tax charged (in the absence of tax treaties) reveals little about the appropriateness of Australia's withholding tax rates. Although Australian rates are higher than those charged in some countries that are major exporters of financial services such as Singapore, they are roughly equivalent to those charged in others such as Japan and the United States (table 6.2). Caution is advisable when drawing conclusions based on tax rates, as lower rates in other countries are not an argument for lower tax rates in Australia. Policy settings, including tax policy, should be based on the goal of maximising community wellbeing, rather than matching policies in other countries (chapter 4).

**Table 6.1 Withholding taxes for foreign investors using Australian financial services<sup>a</sup>**

<i>Type of income</i>	<i>Withholding tax applied</i>
Dividends	Franked dividends exempt <sup>b</sup> Unfranked dividends: 30 per cent unless subject to a tax treaty (then generally between 0 and 25 per cent)
Royalties	30 per cent unless subject to a tax treaty (then generally between 5 and 15 per cent)
Interest	10 per cent unless subject to a tax treaty (then generally between 0 and 10 per cent)
Fund payments <sup>c</sup>	30 per cent
Fund payments received through a managed investment trust (MIT)	15 per cent where the fund payment is made to a foreign resident in a country with which Australia has an effective exchange of information agreement (or 10 per cent for newly constructed energy efficient commercial buildings, known as clean MITs)
Foreign source income received through a MIT	Exempt
Gains from disposal received through a foreign fund under the Investment Manager Regime	Exempt

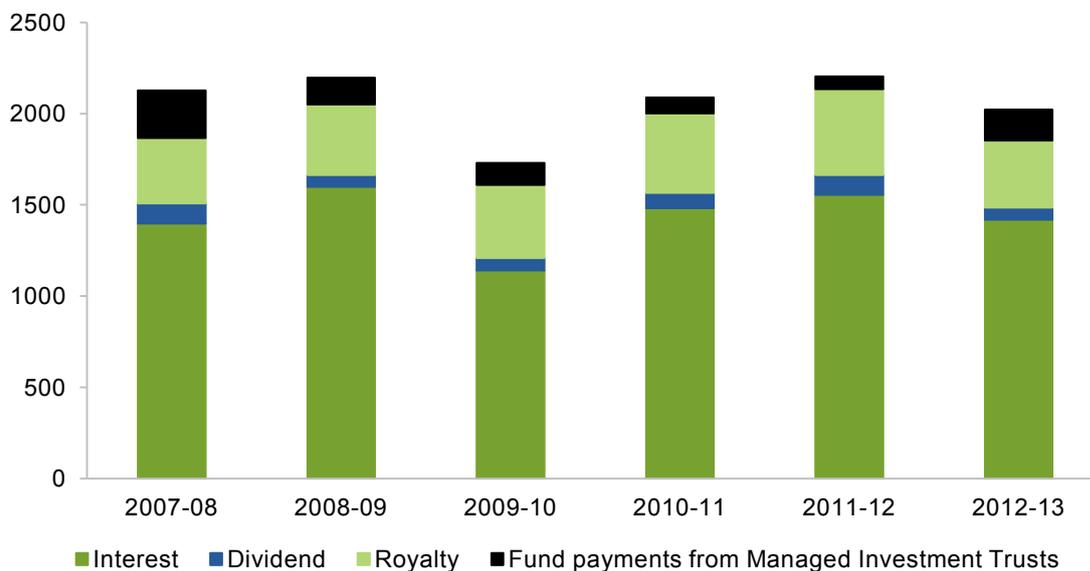
<sup>a</sup> Table is a summary only. A range of additional exemptions are applicable to many of the income sources listed (box 6.6). <sup>b</sup> Franked dividends drawn from earnings subject to Australia's 30 per cent corporate tax rate. <sup>c</sup> Fund payments are the distributions of a managed investment fund excluding dividends, interest, royalties and amounts that are not from an Australian source.

Sources: ATO (2014b); Australian Government (2015h).

The rate of withholding tax applied in Australia varies depending on:

- the type of investment or income (table 6.1)
- a range of legislated exemptions (box 6.6)
- the conditions of tax treaties (box 6.7).

**Figure 6.5 Withholding taxes collected by the Australian Tax Office 2007-08 to 2012-13<sup>a,b</sup>**  
\$ million



<sup>a</sup> Caution should be used when quoting these data as data reliability is low and source data have been adjusted by the ATO to improve data integrity. <sup>b</sup> Managed investment trust data include custodians in receipt of fund payments resulting in some double counting. The ATO may make further adjustments to the Managed investment trust data in the future.

Source: ATO (pers. comm., 14 July 2015).

### The effect of withholding taxes on service exports

By imposing costs on foreign investors, withholding taxes can raise the effective price of the investment products supplied by Australian financial institutions, and thereby reduce demand for the associated service exports. To some extent, withholding taxes also indirectly affect other service exports by increasing the cost of capital for Australian investment, including in services.<sup>3</sup> For example, the Tourism and Transport Forum (sub. DR48) noted that overseas financiers of aircraft for Australian airlines often require additional payments to cover Australian withholding tax, effectively passing the burden of the tax back to the airlines.

The effect of withholding taxes on service exports will depend on the tax treatment applied in the investor's country of residence and the extent to which there is double taxation of an investment (in the source and resident countries). This in turn will depend on the existence of any exemptions or credits, and any relevant taxation treaties (box 6.7). Where

<sup>3</sup> The after-tax rate of return accepted by international investors is set in international capital markets. As Australia is a small open economy, withholding taxes increase the rate of return required to attract foreign investment, thereby raising the cost of capital (box 6.10).

investments in the source *and* resident countries are subject to differing taxation burdens it can affect the efficiency of international investment markets (violating the neutrality principle).

**Table 6.2 International comparison of withholding tax rates<sup>a</sup>**  
Australia and major exporting countries of financial services, 2013<sup>b</sup>

<i>Country</i>	<i>Interest</i>	<i>Dividend</i>	<i>Royalty</i>
OECD Model Tax Convention <sup>c</sup>	10	15	None
Australia	10	30	30
Brazil	15	0	15
Canada	25	25	25
Germany	25	25	15
Hong Kong	0	0	4.95
India	20	20	25
Ireland	20	20	20
Japan <sup>d</sup>	20.42	20.42	20.42
South Korea	20	20	20
Luxembourg	0	15	0
Singapore	15	0	10
Switzerland	35	35	0
United Kingdom	20	0	20
United States	30	30	30

<sup>a</sup> Rates reported are the headline rates that apply to non-residents in the absence of exemptions and tax treaties. <sup>b</sup> Countries represented are a selection of the largest exporting countries of financial services reported by the WTO (2014). <sup>c</sup> Recommended maximum rates for parties negotiating a tax treaty under the OECD's Model Tax Convention on Income and Capital. <sup>d</sup> Rate includes a 2.1 per cent surtax.

Source: PWC (2015).

Study participants noted that double taxation can be a significant barrier to exporting activity. For example, the FSC (sub. 20) noted that tax remains a significant barrier to Australia exporting managed funds and that this barrier is most acute in nations where Australia does not have a tax treaty in place. Cox Architecture (sub. 2) noted that withholding taxes levied in international jurisdictions discourage the provision of services offshore, as it is often difficult to avoid double taxation — even where exemption arrangements and treaties are in place.

AFMA (sub. 14) and the FSC (sub. DR43) observed that take-up of opportunities under a trade agreement can be undermined by uncertainty within an existing tax treaty, or the failure to update tax treaties.

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## Box 6.6 Exemptions to withholding tax

Subsection 128B of the *Income Tax Assessment Act 1936* (Cwlth) consists of around 12 pages of legislation outlining the liability to pay interest, dividend and royalty withholding taxes. A range of exemptions to these withholding taxes are detailed, including for example:

- income derived by a non-resident that is an overseas charitable institution
- income earned by certain non-resident not-for-profit organisations — for example, scientific institutions, public education institutions, and organisations promoting science, aviation, tourism, sports, culture, film and recreation
- dividends paid by pooled development funds<sup>4</sup>
- franked dividends
- interest payments related to certain infrastructure borrowings
- dividends paid by certain shares acquired under employee share schemes
- dividends derived from assets included in the insurance funds of certain life insurance companies
- interest derived on a nostro account by a non-resident that is a foreign bank
- income earned by certain non-resident superannuation funds
- interest payments on offshore borrowings by offshore banking units
- demerger dividends
- certain publicly offered debentures or debt interests.

Exemptions for managed investment trusts are set out in subdivision 842 of the *Income Tax Assessment Act 1997* (Cwlth). Dividend imputation exemptions for conduit income are set out in subdivision 802 of the *Income Tax Assessment Act 1997* (Cwlth). Further exemptions are also available for temporary residents of Australia who pay interest to foreign lenders.

Participants in this study from the financial sector (AFMA, sub. 14, sub. DR37; FSC, sub. 20, sub DR43; TTF sub. DR48) have called for simpler and lower rates of withholding taxes. The FSC (sub. DR43) also called for a flat 5 per cent concessionary rate to be applied to all ‘withholdable’ income paid by managed investment trusts (MITs) participating in the ARFP, with the intention of making Australian financial service providers more competitive with providers from other ARFP countries that have more favourable tax arrangements (particularly Singapore). Previous reviews undertaken or commissioned by the Australian Government have also identified the need for lower, more uniform withholding tax rates, particularly with regard to interest withholding tax (AFCF 2009; Australian Government 2010; FSI 2014a).

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<sup>4</sup> Pooled development funds raise capital and make equity investments in small and medium-sized Australian enterprises.

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## Box 6.7 Tax treaties and the allocation of taxing rights

Australia has a network of 44 bilateral tax treaties with its trading partners (Australian Government Treasury 2015). These tax treaties are generally based on the *OECD Model Tax Convention on Income and Capital* and to a lesser extent, the *UN Model Double Taxation Convention between Developed and Developing Countries*. These conventions provide guidelines for the allocation of the international tax base between the country where the investment takes place (the source country) and the country of the investor's residence (the residence country), with the purpose of:

- reducing or eliminating double taxation caused by overlapping tax jurisdictions
- providing taxation security by establishing tax rules that apply to particular international transactions and avenues for resolution of claims of inappropriate taxation
- preventing the avoidance and evasion of taxes (ATO 2014a).

The potential for international double taxation arises because national governments assert their right to tax income earned within their borders as well as the worldwide income of their residents. An investor earning income from abroad may therefore face a tax claim both from the source country and from the residence country.

Treaties based on the OECD guidelines typically reduce withholding tax rates on cross-border income flows below the levels prescribed by domestic tax laws and below benchmarks set out in the guidelines (for example, that interest not be taxed at a rate above 10 per cent in the source nation). In theory, a country with a wide-ranging network of tax treaties effectively lowers its aggregate level of tax on foreign investment, making itself more attractive to investors from treaty countries. In doing so, that country allows the foreign residence country to collect a higher proportion of the taxation revenue on the relevant investments, relative to what it collected prior to the agreement. However, as noted by the International Monetary Fund (2014), empirical studies on the effect of tax treaties on investment flows are mixed, with some studies showing treaties to have no or negative effects, while others show positive effects.

Australia's taxation agreements are also designed to prevent avoidance and evasion of taxes.

## Costs and benefits of reducing the barriers associated with withholding taxes

It is important to weigh the costs and benefits of changes to Australia's withholding tax regime on a communitywide basis. This is because withholding taxes are levied on the investment activity itself — as distinct from the associated financial service exports — and so primarily affect domestic and international investment markets, with the corresponding effects on financial sector exports being secondary.

Analyses of the costs and benefits of changes to withholding taxes should also consider the effects on the tax base and any problems associated with the integrity of the taxation system. Withholding taxes help preserve the integrity of the taxation system by:

- acting as a brake on tax avoidance schemes by residents, such as the routing of income through offshore structures with the income then returned in a tax exempt form
- generating information for use by tax authorities

- 
- limiting the tax advantage to multinationals from thinly capitalising their Australian subsidiaries or paying them excessive interest or dividends (Australian Government 2010).

Possible changes to withholding taxes include simplification and reductions in the rates of withholding taxes, each of which are considered below.

### The case for simpler withholding tax arrangements

As noted earlier, the rate of withholding tax applied in Australia varies across different investments and types of income, and is dependent on the conditions of tax treaties and legislated exemptions. The web of different rates creates distortions between groups of investors and between investment activities as investment decisions are altered to reflect the incidence of the taxes. Simplifying withholding taxes could be pursued through reforms to domestic arrangements and through the negotiation of international tax treaties.

#### *Simplifying domestic arrangements*

An important consideration in setting withholding taxes is the tradeoff between uniformity and efficiency. There may be a case for some variation in withholding tax rates on different types of investment based on the relative mobility of capital (box 6.8). In Australia, consideration of differences in the mobility of capital has led policy makers to distinguish between active and passive investments, with passive investments considered to be more mobile and therefore taxed at a lower rate. For example, differences in the mobility of capital forms the basis of targeted concessions such as the reduced withholding tax rate on fund payments from MITs (Australian Government 2015c; box 6.9).

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#### **Box 6.8      The tradeoff between uniformity in tax rates and efficiency**

In general, uniformity between the tax rate applied to different investment activities is desirable so as to avoid distorting investment decisions. Uniformity also avoids the complexities and political lobbying that are inevitable in a differentiated regime. However, there are instances where departing from uniformity can enhance economic efficiency.

For example, the ‘inverse elasticity rule’ suggests that where investment activities differ in their elasticity of demand, it is optimal for tax rates to be differentiated across investments. According to this rule the deadweight loss or ‘welfare cost’ of a tax is greatest where it has the largest effect on people’s behaviour (Mirrlees et al. 2011).

In investment markets the increased international mobility of capital has made it difficult for governments to tax capital income at the source of the investment without causing capital flight (that is, the supply of international capital has become increasingly elastic).

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### Box 6.9      **The Managed Investment Trust Regime**

Under the Managed Investment Trust Regime, some eligible unit trusts, known as managed investment trusts (MITs), qualify for lower withholding tax rates. Fund payments from a MIT are subject to the standard withholding tax rate of 30 per cent, except in the following circumstances.

- Where the fund payment is made to a foreign resident in a country with which Australia has an effective exchange of information agreement the rate is reduced to 15 per cent (or 10 per cent for newly constructed energy efficient commercial buildings, known as ‘clean MITs’).
- Foreign sourced income and gains from disposal received through foreign funds are exempt from withholding tax.

A trust qualifies as a MIT if:

- the trustee is an Australian resident, or the central management and control of the trust is in Australia
- the trust carries out most of its investment management activities in relation to Australian assets in Australia
- the trust does not carry on or control an active trading business
- the trust is a managed investment scheme
- the trust is sufficiently widely-held (that is, there are a number of investors and no single investor holds more than a 60 per cent equivalent interest in the trust)
- the trust is appropriately regulated.

The Australian Government has proposed changes to the MIT regime — public consultation on draft legislation for the regime closed on 23 April 2015.

*Source:* Australian Government (2015f).

Exemptions and special rates of withholding tax applying to different types of investments should be justified by differences in the economic effects of those taxes. The complexity of the system, as it stands, creates distortions in financial markets, sometimes with the aim of pursuing unrelated policy goals. For example, the special (lower) withholding tax rate that applies to fund payments from clean energy MITs aims to encourage investment in the construction of new energy efficient commercial buildings (Bradbury and Parliamentary Secretary for Climate Change and Energy Efficiency 2012). However, providing this tax concession not only adds additional complexity to the withholding tax regime and likely exacerbates the associated compliance and/or administrative costs, it also distorts the allocation of international investment capital and potentially crowds out domestic and other non-MIT investment in such activity. Furthermore, using withholding taxes to pursue unrelated policy goals is likely to be less effective than implementing policies that directly target the policy problem in question.

Unless it can be shown that variation in withholding tax rates is efficiency-enhancing, more uniform rates of withholding tax are likely to reduce the distortions associated with treating different types of investment differently for tax purposes. The Tourism and Transport Forum, for example, noted that the current withholding tax on leasing payments

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(which are generally subject to royalty withholding tax) distorts Australian airline decisions and that, as a principle, ‘there should be no difference between borrowing to finance [the] purchase of equipment or leasing equipment’ (sub. DR48, p. 6).

Further, where complexity results in uncertainty about the tax rate applying to investments it can reduce demand for the associated financial services. Removing complexity that is not justified by differences in the economic effects of withholding taxes aligns with the efficiency principle and would also be more consistent with the simplicity principle. It may also have integrity benefits as more uniform rates of withholding tax would make it more difficult to identify opportunities to minimise tax by investing in favoured activities.

Applying lower withholding tax rates to MITs participating in the ARFP, some of which already attract concessions, would only create further distortions in an already complex system. Lower rates are not justified on the basis that the current rates would be uncompetitive with other jurisdictions participating in the ARFP. Although there may be a case for some variation in withholding tax rates on different types of investment based on the relative mobility of capital, the case for variation along these lines has not been executed for ARFP funds. Rather, the FSC (sub. DR43) has argued that the current rates would be uncompetitive with other jurisdictions participating in the passport, and that their proposed change would result in an increase in government taxation revenue (owing to an increase in inbound investment and an increase in corporate tax receipts generated through increased fee revenue).

These arguments do not address the economic case for variation. Although the proposed change would simplify withholding taxes within the ARFP, it would make the system more complex overall, as funds not in the ARFP would face different tax treatment. It remains unclear why investment from countries that participate in the ARFP should receive preferential tax treatment to investment from other countries. The fundamental similarities between managed funds (ARFP or otherwise) suggest that taxes should be applied uniformly to all funds.

### *Simplifying international arrangements*

Simplification of withholding taxes applying to investors from different countries may be more difficult to achieve, but the case for charging different withholding tax rates according to the nationality of the investor is weak. As noted in box 6.7 withholding tax arrangements have been negotiated bilaterally with 44 trading partner countries. While there is some degree of uniformity (as these treaties are generally based on the OECD Model Tax Convention on Income and Capital), the current arrangements are the result of multiple discrete negotiation processes, and the rates of withholding tax charged to investors in different jurisdictions can vary considerably (table 6.1).

This disparity is likely a reflection of the various taxation preferences of each of the contracting partner nations and, accordingly, Australian negotiators may be limited in the levels of uniformity they can achieve in bilateral negotiations. However, where practical,

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the Commission considers that future negotiations should seek uniformity between jurisdictions. There may also be scope to update some tax treaties. The FSC (sub. DR43) noted that many of Australia's tax treaties are out of date. Current treaties in force were negotiated as early as 1972 (Australian Government Treasury 2015).

The increased use of multilateral agreements could also be pursued. There are some examples of agreements of this nature — such as the Nordic Multilateral Tax Treaty, the South Asian Association for Regional Cooperation Income Tax Agreement and the Caribbean Community Income Tax Agreement — but such agreements are rare in practice as they are difficult to negotiate between multiple countries with different economic relationships and domestic laws (UNCTAD 2000).

The increased use of multilateral agreements would also alleviate the problem of ever-falling capital tax rates, whereby international competition for mobile capital creates the incentive for governments to cut their capital taxes below optimal levels, triggering a 'race to the bottom' (Griffith, Hines and Sorensen 2010).

#### RECOMMENDATION 6.2

The Australian Government should simplify Australia's regime of withholding taxes through reforms that pursue greater uniformity in the rates applying to different types of investment, a reduction in the range of domestic exemptions available and the negotiation of more consistent withholding tax rates in tax treaties.

The Australian Government should not introduce additional concessional withholding tax rates for the Asia Region Funds Passport as future changes to the withholding tax regime should seek to introduce greater — rather than lesser — uniformity.

### The optimal rate for withholding taxes — a complex empirical matter

Evaluating the case for lower withholding taxes — as advocated by financial sector stakeholders — is complex and would require detailed empirical consideration of the economywide effects. The economic literature notes that, under certain assumptions, governments of small open economies (such as Australia) should not levy any source-based taxes on capital, including withholding taxes (box 6.10). Despite this general conclusion, there are a number of reasons for governments to retain such taxes.

First, where an investment generates location-specific rents, the rents can be taxed without distorting investment decisions (box 6.11). In theory, and in line with the efficiency principle, location-specific rents should be targeted and taxed separately from the normal returns to capital. In practice, there are a number of problems associated with targeting location-specific rents and governments have found it more practical to maintain taxes that also fall on the normal returns to investment, despite their inefficiency.

- Location-specific rents can be difficult to measure.

- There are practical difficulties in attempting to tax income from different activities at different rates, particularly where these activities may be undertaken by the same firm.
- If the tax rates are high compared to other income sources, as the tax rate on location-specific rents increases, profits may be re-characterised as other forms of income that are taxed at lower rates. For example, if the tax rate on location-specific rents exceeds the tax rate on wage income, recorded economic profits may be redistributed as higher wages.
- Especially low tax rates for highly mobile business activities have been discouraged internationally, as they are considered to promote harmful tax competition and tax evasion (Mirrlees et al. 2011).

#### **Box 6.10 Optimal taxes on capital in a small open economy**

A key conclusion reached in the economics literature on international taxation is that, under certain assumptions and in the absence of location-specific rents (box 6.11), a government in a small open economy should not levy any source-based taxes on capital. This conclusion was originally derived by Gordon (1986) and restated by Razin and Sadka (1991).

The theoretical reasoning for this conclusion is that in a small open economy, which cannot affect the demand and supply of global capital, any tax that the country imposes on the return to capital would only serve to increase the return that investors require to supply capital to that economy. The required return to capital would increase by the full amount of the tax to compensate investors. Consequently, the burden of any source-based capital taxation would be shifted to other factors of production that are relatively immobile or fixed in supply — such as labour and land. In the process, the productivity of the immobile domestic factors would fall due to a lower capital intensity of production.

Since the other factors of production bear the full burden of the tax on capital, the same effective tax burden could be achieved by directly taxing wage incomes and land rents, without reducing the economy's total production to the same extent as the tax on capital (Dahlby 2008). It is more efficient to tax labour and land directly because eliminating the source-based taxes on capital would not change the ultimate incidence of taxation in the economy, and it would reduce the total distortions caused by the tax system.

Second, although the international mobility of capital has grown, capital may still not be perfectly mobile, particularly in equity markets (Australian Government 2010). The efficiency effects of levying source-based taxes on investment in a small open economy (outlined in box 6.10) may not be as severe as if capital were perfectly mobile. As the globalisation and integration of capital markets proceed, however, this is likely to become less relevant.

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### Box 6.11 Normal returns and economic rents

In assessing taxation policy, particularly international taxation policy, a fundamental distinction should be drawn between taxes on the normal return to capital and taxes on economic rents.

Taxes on the normal return to capital undoubtedly affect investment decisions since investors seek to maximise the net present value of investment decisions, inclusive of taxes.

Taxing economic rents does not generally create a distortion. An economic rent arises when a resource generates a profit over and above the normal required return relative to its next-best use. Taxing it should not alter behaviour, since these taxes leave the normal return to capital untaxed, and an investment project that has a positive net present value before tax will also have a positive net present value after tax.

The theoretical positions outlined above abstract away from the potentially substantial problems associated with implementing such taxes, particularly where doing so involves identifying and quantifying economic rents. What's more, some taxes on economic rents may still alter investment decisions as investors may seek to maximise the economic rents received. These distortions generally occur where the economic rents are not location specific, for instance where:

- economic rents are highly mobile. For example, a multinational firm that has market power and can locate production in multiple countries is likely to want to maximize the post-tax value of these economic rents. In choosing between two otherwise similar countries with source-based taxes on economic rents, the firm will tend to favour the country with the lower tax rate
- economic rents are available in multiple locations. Where the normal component of returns is relatively low and the rent component of returns is relatively high, investors may prefer to invest in locations that have a standard corporate income tax at a sufficiently low rate, rather than locations that tax only economic rent but at a higher rate.

*Source:* Mirrlees et al. (2011).

Third, many jurisdictions provide tax relief for the foreign source income of their residents to offset, at least partially, double taxation in the host and home countries. If the foreign country fully credits its residents for the taxation of foreign governments, an increase in the withholding tax rates is effectively borne by the treasury of the foreign government. This means that a significant share of the tax burden may be exported to other countries, and the incentive to invest is not altered by the withholding tax (Dahlby 2008).

Arriving at an optimal rate for withholding taxes therefore requires detailed empirical consideration of the economywide effects of such taxes, including among other things, the effect of these taxes on the level of domestic investment, the prevalence of location-specific economic rents in Australian investments, the secondary effects of the tax on land rents and wages, interactions with other taxes and the effects of (and on) relevant international arrangements.

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#### RECOMMENDATION 6.3

During the course of the Tax White Paper process the Australian Government should make a determination on the optimal rate for withholding taxes in Australia having regard to:

- the effect of withholding taxes on domestic and international investment, and on the supply of services by Australian providers
- the prevalence of location-specific economic rents
- the secondary effects of withholding tax on land rents and wages
- interactions with other taxes
- any relevant international developments.

### Dividend imputation

The dividend imputation system was introduced in 1987 to reduce the double taxation of corporate profits (company taxation and income tax paid by shareholders on dividends) and to reduce the tax bias in favour of debt over equity (Australian Government 2010).<sup>5</sup> Under the imputation system, company tax is ‘imputed’ or allocated to the shareholders by way of franking credits attached to the dividends they receive. Australian shareholders are entitled to a tax offset equal to the amount of franking credit. Non-resident shareholders are not entitled to any tax offset for franked dividends.

#### The effect of dividend imputation on service exports

Dividend imputation produces a bias against non-resident shareholders who are potentially taxed twice on dividend payments when they invest in Australia — once through corporate tax in Australia, and a second time through income tax on the dividend at home (where their home country does not provide any offset for corporate tax paid in Australia). This could lead to a decrease in demand for associated financial service exports, as purchasing Australian stocks often entails the use of services provided by Australian financial intermediaries such as banks, financial advisors and stock brokers. Despite this bias, an estimated \$12 billion (30 per cent) of the imputation credits distributed each year are received by non-resident shareholders (Australian Government 2015h).

Dividend imputation also produces a bias against investment abroad by Australian companies (and individuals), which increases the ongoing cost of service exports supplied via a commercial presence abroad. As ANZ (sub. 23) noted, domestic shareholders of Australian companies that invest overseas must pay tax at the full marginal rate on

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<sup>5</sup> Most tax systems contain a ‘debt bias’ as interest payments are typically tax deductible for corporate income tax purposes, while equity returns are not. This bias can create distortions in the domestic economy, for instance by encouraging inefficiently high debt-to-equity ratios in corporations.

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dividends from foreign profits, even if foreign tax has already been paid on income used to fund those dividends. This decreases the incentive to invest in an Australian business's global activities — as there is no franking credit attached to tax paid outside Australia<sup>6</sup> — and violates the principle of capital export neutrality. It also means that dividends from foreign assets will be more valuable to offshore investors than to Australian investors (ANZ, sub. DR45).

### Changes to dividend imputation should be considered as part of the Tax White Paper

Tax credits for dividends paid out of foreign source income have been proposed as a means to address the bias against investment abroad by Australian companies (ANZ 2015; Board of Taxation 2003). Providing tax credits for foreign source income could facilitate investment by Australian companies overseas (and associated service exports) by reducing capital costs and increasing the efficiency of international capital markets through moving closer to capital export neutrality. However, providing tax credits for foreign source income would also reduce Australian Government taxation revenue. It would also reduce the integrity benefits of the imputation system (by reducing the incentive for Australian companies to pay Australian corporate tax) and — particularly where those tax credits are not linked to actual tax paid overseas — increase incentives for Australian companies to shift profits to foreign countries with lower company tax rates than in Australia (Australian Government 2010).

The implications of more fundamental changes — such as removing dividend imputation altogether — would involve a number of complex trade-offs that go well beyond service exports. Removing dividend imputation would have implications for government revenue, foreign investment into and out of Australia, investment returns for domestic shareholders, the cost of capital for some companies and the integrity of the tax system. The discussion paper for the Tax White Paper flagged dividend imputation as an issue for consideration (Australian Government 2015h). ANZ (sub. DR45) was supportive of the Commission's draft recommendation that changes to dividend imputation should be considered as part of the comprehensive and broader ranging review process of the Tax White Paper.

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<sup>6</sup> The disincentive is diminished if the Australian business pays comparatively lower corporate taxes on the overseas investment.

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#### RECOMMENDATION 6.4

The Australian Government should not make changes to the dividend imputation system solely to increase service exports. The Australian Government should instead consider changes to dividend imputation as part of the Tax White Paper process, incorporating analysis of the effects on:

- domestic and international investment, and the supply of services by Australian providers
- domestic taxation, including the balance of taxes between different investment activities and the broader balance of taxation between investment, saving and consumption, and between debt and equity
- the integrity of the taxation system
- taxation revenue
- the efficiency of international capital markets.

### **Taxation arrangements for managed funds**

Taxation-related barriers to the export of managed funds were examined in the Australian Financial Centre Forum's report *Australia as a Financial Sector: Building on our Strengths* (The Johnson Report). The report, commissioned by the Australian Government to provide recommendations on how to secure Australia's future as a leading financial services centre, identified two main barriers that could potentially reduce the demand for exports of managed funds:

- uncertainty surrounding the taxation of offshore funds that invest in Australia
- the limited range of available collective investment vehicles (CIVs).

#### The effect of tax uncertainty on service exports

The main areas of uncertainty identified by the Johnson Report, in regard to offshore funds that invest in Australia, related to:

- what determines, for tax purposes, where an organisation carries on its business, or where it earns its income
- what determines the type of income the fund is deemed to have earned, in particular whether that income is a capital gain or revenue
- the tax implications of where management decisions are taken (AFCF 2009).

These uncertainties could reduce the demand for Australian based managed funds or the use of Australian based investment advisers by foreign fund managers. The Australian

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Government has sought to address these uncertainties through the introduction of the Investment Manager Regime (IMR) (box 6.12).

### Box 6.12 Investment Manager Regime

To address sources of tax uncertainty faced by managed funds, the Australian Government has introduced an Investment Manager Regime (IMR) to provide a set of clear and comprehensive rules on the taxation of certain non-resident investments into Australian and offshore assets. Three sets of amendments to the income tax law have been made.

The first element of the IMR reforms was enacted by the *Tax Laws Amendment (Investment Manager Regime) Act 2012* (Cwlth). The amendment applied a retrospective tax exemption to IMR income and gains of an 'IMR foreign fund' (and for foreign investors in such funds), for the year ended 30 June 2011 and for earlier years. This blanket exemption was intended to provide certainty to qualifying funds and their foreign investors, in relation to their obligations to disclose Australian tax liabilities under US accounting standards.

On 19 January 2011 the Australian Government announced the second element of the reforms, which made income from the relevant investments of a foreign fund — that are taken to have a 'permanent establishment' in Australia — exempt from income tax (known as the IMR concession).

The third and final element of the legislation was implemented in July 2015. The legislation extended the IMR concession to cover investments in Australian assets (excluding real property) that are of a portfolio nature and broadened the 'widely held' test.<sup>7</sup> In addition, foreign entities are eligible for the IMR concession if they directly invest in Australia or invest via an Australian fund manager (Australian Government 2015d).

### The limited range of collective investment vehicles

The FSC (sub. 20, DR43) and previous reviews (AFCF 2009; Board of Taxation 2011) raised concerns that the limited range of CIVs available in Australia is not providing the flexibility needed by investors. One of the principal reasons given for the limited range is that unit trusts are the only vehicle permitted to provide tax flow-through (from the vehicle to the end investor) under Australian tax law. This limitation could be a barrier to exporting these services as the unit trust (a vehicle generally associated with common law jurisdictions) may not be familiar to some overseas investors (AFCF 2009) and investors may simply have preferences for other vehicles (FSC, sub DR43). This would be expected to reduce the demand for exports of financial services from Australia.

The FSC (sub. 20, DR43) considered that a CIV regime comprising a broader range of tax flow-through CIVs (particularly corporate and limited partnership vehicles) would allow

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<sup>7</sup> Under the Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015 (Cwlth), the 'widely held' test requires trusts that wish to access the IMR concession to either: have no member with a total participation interest of 20 per cent or more, or not have five or fewer entities with a combined participation interest of at least 50 per cent; or be a type of entity specifically listed in the legislation.

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Australian based fund managers to compete more effectively internationally. The FSC's proposed model for a corporate CIV calls for a new type of entity that would:

- be treated as an MIT for taxation purposes and employ the existing 'eligible activity' test for MITs
- be governed as a corporation, with many of the features of a corporation
- adapt overseas models, such as those used in Luxembourg and the United Kingdom, to the existing Australian regulatory framework.

The Australian Government is considering such reforms. The discussion paper for the Tax White Paper has noted that work is underway.

The Government considers that there is a case for extending the range of collective investment vehicles that can be offered by Australian funds managers ... While a lot of work has already been done in this area, there are still a number of difficult taxation and regulatory issues that need to be worked through. The Treasury will consult with industry stakeholders in coming months with a view to developing proposals for inclusion in the Options Paper. (Australian Government 2015h, p. 91)

The FSC (sub. DR43) raised concerns about the potential for delays if a broader CIV regime continues to be included in the Tax White Paper process. The FSC recommended that the development of a broader range of CIVs should be decoupled from the Tax White Paper process to accelerate their development, with a view to introducing corporate CIVs prior to the commencement of the ARFP in 2016.

### The costs and benefits of changes to the taxation of managed funds

Although it is difficult to assess the size of the taxation barriers facing managed funds, the market for managed funds is large with global funds management assets totalling an estimated \$146 trillion at the end of 2013 (TheCityUK 2014). The size of this market, coupled with the high level of mobility of global funds, suggests that there are potentially large benefits from ensuring the tax treatment of managed funds does not unnecessarily create barriers to the export of such services, or disadvantage the domestic industry in competing for foreign customers.

#### *The Investment Manager Regime*

There are likely to be benefits from providing clarity on the level of taxation faced by foreign managed funds investing in Australia (or using Australian intermediaries) through attracting additional flows of investment by foreign managed funds and thus increasing associated service exports. However, there are also potential costs to introducing the IMR. The IMR does more than just provide taxation clarity — it also introduces an income tax exemption for foreign funds that may otherwise have been taxed prior to the introduction of the Regime, which will affect the value of tax receipts collected by the Australian Government. There is also a risk that such an exemption could be inappropriately accessed

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by intermediaries and domestic investors with the aim of minimising taxation. There is a need to ensure that the exemptions introduced as part of the IMR do not undermine Australia's commitments in relation to the OECD and G20's Action Plan on Base Erosion and Profit Shifting.

The introduction of the final element of the IMR has undergone considerable public consultation and should go some way to providing the clarity required to attract foreign investment. As the final element of the legislation has just been implemented (1 July 2015), it is too soon to assess the Regime's effectiveness. However, there would be merit in a review in the near future and the Commission considers that this should be conducted by the Board of Taxation no later than 2020 — a recommendation supported by the AFMA (sub. DR37). At a minimum, the review should examine:

- the effectiveness of the Regime in attracting additional flows of investment by foreign managed funds investing in Australia, or using Australian intermediaries
- the effect of the Regime on tax revenue
- any concerns related to inappropriate use.

In addition, public consultation should be undertaken to ensure that the Regime has been implemented in a manner that is accessible, understandable, and that minimises the administrative and compliance costs imposed on the sector.

#### RECOMMENDATION 6.5

The Board of Taxation should review the Investment Manager Regime no later than 2020. This review should, at a minimum:

- assess the effectiveness of the Regime in attracting additional investment and the effect on tax revenue
- address any concerns related to inappropriate use of the Regime
- publicly consult to ensure that administrative and compliance costs associated with the Regime are minimised.

#### *A broader and more flexible range of collective investment vehicles*

The development of a broader range of collective investment vehicles has the potential to provide significant benefits for the financial services sector, as the new vehicles increase the flexibility of fund managers to meet investor demands. However, care should be taken to ensure that the costs of introducing new CIVs are minimised by:

- implementing legislation in a manner that minimises business compliance costs
- ensuring that the new vehicles do not create additional concessionary schemes that have efficiency costs

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- drawing on models currently used in overseas jurisdictions (though Australia’s unique legal, regulatory and tax frameworks may limit their applicability).

Though detail on the alternative CIVs under consideration by the Australian Government is yet to be released, the Commission considers that their development is important to facilitate the export of financial services and is sympathetic to industry concerns over the long timeframes involved thus far. While accepting the need to prioritise the development of new CIVs, the Commission sees the Tax White Paper as the appropriate process to set priorities for tax reform more broadly and to consider sequencing issues with other legislation — in particular with the finalisation of the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015 (Cwlth).

**RECOMMENDATION 6.6**

A range of collective investment vehicles is important for facilitating the export of financial services and the Australian Government should continue to advance their development as part of the Tax White Paper process.

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## 7 Education and health services

### Key points

- Streamlined visa processing (SVP) was designed to facilitate simpler and faster visa processing for students enrolled at eligible education providers, but has unintended consequences that likely include some reduction in demand for Australian education services. There is a strong case for reforming SVP.
  - In June 2015, the Australian Government announced the simplified international student visa framework (SSVF) which is scheduled to replace current student visa arrangements (including SVP) from July 2016.
  - The broad design of the SSVF — a single risk framework applied across all education providers, with the Department of Immigration and Border Protection having primary responsibility for managing immigration risk — is a major improvement on current arrangements.
- The Commission has identified further barriers to international education services and considered how government action could address these barriers.
  - The Australian Government launched the Quality Indicators for Learning and Teaching online platform in September 2015, with the objective of ensuring adequate information is available for international and domestic students to make informed decisions about their study options in higher education. The Australian Government should review the effectiveness of the platform in meeting this objective no later than 2018.
  - The Australian Government and education providers are scoping the potential for an industry-led national quality framework for education agents and developing a code of ethics for education agents working with Australian institutions. These initiatives could help address concerns about the behaviour of some education agents.
  - The Australian Government should examine the relationship between the use of online education by international students in Australia and student visa non-compliance to inform options for enabling more innovative and flexible approaches to delivering education services.
  - While some Vocational Education and Training providers value the benefits of having Australian accreditation for their courses when marketing overseas, this is not justification for relaxing existing accreditation standards. Relaxing standards would present risks, including lowering the general quality and reputation of Australian accredited courses.
- The Commission has identified few sector-specific barriers to the export of health services.
  - A number of Australian businesses have been able to export their health expertise (including health and aged care management and training services) to key offshore markets, such as China. Some participants reported that they are yet to encounter major legal or regulatory barriers to operating offshore.

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This chapter covers barriers to service exports that are specific to the health and education sectors. For each sector, it provides a background on the types of services provided and government policies affecting the provision of those services. The chapter then examines barriers to exporting Australian services that arise in Australia and other countries.

## **7.1 Australia's international education sector**

International education is one of Australia's largest service exports by value (chapter 3). Education services delivered onshore account for the majority of Australia's education service exports (chapter 3). Many Australian education providers have expanded into offshore delivery — there are now 31 offshore university campuses and hundreds of partnerships across all areas of education. Australian education providers also offer online courses to international students offshore (Australian Government 2015c). Australian education providers offer a range of services to international students including school education, vocational training, higher education and English language tuition.

### **Government involvement in the international education sector**

Governments at the Australian, state and territory levels are heavily involved in the international education sector, including (in the case of state and territory governments) through the ownership of public institutions that deliver education services. Australia has a regulatory framework to provide quality assurance and consumer protection for education services supplied to international students (AEI 2014a). This framework complements generally applicable regulatory arrangements designed to promote quality outcomes for education services supplied by Australian providers — whether those services are consumed by domestic or international students (UNSW 2014). Governments are also involved in promoting Australia (or particular regions within Australia) as a destination for international education (chapter 4).

The Australian Government regulates the intake of international students coming to Australia through its student visa program. The Australian Government also sets requirements for students to obtain permanent residency after they complete their studies — as of August 2015, just under one third of those with a student visa expiring between 1 July 2006 and 30 June 2011 had gone on to get a permanent or provisional visa (chapter 3).

Over the past decade, numerous reviews have examined aspects of Australia's international education sector (box 7.1).

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## Box 7.1 International education — a thoroughly reviewed sector

*Future Directions for Streamlined Visa Processing* (Department of Immigration and Border Protection (DIBP), June 2015) — a strategic evaluation of current streamlined visa processing arrangements to inform the future direction of the student visa program following the expiry of the current policy guidelines that underpin streamlined visa processing in mid-2016. With the report's release, the Australian Government announced the introduction of a simplified international student visa framework to support the Australian education services sector.

*Draft National Strategy for International Education* (Australian Government, April 2015) — outlines three pillars (getting the fundamentals right; reaching out to the world; staying competitive) with six key goals, each underpinned by strategic actions and measures of success. The Government plans to finalise the strategy in consultation with the sector by the end of 2015 (as advised by the Department of Education and Training, 11 November 2015).

*Learning the Hard Way* (NSW Independent Commission Against Corruption, April 2015) — identifies several corruption risks created by universities' international student businesses, and puts forward anti-corruption initiatives to help the universities manage them.

*International Education Services* (Productivity Commission, April 2015) — focuses on two key policy levers the Australian Government has at its disposal to influence international education services: the visa system and regulation aimed at providing quality assurance in the delivery of education to international students.

*Reform of the Education Services for Overseas Students (ESOS) Framework: Discussion Paper* (Department of Education, October 2014) — The *Education Services for Overseas Students Act 2000* (Cwlth) establishes legislative requirements and standards for the regulation of education and training institutions offering courses to international students in Australia on a student visa. The discussion paper outlines options for making ESOS more contemporary, flexible and effective. The Education Services for Overseas Students Amendment (Streamlining Regulation) Bill 2015 was introduced to Parliament on 17 September and passed the House of Representatives on 15 October. The Bill was referred to the Senate Committee on Education and Employment, which is to report on 30 November 2015. The Department anticipates undertaking further consultation on a revised National Code of Practice for Providers of Education and Training to Overseas Students in late 2015, following passage of the Streamlining Regulation Bill (as advised by the Department of Education and Training, 11 November 2015).

*Australia – Educating Globally* (Chaney Report, February 2013) — sets out 35 recommendations to address seven key issues identified as crucial to a sustainable future for international education (coordination, quality, a positive student experience, partnerships, ensuring the integrity of the student visa program, data analysis and research in international education, and competition, promotion and marketing).

*Strategic Review of the Student Visa Program 2011* (The Knight Review, June 2011) — considered how the student visa risk management framework could be reformed to achieve enhanced integrity in the student visa program while facilitating the competitiveness of Australia's international education sector. Consideration of how the student visa risk management framework could be informed by a provider-based risk approach was a key issue.

Sources: Australian Government (2015c); Department of Education (2014); DET (2014); DIBP (2015g, 2015j); ICAC (2015); IEAC (2013); Knight (2011); PC (2015f); Pyne (2015c).

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In June 2015, the Australian Government created the Coordinating Council for International Education, which includes ministers responsible for policies and programs that support international education. The Council is responsible for finalising Australia's National Strategy for International Education in 2015 (Pyne 2015a).

## 7.2 Barriers to education service exports

Several aspects of existing policy settings for international education are likely to impede the growth of Australian education service exports, by reducing demand for education services, increasing the cost of providing education services, or both (chapter 2). There could be substantial benefits from reducing barriers to education exports (depending on how restrictive these barriers are) given the large and growing market for international education services globally and Australia's position as a country with established high-quality education institutions, English language tuition and proximity to growing markets in Asia. Policy settings that detract from the quality and reputation of Australian education institutions warrant particular attention given the importance of these factors in driving demand for Australian education exports (chapter 3).

Participants in this study identified a number of barriers to education exports that are common to other sectors. These included accommodation costs and standards (ISEA, sub. 4; StudyNSW, questionnaire 11), access to public transport concessions and healthcare (English Australia sub.DR36; Tourism and Transport Forum Australia sub.DR48), visas for professionals coming to and from Australia (Curtin University, questionnaire 4; Universities Australia, sub. 17; University of Tasmania, sub. 18), recognition of qualifications (Universities Australia, sub. 17) and access to post-study work visas (TAFE SA, questionnaire 12; Tasmanian Government, sub. 29). Domestic barriers that are common to multiple sectors are examined in chapter 4. The effect of export barriers that are specific to the education sector and the potential benefits and costs of reducing those barriers are described in turn below.

### Student visa policy settings in Australia

The objective of Australia's student visa program is to facilitate the movement of genuine international students wishing to study in Australia, while maintaining immigration integrity (DIBP 2015g).<sup>1</sup> Meeting this objective requires that the visa application process is no more burdensome than required to achieve immigration integrity and does not create unnecessary costs or adverse effects.

Currently, student visa applications are processed either under the Assessment Level (AL) framework or streamlined visa processing (SVP) arrangements. The AL framework is

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<sup>1</sup> Immigration integrity means ensuring that student visa applicants are genuine in their intention to complete a course of study and do not use the program for motives other than gaining an education (DIBP 2015g).

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based on the immigration risk applicable to the student's country of citizenship (country immigration risk). The AL framework aims to align visa evidentiary requirements (relating to financial capacity, English language proficiency and academic qualifications) to immigration risk, taking into account rates of visa refusal, cancellation and non-compliance. Each country, across each education sector<sup>2</sup>, is assigned an AL based on the calculated immigration risk posed by students from that country studying in a particular education sector. There are three assessment levels in the student visa program: AL1 represents the lowest immigration risk and AL3 the highest (DIBP 2015g).

SVP arrangements are based on the immigration risk of students associated with a particular education provider (provider immigration risk). Provider immigration risk is used to determine whether students applying to a particular education provider are able to access SVP. There are three provider risk ratings: AL1 is the lowest and AL3 the highest.

Neither student visa processing system directly considers risks associated with the delivery of education services, such as the risk a provider will not deliver a quality education service (provider quality risk).

### *Streamlined visa processing aims to facilitate simpler and faster processing*

The Australian Government introduced SVP in March 2012 to facilitate simpler and faster visa processing for students enrolled at eligible education providers. The Government initially limited access to SVP to Australian universities in recognition of the low immigration risk of students enrolled in universities (as of July 2015, 42 out of the 43 Australian universities were participating in SVP (Department of Immigration and Border Protection (DIBP), pers. comm., 24 July 2015)). The Government extended SVP arrangements in March 2014 to 19 eligible non-university higher education providers and in November 2014 to 55 additional eligible providers, including those offering advanced diploma courses (DIBP 2015g).

Under current eligibility requirements for SVP, education providers must:

- be registered to deliver an advanced diploma, bachelor, masters or doctoral degree level course to international students
- achieve an AL1 or AL2 immigration risk rating in relation to the immigration outcomes of their prospective and actual international students
- be associated with at least 100 active student visa holders
- meet the requirements set out in the guidelines for education provider participation in SVP arrangements (DIBP 2015g).

Prospective international students who have a confirmation of enrolment from a participating SVP provider at bachelor, masters or doctoral degree level, or for a

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<sup>2</sup> The sectors are defined by visa subclass: Non Award, Postgraduate Research, Higher Education, VET, Schools, English Language Intensive Courses for Overseas Students (ELICOS), Foreign Affairs/Defence.

non-award university student exchange or study abroad program, are assessed under SVP. These students are generally subject to evidentiary requirements similar to those that apply under AL1, regardless of their country of citizenship (DIBP 2015g).

Under SVP, participating education providers take on additional responsibilities for ensuring that the students they recruit are genuine (which go beyond general requirements that apply to all education providers who are registered to deliver services to international students). Providers must have strategies to manage risks associated with the enrolment of international students, including ensuring students have the requisite level of English language and sufficient funds to support themselves (and their dependents) for the period they are residing in Australia. An SVP provider that fails to implement these strategies or to maintain a provider immigration risk rating of AL1 or AL2 can lose their eligibility for SVP (DIBP 2015g). Table 7.1 summarises current evidentiary requirements under the AL framework and SVP.

**Table 7.1 Current evidentiary requirements for student visas**  
Assessment Level Framework and Streamlined Visa Processing<sup>a</sup>

Requirements	Assessment Level 1	Assessment Level 2	Assessment Level 3	SVP
Financial	By declaration	<u>12 Months</u> (approximately \$40 000) and declaration for remainder of stay	<u>12 months</u> (approximately \$40 000) which must be in the name of the applicant or a close relative of the applicant and held for three months. Declaration required for remainder of stay	Must satisfy provider. DIBP can also request evidence
English	Must satisfy provider	Must satisfy provider	Formal evidence required	Must satisfy provider
Academic	Must satisfy provider	Must satisfy provider	Formal evidence required	Must satisfy provider
<i>The Genuine Temporary Entrant requirement</i>				
Applies to all SVP and Assessment Level Framework applications				

<sup>a</sup> 'Provider' is the education institution for which the student holds confirmation of enrolment. Irrespective of whether student visa applicants are assessed under the Assessment Level framework or Streamlined Visa Processing: both the course and the provider must be registered; applicants must meet the Genuine Temporary Entrant requirement, under which the Department of Immigration and Border Protection assesses whether the applicant's individual circumstances indicate they intend to stay in Australia temporarily; and the same health, character and health insurance requirements apply. The Department of Immigration and Border Protection is responsible for issuing student visas to applicants.

Source: DIBP (2015g).

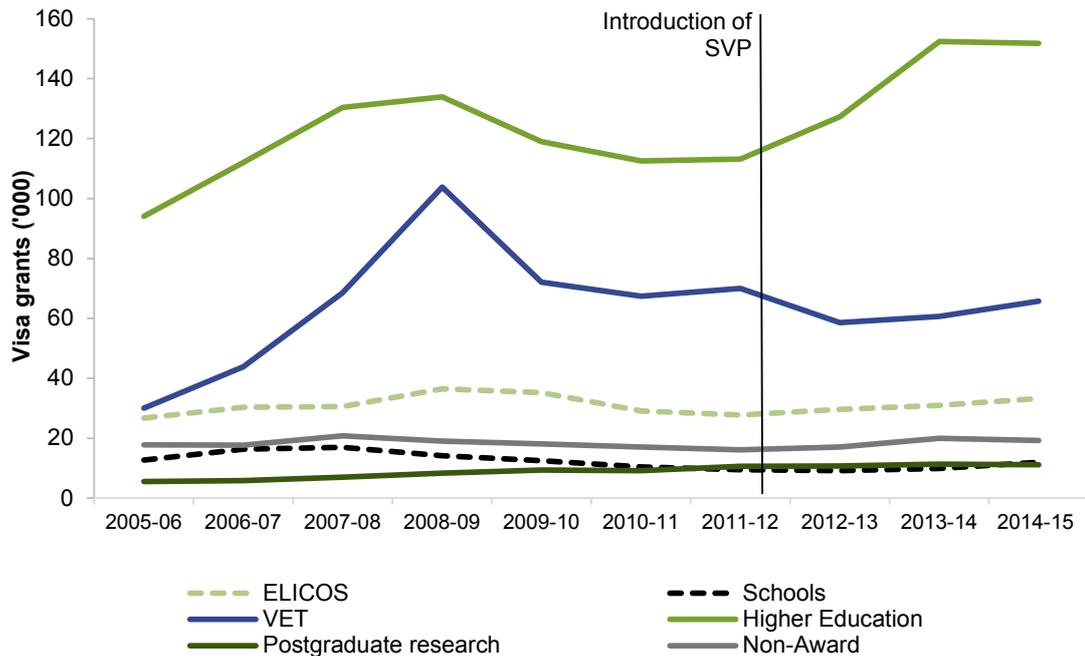
### *Streamlined visa processing has benefited eligible providers and students*

Since the introduction of SVP, eligible applicants have enjoyed shorter visa processing times than applicants under the AL framework. In the months immediately following the

introduction of SVP in March 2012, processing times for SVP students were on average around 60 per cent shorter than for students applying under the AL framework. Since then, the difference between processing times for SVP students and non-SVP students has decreased. DIBP has suggested this could be due to a number of factors, including an increased proportion of the overall caseload being processed under SVP (DIBP 2015g).

The increase in the number of student visa grants in the higher education sector since March 2012 is consistent with SVP having a positive effect on the growth of that sector (figure 7.1). However, the magnitude of this effect is difficult to determine accurately. Other factors, such as global economic conditions, the perceived quality of Australian education, changes to post-study work rights (chapter 4) and the value of the Australian dollar would also have affected trends in the number of student visas granted (DIBP 2015g).

Figure 7.1 **Total student visa grants by sector**  
2005-06 to 2014-15



Sources: DIBP (2015g, 2015k).

Econometric analysis undertaken by the Centre for International Economics estimated that the introduction of SVP was associated with a 19 per cent increase in higher education visa applications after accounting for other factors. (The other factors included changes to post-study work rights, exchange rates and indicators of student satisfaction with their learning and living experiences in Australia (CIE 2014).) The Centre for International Economics report, which included data on higher education visa applications up to and

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including 2013-14, nonetheless noted that ‘it is probably too early to associate SVP with an increase in international student numbers’ (CIE 2014, p. 16).

Universities Australia (2014) argued that SVP has had a positive effect on demand for education in Australia by providing a positive signal that Australia was ‘open for business’ and welcoming of international students. DIBP has noted that SVP has seen a new co-operative approach between education providers and DIBP, including mutual information sharing, and that this ‘has been extremely beneficial’ (DIBP 2015g, p. 18).

***Streamlined visa processing has unintended consequences that likely include some reduction in demand for Australian education services***

Stakeholders have pointed out that limiting the availability of streamlined visa arrangements to certain types of education providers has put non-eligible providers at a competitive disadvantage (in terms of their ability to offer students faster and simpler visa processing) and created market distortions (ACPET, sub. 8; DIBP 2015j; English Australia 2014; The Imperial College of Australia, questionnaire 13; Independent Schools Council of Australia, sub. 24). Stakeholders stated that these competitive disadvantages have been exacerbated by the fact that some students and agents are incorrectly interpreting provider access to SVP as a ‘stamp of quality’ for the education provider, which gives SVP providers a further advantage over non-SVP providers in attracting students (ACPET 2014; DIBP 2015g; English Australia 2014). A survey of SVP education providers suggests some providers have been able to use their access to SVP to gain a marketing advantage over non-SVP competitors (DIBP 2015g).

There are concerns that the introduction of SVP has created perverse incentives for:

- international education agents to channel students to higher education pathways and certain provider types, regardless of their aptitude or career aspiration (ACPET 2014; English Australia 2014)
- providers to add advanced diplomas to their offering following the extension of SVP to these courses, despite those courses not being their core business (ACPET 2014; PC 2015f).

Along with misperceptions that SVP is a stamp of quality for the education provider, these perverse incentives reduce the likelihood that international students will have a quality learning experience in Australia. In particular:

- incentives to channel students into higher education pathways mean that a portion of those students will have a less beneficial learning experience than if they had chosen another education pathway (such as vocational training)
- if providers offer advanced diplomas primarily to access SVP and have little expertise in providing such courses, there are potential downside risks to the quality of those courses

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- students who enrol with education providers that have access to SVP on the false belief that SVP is a marker of quality could find that their learning experience falls short of their expectations.

When the quality of international students' learning experience in Australia does not meet their expectations, it has the potential to adversely affect the reputation of Australian education institutions. As noted in chapter 3, the reputation of Australian education institutions is a key driver of education exports, so the unintended consequences of streamlined visa processing likely include some reduction in demand for Australian education services.

### *Streamlined visa processing has caused concern about immigration integrity*

There are also concerns that SVP has created perverse incentives for some prospective students and education agents to target institutions with access to SVP initially, and once granted a visa, for some students to 'course hop' to another provider offering an easier or less expensive course, potentially in breach of their visa conditions (DIBP 2015g; Universities Australia 2014).

DIBP noted that:

Course hopping is of concern as it may be indicative of students providing misleading information to the Department and their education provider in order to circumvent the intentions of the SVP arrangements. In certain circumstances, course hopping may also be indicative of students using the student visa programme to obtain a work or residency outcome rather than a study outcome. (DIBP 2015g, p. 13)

In its review of SVP, DIBP found that the number of students moving from a higher education course to a vocational education and training (VET) course increased following the introduction of SVP. While this is not necessarily evidence of course hopping (there are legitimate reasons why a student would change their study plan), DIBP concluded 'it does appear that SVP has had some impact upon the initial and post-arrival enrolment choices of some students' (DIBP 2015g, p. 14).

A survey of SVP providers found that 60 per cent of universities and 45 per cent of all respondents indicated the number of non-genuine students seeking enrolment with their institution had increased since commencing as an SVP provider (DIBP 2015g).

Some stakeholders have argued that education providers often lack the expertise or resources required to undertake immigration risk management activities assigned to them under SVP, such as assessing financial evidence (ACPET 2014; DIBP 2015g; English Australia 2014).

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*The immigration department has proposed a new approach to student visa processing*

In its review of SVP arrangements, DIBP recommended replacing the current SVP and AL frameworks with a single immigration risk model that:

- applies to all *Commonwealth Register of Institutions and Courses for Overseas Students* (CRICOS) registered providers, across all courses and all education sectors (including schools, VET providers and smaller providers)
- considers the immigration risk outcomes associated with both the student's source country and their intended education provider, to guide student visa evidentiary requirements (box 7.2)
- provides opportunities for streamlined evidentiary requirements for student visa applications that pose a low overall risk based on consideration of country and provider immigration risks (DIBP 2015g).

These changes aim to remove market distortions that arise from limiting the availability of streamlined visa arrangements to certain types of providers and to create a more nuanced framework for assessing immigration risk. Under DIBP's proposed new arrangements:

- there would be no obligation for education providers to have strategies in place to manage or lower the immigration risks associated with the enrolment of international students
- providers would only be responsible for ensuring that students meet their enrolment requirements (DIBP, pers. comm., 24 July 2015).

During the DIBP's review of SVP arrangements, several participants proposed broadening the visa risk assessment framework beyond DIBP's proposed model to include factors other than immigration risks, such as provider quality risk (DIBP 2015g). The Commission flagged the inclusion of provider quality risk as an option in its research paper on international education services (PC 2015f).

DIBP argued against including risks relating to the education provider's delivery of education or business risk when determining visa evidentiary requirements, noting:

... within Australia's overarching international education framework there are already mechanisms in place that consider an education provider's business risk (the Tuition Protection Scheme), the delivery of education (regulation by the Australian Skills Quality Authority (ASQA) and the Tertiary Education Quality Standards Agency (TEQSA)) and immigration risk (the student visa programme).

... if ASQA or TEQSA has determined that an education provider is of sufficient standing and quality to deliver education to international students and those students are of low immigration risk, then the visa process should be facilitated for those students. If a provider does not comply with relevant delivery of education regulation then it is open to ASQA or TEQSA to impose sanctions, including cancelling that provider's registration and preventing them from recruiting international students. (DIBP 2015g, p. 25).

## Box 7.2 The immigration department's proposed provider and country immigration risk model

The Department of Immigration and Border Protection's (DIBP) June 2015 report *Future Directions for Streamlined Visa Processing* proposed a preferred model for student visa applications, which would consider the immigration risk outcomes associated with both the student's country of citizenship and their intended education provider.

Under this model, each *Commonwealth Register of Institutions and Courses for Overseas Students* registered education provider would be allocated an immigration risk rating of between one (lowest risk) and three (highest risk) based on the immigration risk outcomes of their international students over the previous 12 month period. The same approach could also be used to allocate an immigration risk rating to each country.

Each student's evidentiary requirements for financial capacity and English language ability would be determined based on a combination of the immigration risk outcomes of their education provider and their country of citizenship. For example, students enrolled at an education provider that has demonstrated low immigration risk outcomes would potentially have minimal financial and English language evidentiary requirements (similar to current AL1 and SVP requirements) regardless of their country of citizenship. However students enrolled at an education provider associated with higher immigration risk outcomes might only have access to these arrangements if they are from lower immigration risk countries.

As at 30 October 2015, policy relating to evidence of academic qualifications was pending approval by the Minister for Immigration and Border Protection. There are already requirements for education providers to ensure students have the necessary academic background under the *Education Services for Overseas Students Act 2000* (Cwlth) and National Code.

### Evidentiary requirements under a combined provider and country immigration risk model

	<i>Education provider immigration risk rating</i>	<i>Country immigration risk rating</i>	<i>Evidentiary requirements</i>
Lower evidentiary requirements	1 2 3	1,2 or 3 1 or 2 1	Generally these students would not be required to provide evidence of their English language or financial capacity to DIBP (similar to current SVP and AL1 arrangements)
Higher evidentiary requirements	2 3	3 2 or 3	Generally these students would be required to provide evidence of their English language and financial capacity to DIBP.
Genuine Temporary Entrant requirement – continues to apply to all applicants			

Sources: DIBP (2015g; pers. comm., 30 October 2015).

DIBP (2015g) also recommended reducing the number of student visa subclasses from eight to two to reduce the complexity of the scheme.

On 16 June 2015, the Australian Government announced the introduction of a simplified international student visa framework (SSVF) based on DIBP's recommendations. A working group with international education sector stakeholders has been formed to guide implementation of the new framework on the expiry of SVP arrangements on 30 June

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2016. The agencies responsible for the quality assurance and regulation of education services for overseas students will work closely with DIBP on the new regime (Pyne 2015c).

*The immigration department's proposed approach is a major improvement on the status quo*

In principle, student visa arrangements that support high levels of immigration integrity and minimise costs associated with regulatory compliance and administration, would:

- clearly assign responsibility for managing risks to the party who is best placed to do so (in terms of their expertise, available regulatory 'levers', and freedom from conflicts of interest)
- match each regulatory instrument or 'lever' (for example, the granting of student visas) to one policy objective (for example, maintaining immigration integrity)
- ensure regulatory requirements for visa applications are proportionate to the immigration risk posed by different types of student visa applicants. This would require that the risk assessment framework treats applications consistently and is sufficiently comprehensive to accurately identify the immigration risks associated with different types of student visa applications.

DIBP's proposed model is likely to bring student visa processing more in line with these principles and, in doing so, help address market distortions and the unintended consequences of SVP arrangements.

*Clear allocation of responsibility for assessing student visa applications will enhance risk assessments*

DIBP having primary responsibility for managing immigration risks is consistent with clearly assigning responsibility for maintaining immigration integrity to the party who is best placed to do so. Clearly assigning responsibility for managing immigration risks to DIBP would likely improve the rigour of risk assessments and/or reduce compliance costs imposed on education providers. DIBP's expertise and knowledge means it is better placed to undertake complex risk assessment functions currently assigned to education providers under SVP (such as financial risk assessments).

Clear assignment of responsibility for managing immigration risks will help to avoid conflicts of interest when education providers are responsible for both managing some elements of immigration risk and attracting international enrolments.

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*A more consistent approach to visa risk assessment would help reduce existing distortions that give rise to concerns about immigration integrity and provider quality*

DIBP's proposal to replace the current SVP and AL frameworks with a single immigration risk model is consistent with the principle of ensuring regulatory requirements for visa applications are proportionate to immigration risk and would also address perverse incentives associated with SVP. Such a system could lead to:

- more accurate risk assessments, as it would apply a more comprehensive and consistent set of risk factors when assessing all student visa applications
- reduced incentives for students to be channelled into higher education pathways that are poorly aligned with their aptitude or career aspirations, as access to streamlined processing would no longer be tied to specific types of education institutions
- reduced course hopping to the extent that the revised risk assessment framework is more likely to detect students that pose a higher immigration risk.

*Separating provider quality risk and immigration risk will help ensure the purpose of the student visa scheme is clear*

Neither the current AL/SVP framework, nor the proposed SSVF has been designed to address education provider *quality*. The quality of education institutions is clearly an important driver of education service exports and should be managed — but not through the process of granting student visas. That some students and agents (inappropriately) interpreted SVP eligibility as a proxy for provider quality might suggest that students and agents face impediments to accessing information on provider quality when selecting a place to study. To the extent these impediments are significant, the Australian Government can — and in the Commission's view should — address risks relating to the quality of education services using mechanisms outside the student visa process.

Focusing the student visa application process on immigration risks and addressing other types of risks through other mechanisms (as proposed by DIBP) is consistent with the three principles outlined above. It would also support the objectives of maintaining high levels of immigration integrity and minimising costs associated with regulatory compliance and administration. Specific benefits of clearly separating the management of immigration risks and other types of risks include:

- ensuring the objective and processes underpinning student visa arrangements are transparent
- avoiding overlaps with other agencies responsible for regulating education provider quality or delivering information on provider quality to international students
- avoiding the possibility that incorporation of provider quality risk could dilute the effectiveness of the student visa regime in identifying immigration risk (as low provider quality risk does not necessarily correlate with low immigration risk).

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### *Changing student visa processing arrangements would involve transitional costs and have distributional consequences*

The proposed changes to current student visa processing arrangements would have the following effects:

- Shifting responsibilities for managing elements of immigration risk associated with student visas from education providers back to DIBP may result in DIBP incurring additional regulatory costs. However, it will be difficult to fully gauge the budgetary consequences for DIBP until the final regulatory settings are determined and the new model is implemented. DIBP's intention is for the proposed changes to enhance efficiency where possible, such that DIBP's regulatory costs under the proposed new student visa arrangements will be broadly similar to its costs under the current student visa arrangements (DIBP, pers. comm., 24 July 2015).
- Some education providers would be able to reduce their costs as they would no longer be required to devote resources to assessing applications under SVP. Using a 2014 survey of providers, DIBP estimated the annual cost to providers of administering the SVP arrangements to be approximately \$250 000 per provider or \$29 million in total for the 115 providers participating in the SVP arrangements (DIBP 2015g).
- Other education providers could choose to undertake risk management strategies if they thought this would offer them net benefits, for example through obtaining a lower immigration risk rating. Some of these providers would need to put in place additional strategies if they wanted to obtain or maintain the lowest immigration risk rating under the proposed system (DIBP 2015g).

### *The way forward on student visa arrangements*

Many participants in this study welcomed the announcement of the SSVF (ABDC sub. DR44; ACPET 2015; English Australia, sub. DR36; IEAA 2015b; Universities Australia 2015). English Australia (sub DR36) noted the replacement of the SVP with the SSVF will remove a major barrier to the growth of education exports and predicted that the introduction of SSVF will have a positive effect on enrolments across providers.

In the Commission's view, the broad design of the SSVF — a single risk framework applied across all education providers, with DIBP having primary responsibility for managing immigration risk — is a major improvement on current student visa arrangements and should be progressed. The SSVF is more consistent with principles of good regulatory practice than the current SVP and would address the perverse incentives outlined above that arise from providers having differential access to SVP. The net benefits of the SSVF will ultimately depend on how it is implemented.

The Commission is supportive of DIBP sharing data with education institutions, and consulting closely with education peak bodies and other key government agencies on the

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implementation of the proposed student visa processing framework, including through the Education Visa Consultative Committee working group.

RECOMMENDATION 7.1

The Australian Government should ensure that the following principles guide the further development and implementation of the simplified international student visa framework, announced in June 2015.

- Clear assignment of responsibility for managing risks to the party best placed to do so.
- The student visa program should address a single policy objective of maintaining immigration integrity.
- Regulatory requirements for visa applications should be proportionate to the immigration risk posed by different types of student visa applicants.

### *Student visa fees and charges*

Some participants in this study stated that student visa fees and charges in Australia were a barrier to the growth of education exports (DEC International, questionnaire 5; English Australia, sub. 19, sub. DR36). For example, English Australia (sub. DR36) called for a decrease in the Student Visa Application Charge — particularly for students who are studying in Australia for a short period — to promote both international competitiveness and administrative fairness.

Visa charges are not a substantial barrier to education exports. The cost of visa charges is typically small relative to other costs incurred by international students, such as tuition fees, accommodation and other living costs, and international travel. Reducing visa charges would therefore likely have limited effects on the cost of studying in Australia (relative to other countries) and demand for education services. Surveys of international students suggest a range of other factors, such as the quality of institutions, tuition fees and the cost of living, are more important determinants of where students choose to study than the cost of visa fees and charges (DET 2015b; Hobsons EMEA 2014; ICAMR and IIIIE 2015).

The DIBP and Customs and Border Protection Service reviewed border fees and charges in 2015, with some changes to border charging arrangements announced in the 2015-16 Budget. These included an increase in the base student visa application charge from \$535 to \$550 (for student visa sub-classes 570-575 and 580) (DIBP and ACBPS 2015). Other recommendations of the review, which has not been publicly released, remain under consideration by the Australian Government. For these reasons, the Commission has not made recommendations on visa fees and charges in this study.

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## Information on the quality of Australian education services

International students, when considering study options in Australia, may find it challenging to discern which provider and course best meets their needs. Agents in international students' home countries, which are responsible for providing those students with information and advice on study options, may encounter similar difficulties.

For example, international students and agents might face language or technical barriers to accessing information that is largely targeted at Australian students. In some cases, international students or agents may put a large weight on specific types of information sources, with the risk that the information sources that they favour are inaccurate or not designed to help students compare the quality of providers (such as the list of SVP eligible providers).

To assist both international and domestic students, the Australian Government (and other bodies, such as the Australian Curriculum, Assessment and Reporting Authority) collect and publish information on education services, including student perceptions of teaching quality and/or student outcomes. For example:

- the Australian Government's 'My Skills' website provides information on VET providers and courses, including student satisfaction and employment outcomes (DET 2015c)
- the Australian Curriculum, Assessment and Reporting Authority's 'My School' website provides performance data on almost 10 000 Australian schools (ACARA 2015).

Some publicly available sources of information are still under development. For example, from July 2014 to 2015, the My Skills website presented training activity data for all publicly funded VET providers, but only some private providers. Data were presented for private VET providers that reported their full activity to the National Centre for Vocational Education Research in 2013 or where the training activity was delivered under contestable funding arrangements (as advised by the Department of Education and Training, 29 July 2015).

### Barriers to accessing information on teaching quality can distort international students' enrolment decisions

Impediments to international students and agents accessing information on the quality of Australian providers could reduce demand for Australian education service exports in two ways. As noted in chapter 3, the quality and reputation of Australian education institutions are key factors driving demand for those services, so if some international students are not confident that a particular Australian provider or course is likely meet their needs they may choose to study in another country. Similarly, impediments to accessing information could lead some international students to select Australian courses that fall short of their expectations. These types of experiences could affect Australia's reputation among prospective students. For example, studies have found that word of mouth can be an

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important influence on student decisions about where to study (Hobsons EMEA 2014; Ling and Tan 2015).

### Government measures to address information barriers should be well targeted

The Australian Government launched the Quality Indicators for Learning and Teaching (QILT) online platform in September 2015 (DET 2015d). The online platform is designed to ensure adequate information is available for international and domestic students in the higher education sector to make informed decisions about their study options. It draws on government-endorsed surveys on student experience, graduate outcomes and employer satisfaction (DET 2015h). From late 2015, the My Skills website will include total VET activity data for all providers that reported in 2014 (as advised by the Department of Education and Training, 11 November 2015).

The Australian Institute of Professional Education (AIPE) argued that:

Strong promotion of the [Quality Indicators for Learning and Teaching and My Skills] sites by government will assist in ensuring students have access to the information they need to understand the level of quality being achieved by different providers. (sub. 22, p. 6)

Collecting further information on provider quality, or tailoring existing information to specific types of students, would impose administrative costs on education providers and government departments responsible for collecting and disseminating that information. For example, the Independent Schools Council of Australia (sub. 24) argued that very detailed and publicly available sources of data on school providers are already in place, including the My School website, and was concerned about the impost on schools if they were required to provide more information than is currently available.

Given the costs associated with enhancing the availability and accessibility of information on education provider quality, the Australian Government should assess the need for such measures after new initiatives (particularly the QILT online platform) have had time to take effect.

The Department of Education and Training has advised that the administration of the QILT will be reviewed in late 2016. It notes consideration will be given to revised arrangements for administration of QILT, including the QILT website, for the second QILT contract due to commence from early 2017 (as advised by the Department of Education and Training, 11 November 2015).

If practicable, this review should consider the effectiveness of the QILT online platform in providing adequate information for international and domestic students to make informed choices about where, and what, to study in Australia. Alternatively, the Department should initiate a separate review of the effectiveness of the QILT online platform in assisting international students.

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#### RECOMMENDATION 7.2

The Department of Education and Training should review the effectiveness of the Quality Indicators for Learning and Teaching online platform in meeting its proposed objective — providing adequate information for international and domestic students to make informed choices about where, and what, to study in Australia. The review should occur no later than 2018.

## Education agents

In Australia, many education providers use education agents to recruit a portion of their international student intake. One study using questionnaire responses from 36 Australian universities estimated that around 60 per cent of total international student commencements in 2013 were through agents (Olsen 2014).

Education agents are a valuable resource for education providers and students, but there have been concerns about the behaviour of some agents

Education agents can provide a cost-effective way for Australian providers to recruit students and play a valuable role in counselling students and ensuring they are well prepared for their overseas experience (AIPE sub. 22; English Australia, sub. 19). The use of agents has associated costs and risks — education providers forego some control over their recruitment activities and they depend on agents to relay information about their courses to prospective students, with the risk that this information is inaccurate. Institutions also rely on the accuracy of the information that agents provide to them regarding the competency and genuineness of prospective students.

Past reports on the international education sector have drawn attention to the behaviour of some education agents (ICAC 2015; Knight 2011). Complaints about agents reported to the Overseas Students Ombudsman (2013) include:

- giving false or misleading advice about a course or provider
- enrolling a student with one provider while telling the student they had been enrolled with a different provider
- arranging sub-standard accommodation in Australia.

In an investigation in 2015, the Independent Commission Against Corruption NSW (ICAC) highlighted the risks associated with some universities' reliance on agents in recruiting students from offshore markets (ICAC 2015). The ICAC (2015) argued that education agents' incentives to ensure the students that they recruit are successful in their enrolment application (so the agent receives a commission) means that universities face

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problems associated with unchecked credentials, students with poor English-language proficiency, and collusion between agents and students.

The evidence on whether the problems associated with the use of education agents are widespread is limited and mixed. The Council of International Students Australia has argued that there are a few ‘rotten apples’ among agents and that these agents have sent non-genuine students to Australia — although the practice has become more widespread (Loussikian 2015). Evidence reported by the ICAC (2015) reveals that even large institutions (which would be expected to have greater resources to monitor and manage their agents compared with smaller education providers) are not immune from problems relating to the use of agents.

Where problems associated with the use of education agents affect the quality of international students’ learning experience in Australia, this has the potential to reduce future demand for international education services.

### **Government and education providers are taking steps to improve how providers engage with agents**

The Australian government is funding the International Education Association of Australia (IEAA) to undertake two projects relating to education agents. The first is a feasibility study into an industry-led quality framework for agents, which the Department of Education and Training received from IEAA in late June 2015 and is considering (as advised by the Department of Education and Training, 11 November 2015). The second project is the development of a code of ethics for international education agents to enhance the quality and reputation of Australia’s international education sector, which was announced on 28 August 2015 and is in the industry consultation stage (Pyne 2015b).

Given the work being undertaken to develop an industry-led national quality framework and a code of ethics for Australia’s international education agents, it would be premature to consider more heavy handed forms of regulations (such as direct regulation of agents), which would likely involve considerable administrative and compliance costs.

### **Restrictions on online education**

In Australia, national regulations limit the provision of online education to international students who hold a student visa. For example, international students studying in Australia may not complete more than 25 per cent of their total course by distance and/or online learning (DEEWR 2007).

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## Reducing restrictions on online education could increase demand for international education services

Peak bodies for education have previously expressed concern that restrictions on online learning could impede the development of online education services and reduce the ability of providers to offer innovative education for international students (Department of Education 2014). The AIPE noted ‘flexibility and online delivery in Australia have not kept pace (if indeed they were historically comparable) with developments in the USA and most Western European countries’ (sub. 22, p. 14).

Regulations that limit the use of online education by international students could adversely affect demand for international education services and impose costs on providers by limiting the ways in which they can deliver courses. Surveys of international students reveal that teaching quality is one of the main factors influencing their decision to study in Australia (DET 2015b) and that international students consider uses of technology (including online learning) as an important determinant of quality (Hobsons EMEA 2014). The Australian Business Deans Council observed that:

Students enrolled in face-to-face programs now demand as default, the convenience of access to online material ... There may be some risk with unscrupulous operators who enrol students for migration or other purposes that will need to be monitored, but not loosening restrictions will create a further competitive barrier to scrupulous operators such as universities and their business schools to produce world class learning experiences, which are now strongly online in nature. (sub. DR44 p 5)

The Australian Government has indicated that it will, as part of the review of the Education Services for Overseas Students framework, consider increasing the flexibility for some types of courses on the CRICOS as appropriate for distance and online learning (Australian Government 2015c).

The Department of Education and Training anticipates undertaking further consultation on a revised National Code of Practice for Providers of Education and Training to Overseas Students in late 2015, which will include consideration of amendments to allow a more flexible approach to delivering education services online (box 7.1) (as advised by the Department of Education and Training, 11 November 2015).

## Policy trials could help mitigate the risk of reducing restrictions on online education

Relaxing or removing limits on the use of online education by international students could have associated risks, such as:

- increasing the risk of non-compliance with student visa requirements, such as those relating to making satisfactory course progress and not working more than a certain number of hours per fortnight, if students are attending classes on campus or meeting with their teacher less frequently

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- adverse consequences for course quality, particularly for schools and English language courses where face-to-face learning is considered essential (Universities Australia 2014). Universities Australia (2014) has noted further work will be needed to develop an appropriate set of accountability measures to balance flexibility in teaching modalities with the best learning outcomes for students and their course progression.

In principle, quality of learning outcomes for domestic and international students are best achieved through a strong regime for assessing learning outcomes, rather than limiting the use of online education. If current assessment arrangements are not sufficient to ensure quality outcomes, as suggested by the Australian Council for Private Education and Training (sub. DR38), the government and education providers should examine more direct options for addressing those deficiencies.

Risk of non-compliance with student visa requirements could be evaluated through policy trials. One option for addressing the risk of non-compliance with student visa requirements would be to gradually relax the restrictions over time and monitor whether there is an increased incidence of non-compliance with student visa requirements. Alternatively, the Government and providers could examine whether there are more efficient ways to monitor students' course progress (such as through more frequent assessments that ensure required learning outcomes are being achieved). These types of policy trials should be accompanied by a periodic evaluation by an independent body to assess any risk to immigration integrity, and any unintended consequences for course quality.

#### RECOMMENDATION 7.3

The Australian Government should examine the relationship between the use of online education by international students studying in Australia and student visa non-compliance to inform options for relaxing restrictions on online education set out in the National Code of Practice for Registration Authorities and Providers of Education and Training to Overseas Students 2007.

### **Effects of Australia's quality framework on offshore VET providers**

VET providers that deliver accredited training, which leads to nationally recognised qualifications or credentials, must meet requirements under the Australian Qualifications Framework and national quality assurance standards. These requirements include that training must provide students with specific knowledge and skills (competencies) relevant to a particular industry or group of industries. The requirements extend to training provided to students in other countries if they are to have Australian qualifications. Many of the competencies are specific to Australia (for example, competencies covering Australian health and safety legislation).

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## Australian accreditation requirements constrain VET providers' ability to tailor their course to offshore markets

Some VET providers have identified the inflexibility of Australia's accreditation arrangements as a barrier to providing their services offshore. One participant noted that it is difficult to market Australian VET expertise when the content of courses is focused on the Australian market and training packages are not designed for overseas use (for example, students in China being required to learn about the Victorian Building Code or Australian Accounting Standards) (Victorian TAFE International, pers. comm., 20 July 2015).

Some VET providers have avoided the complexities of Australia's accreditation arrangements by providing customised non-accredited training or adopting different service models, such as offering skills development rather than a full Australian qualification (Victorian TAFE International, pers. comm., 20 July 2015). Participants noted that some customers have a preference that qualifications are accredited and that it is difficult to explain to offshore customers why Australian accreditation cannot be obtained (MEGT Institute/ABILITY English, pers. comm., 29 July 2015).

## Existing requirements play an important role in ensuring the quality and reputation of Australian accredited courses

While some VET providers value the marketing benefits of having Australian accreditation, this is not justification for relaxing existing accreditation standards. Relaxing standards to allow VET providers to tailor their services to particular markets would present risks. These risks include consumer or safety risks if graduates from Australian-accredited courses delivered offshore (structured around international rather than Australia standards) subsequently practiced in Australia. Over time, permitting greater customisation of courses, with varying standards, could also risk lowering the general quality and reputation of Australian accredited courses.

Risks associated with relaxing standards, coupled with the possibility of providing non-accredited training, mean that the Commission does not consider that Australian accreditation requirements constitute an unnecessary barrier to exports of education services.

## 7.3 Australia's health service exports

Australia's health service sector comprises private, government and not-for-profit entities that provide a range of services including hospital services (medical, paramedical, nursing, and laboratory and ambulance services), non-hospital services (medical, specialised and dental services) and social services relating to health (such as some aged care services).

Most Australian health service exports occur through Australian businesses establishing a commercial presence abroad (chapter 3). For example, the largest operator of private hospitals in Australia, Ramsay Health Care, has established a commercial presence in

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several overseas markets (box 7.3). Other health service exports include medical tourism to Australia (patients travelling to Australia for medical care and procedures) and cross-border supply of health services, such as telemedicine, clinical trials and diagnostic services. For example, Adelaide is home to a network of research organisations that operate clinical trials, including for international sponsors (ANZCTR 2015; IDT CMAX 2015).

### **Box 7.3 Case Study: Ramsay Health Care in China**

Ramsay Health Care is a global hospital group that owns and operates a range of health care facilities across Australia, France, Indonesia, Malaysia and the United Kingdom. Some of Ramsay's private hospitals in Australia, such as John Flynn Private Hospital in Queensland, have provided medical services to international patients. Ramsay's main approach to exporting health services is by establishing a commercial presence in other countries, including through joint ventures and acquisitions.

In July 2013, Ramsay Health Care entered into a joint venture arrangement with Malaysian multinational conglomerate Sime Darby Berhad (Ramsay Sime Darby Health Care). The deal was Ramsay's first investment in Asia since acquiring three Indonesian hospitals in 2005. The joint venture takes advantage of Ramsay's expertise in hospital management and Sime Darby's business networks in Asian markets.

Since 2013, Ramsay Sime Darby Health Care has sought to expand its operations into Vietnam and China. Ramsay has identified opportunities for health service investment in China due to China's growing middle class, ageing population and liberalisation of policies for foreign investors. The expansion into China has taken several years, partly due to the need for a local partner before the project could proceed. In May 2015, Ramsay Sime Darby Health Care signed a conditional contract to form a joint venture with Chinese health care company Chengdu Jinxin Healthcare Investment Management Group Limited, which operates a number of hospitals, and is in the process of developing a new hospital in the city of Chengdu.

Ramsay will have an effective 25 per cent stake in the final joint venture and is expected to be the first international hospital operator to invest across a broad spectrum of specialty facilities in the Chinese hospital market.

*Sources:* International Medical Travel Journal (2013); Ramsay Health Care (2015a, 2015b); Rex (2014); Voigt et al. (2010).

The footprint of Australian health-related exports goes beyond direct provision of health services. Several Australian businesses (such as the Royal District Nursing Service (box 7.4)) export services relating to health management and training and the design of hospitals and aged care facilities.

## **Government involvement in health services**

The Australian, state and territory governments are heavily involved in the funding, regulation and delivery of health services in Australia, including through the ownership of public hospitals (PC 2015d). Governments also support health-related exports, such as by undertaking trade missions to other countries and providing funding to assist businesses to

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increase access to global supply chains. For example, in 2013 the Industry Capability Network (an Australian business network that acts as a conduit between service providers and project managers seeking to procure services) collaborated with the Victorian Government to deliver a trade mission to South–East Asia with the support of the Australian Government’s Supplier Access to Major Projects program. The South–East Asia mission focused on the delivery of hospital and aged care facilities, as well as related urban infrastructure (ICN 2013).

**Box 7.4 Case Study: Royal District Nursing Service in China (Aged Care)**

The Royal District Nursing Service (RDNS) is Australia’s largest provider of home nursing services. The RDNS receives about 80 per cent of its funding from the Australian, state and territory governments and the rest from client fees and fundraising. In 2014, RDNS signed a joint venture agreement with China’s Zhongshan College to develop and operate an aged care facility in Jiangsu Province, north of Shanghai. The Zhongshan aged care facility will include 1500 integrated care places, a 400 bed hospital and links to the college’s education faculty. RDNS will work with Zhongshan College to develop, operate and manage the facility, which will include training, deployment and management of care staff, all with the aim of developing clinical care and support for the elderly. RDNS’s key contributions include consulting services in aged care, health care, nursing, rehabilitation and training. In exchange for providing these services, RDNS has a 25 per cent share of the aged care facility. RDNS has not invested any funds directly into the joint venture.

Key factors that have enabled RDNS to enter into the Chinese aged care market include:

- its involvement in a Victorian Government trade mission in 2012, which enabled RDNS to establish contacts in China
- RDNS sending senior staff to China for extended periods in 2013 to develop business relationships
- RDNS having a Mandarin-speaking employee from China who has experience in aged care in Australia
- the assistance of Austrade in China, which helped broker the joint venture.

RDNS observed that being associated with Australian and state governments provided a level of credibility with Chinese partners which would not be available from entering the Chinese aged care market independently.

RDNS has not encountered major legal or regulatory barriers to operating in China, or other markets such as Singapore and Malaysia. The main difficulties faced have been general challenges associated with doing business in another country.

*Sources:* RDNS (2014; pers.comm., 30 July 2015).

A consequence of heavy government involvement in Australia’s health system is that market prices play a smaller role in driving services delivery compared to many other sectors and therefore Australian health service providers often have muted incentives to export their services. For example, public health institutions must balance the financial benefits of health service exports against the risk of diverting resources away from their

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core activities and compromising the delivery of health services to Australians (Deloitte Access Economics 2011; TIAC 2004; West 2014).

## **7.4 Barriers to health service exports**

In this study, participants identified a number of barriers to health service exports that are common to other sectors. Examples include barriers imposed by other countries such as: limits on foreign equity, licensing requirements for foreign professionals and non-recognition of foreign qualifications (chapter 5). One sector-specific barrier identified by stakeholders in the health service sector relates to processing times and evidentiary requirements associated with obtaining an Australian medical treatment visa.

### **Medical visa arrangements for travel to Australia**

There have been concerns that Australia's medical visa application process is a barrier to medical tourism

DIBP offers temporary medical treatment visas that allow people from other countries to visit Australia to have medical treatment, to have medical consultations or to accompany someone who is seeking medical treatment. Key source countries included New Caledonia, Papua New Guinea, Fiji and Indonesia (DIBP 2014d). Conditions for obtaining a medical treatment visa include that the applicant meets financial, health and character requirements and does not have a medical condition that could be a threat to public health (DIBP 2015i). Studies have argued that Australia's medical visa system can be a barrier to medical tourism to Australia. Specific concerns include the time taken to process medical visas and the onerous evidentiary requirements for visa applications (TIAC 2004; Voigt et al. 2010). The Global Melbourne Health plan, released by the Victorian Government in 2014, identified that visa processes for medical treatment had been raised by stakeholders as a regulatory barrier to trade (Victorian Government 2014).

These concerns have led some of these studies to recommend that the Australian Government consider streamlining the application process for medical treatment visas.<sup>3</sup> Professor John Catford, medical director at private hospital group Epworth, raised the possibility of streamlined visa arrangements to encourage international health care in Victoria (quoted in West 2014).

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<sup>3</sup> In 2013, the Australian Government merged the 675 medical treatment (short stay) visa and the 685 medical treatment (long stay) visa into the current 602 medical treatment visa. There were no substantial changes to eligibility or evidentiary requirements for medical treatment visas as part of this process (DIBP, pers. comm., 29 July 2015).

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There is little evidence that Australia's medical visa application process is more burdensome than necessary

Studies that have identified medical treatment visas as a barrier to medical tourism to Australia generally focus on the effect of the medical visa application process on demand for health tourism to Australia. The studies provide little evidence to demonstrate that the application process is more burdensome or lengthy than is required to achieve the underlying objective of the visa program in managing immigration risks. It is therefore difficult to establish whether the impediments to medical tourism associated with the medical treatment visa application process constitute an *unnecessary* barrier to service exports.

The extent to which the medical treatment visa application process impedes medical tourism will vary across medical visitors.

- Some visitors to Australia seeking medical care do not obtain a medical treatment visa (Deloitte Access Economics 2011; chapter 3). It is estimated that approximately 11 700 people travelled to Australia in 2014-15 for medical reasons<sup>4</sup> (Tourism Research Australia 2015, unpublished data), whereas DIBP granted about 2900 medical treatment visas in the same period (DIBP 2015h). Deloitte Access Economics (2011) found that many patients entering Australia for minor medical treatments, such as some cosmetic surgery and IVF, used a short term visitor visa. DIBP noted that this might be appropriate in some cases if the person is primarily visiting Australia as a tourist or to visit family (DIBP pers. comm., 29 July 2015).<sup>5</sup>
- Medical visa processing times depend on the patient's home country. Currently, DIBP's standard processing time for medical treatment visas lodged outside of Australia is 1 week for low risk applications and 1.5 months for high risk applications (DIBP 2015o).<sup>6</sup>

In the draft report, the Commission sought further information from participants on the scope for streamlining current medical treatment visa application processes. The response to the information request was very limited and did not provide compelling evidence that the medical visa application process is more burdensome than necessary.

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<sup>4</sup> Available data do not indicate whether medical treatment was the main reason for travel.

<sup>5</sup> Visitor visa applicants who declare that they will be visiting a medical facility have to undergo health screening and must meet the full health requirements as specified under public interest criteria for this visa (DIBP, pers. comm., 29 July 2015).

<sup>6</sup> Low risk applies to 34 nationalities eligible to apply for an Electronic Travel Authority visa (nationalities eligible to apply for an Electronic Travel Authority visa are set out in table 8.1, chapter 8). Actual processing times for applications may be shorter or longer than the standard times due to a range of factors affecting processing of applications.

## Measures to improve Australia's cost-competitiveness in medical tourism

Medical tourism offers a number of potential benefits to Australia, such as providing public hospitals with revenue to help fund additional capacity and research (TIAC 2004; West 2014) and opportunities for Australian surgeons to maintain their skills in particular procedures by treating more patients. Some stakeholders also see medical tourism as an opportunity to develop regional areas in Australia, such as Cairns and Darwin.

The Australian health service sector currently faces a number of commercial disadvantages that limit the potential for Australia to become a major destination for medical tourism, including:

- considerable international competition from some Asian countries, such as Singapore and Thailand, which can provide acceptably high quality health care but at much lower prices than in Australia (Deloitte Access Economics 2011). Some surgical procedures cost twice as much in Australia as in some Asian countries (table 7.2)
- the ability for residents of key source countries, such as China, to access high quality (and potentially less expensive) health care closer to their own borders (Deloitte Access Economics 2011)
- many parts of the Australian health system not being set up for wide-scale uptake of medical tourism. There are also limited on-the-ground networks, such as referral agencies and clinicians, marketing companies and coordinators of medical records (Deloitte Access Economics 2011).

**Table 7.2 Cost comparison for selected surgeries<sup>a</sup>**

	<i>Heart bypass</i>	<i>Hip replacement</i>	<i>Knee replacement</i>	<i>Hysterectomy</i>
	\$	\$	\$	\$
Australia	33 340	23 800	20 090	7 110
United States <sup>b</sup>	146 070	48 310	44 940	22 470
India <sup>b</sup>	10 450	10 110	9 550	3 370
Thailand <sup>b</sup>	12 360	13 480	11 240	5 060
Singapore <sup>c</sup>	14 920	9 680	10 480	4 840
Malaysia <sup>b</sup>	10 110	11 240	8 990	3 370
South Korea <sup>b</sup>	38 370	12 810	27 080	14 270

<sup>a</sup> Cost data were compiled from various sources and should be treated as indicative only. <sup>b</sup> Converted into Australian dollars at a rate of A\$1.00 = US\$0.89 based on the average monthly exchange rate over the period for which the data were compiled (2006 to 2012) (RBA 2015). <sup>c</sup> Converted into Australian dollars at a rate of A\$1.00 = SGD\$1.24 based on the average monthly exchange rate over the period for which data were compiled (2006 to 2012) (RBA 2015).

Source: Medhekar (2014).

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Australia's potential as a destination for medical tourism could improve in the future, particularly if Australia were to undertake broader reforms conducive to increased efficiency in the Australian health system, which could put downward pressure on treatment costs. The Productivity Commission (2015d) has previously identified opportunities for efficiency gains in the Australian health care system through reforms to health technology assessment, increased evidence-based guidance for clinicians, improved payment models, health workforce reforms, and greater information and transparency.

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## 8 Tourism, professional services and information technology

### Key points

- There can be a case for government involvement in the provision of destination marketing and major events to promote visitor activity for tourism-related businesses.
  - There are few publicly available analyses of the costs and benefits of the destination marketing or major events provided or funded by state and territory governments.
  - Governments should undertake an analysis of the costs and benefits of government involvement in a destination marketing program or major event prior to funding the activity, and should not support the activity unless the analysis suggests that there would be net benefits to the Australian community. The analysis should be publicly released as soon as practicable.
  - The analysis undertaken should be fit for purpose, and the scale and complexity of the analysis should be commensurate with the value of government funding being provided to the activity.
- With perhaps the exception of Sydney Kingsford Smith Airport, providing unrestricted access to any airport in Australia's major gateways would be expected to deliver net benefits to the Australian community.
  - As soon as practicable, the Australian Government should provide unrestricted access for foreign airlines flying to and from Brisbane, Melbourne and Perth airports as well as all secondary airports in Australia's major gateways.
  - Following this, unrestricted access to Sydney Kingsford Smith Airport should be provided unless a published assessment shows that the costs would outweigh the benefits to the Australian community.
- The tourism sector, and other sectors that rely on visitors travelling to Australia, would benefit from the provision of premium processing arrangements at the border, such as priority visa processing and off-terminal clearances. These services should be charged for, in line with the Australian Government's guidelines on cost recovery.
- Service providers from the professional services and information technology (IT) sectors face international barriers when seeking to export, such as onerous licensing regulations, investment barriers and restrictions on the transfer of data. These barriers are not unique to the professional services and IT sectors (see chapters 4 and 5 for discussion).
  - There is insufficient evidence to conclude that mandatory registration of engineers would have net benefits or increase the level of engineering exports.

This chapter examines the sector-specific barriers raised by participants in the tourism (section 8.1), professional services (section 8.2) and information technology (section 8.3) sectors. The barriers discussed in this chapter are not the only barriers faced by service

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providers in these sectors. Barriers that are more general in nature and affect multiple service export sectors are discussed in chapters 4 and 5.

## 8.1 Barriers to, and support for, international tourism

Australia's international tourism sector is affected by a range of government policies. Under the Tourism 2020 policy, governments have agreed to a goal of at least doubling the size of overnight visitor expenditure in Australia (from 2011 levels) by 2020 (box 8.1). The Australian, state and territory governments provide support to the tourism sector, primarily through the provision of destination marketing to promote Australia (or its regions), and through the funding or provision of major sporting, cultural and business events. Dedicated government tourism agencies — Tourism Australia and its state and territory equivalents — play a key role in managing these activities. The total expenses of Australia's tourism agencies in 2013-14 was about \$700 million (figure 8.1).

### Box 8.1 Tourism 2020

The Tourism 2020 plan was released in December 2011, and aims to double overnight visitor expenditure by 2020. The plan identifies six priority areas to meet this objective:

- grow demand for visitors from Asia via marketing and consumer research
- build competitive digital capabilities, such as online marketing and sales platforms for tourism businesses
- encourage investment in tourism-related infrastructure via reductions in red tape for development approval processes
- ensure that the tourism transport environment supports growth, including facilitating an increased level of domestic and international airline seats
- increase the supply of labour, skills and Indigenous participation in tourism businesses
- build industry resilience, productivity and capability.

A draft implementation plan (2015–2020) for achieving the Tourism 2020 objectives identifies reform priorities including: limiting regulatory burden on tourism businesses (including visa arrangements, aviation capacity (both aviation infrastructure and air services) and planning and zoning requirements); working with industry to support the development of tourism infrastructure; and undertaking coordinated and effective marketing campaigns.

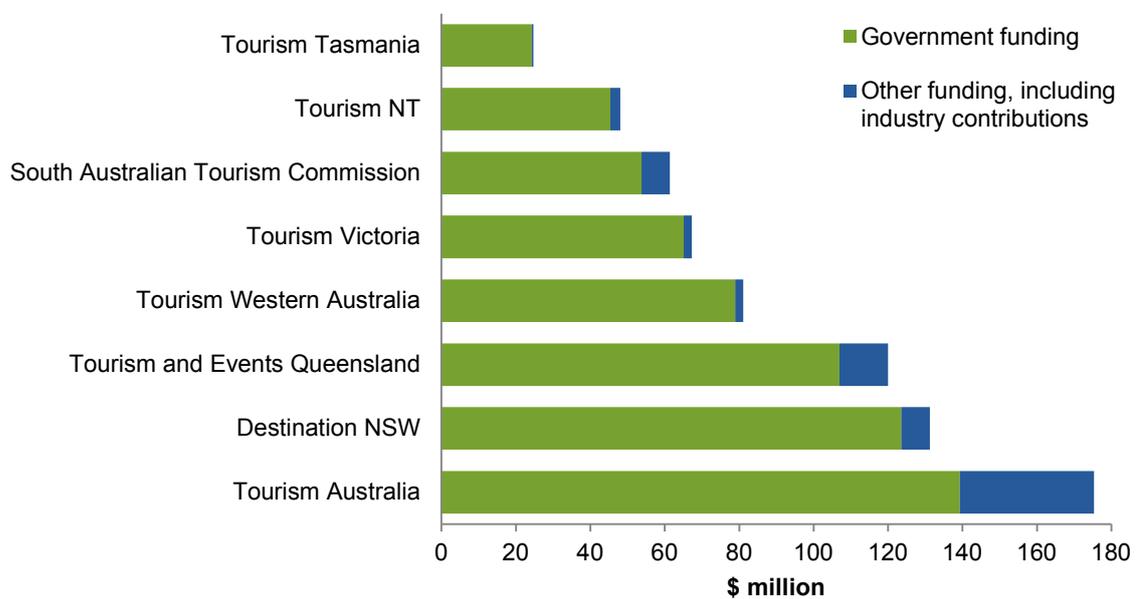
*Sources:* Austrade (2014a); DRET (2010).

Policy settings should be set based on their effect on community wellbeing, and not based on increasing service exports alone (chapter 2). Targeting a metric such as doubling visitor expenditure under Tourism 2020 is not the same as maximising the net benefits to the Australian community and risks diverting resources from more worthy policy outcomes. Rather than target a particular level of economic activity from a sector, governments should focus on removing policy impediments to tourism exports where they are identified, to allow the sector to take advantage of export opportunities. The Commission's

recommendations for reform draw on a research paper on Australia’s international tourism industry released by the Commission in February 2015, and additional evidence and views of participants put forward in this study.

Broader reforms relating to policy areas that affect the number of visitors to Australia would also benefit the tourism sector. These include improving investment in tourism-related infrastructure, addressing workforce capability issues, and assessing Australia’s export assistance programs, including grants. Broader domestic reform options are considered in chapter 4.

**Figure 8.1 Total expenses of Australia’s tourism agencies, 2013-14<sup>a</sup>**  
Including employee benefits, payments to suppliers, grants and depreciation



<sup>a</sup> Data for Visit Canberra are not available. Government funding is composed of government appropriations and agencies’ operating surplus/deficit attributable to government. Other funding includes industry contributions, rent and interest. Industry contributions may not be included in the figures where they are provided directly to a marketing campaign. The total spending of Australia’s tourism agencies is a lower bound of support for tourism, as some funding, such as for the Commonwealth Games and the Formula 1 Grand Prix, does not go through these agencies.

Sources: Destination NSW (2014); SATC (2014); TEQ (2014); Tourism Australia (2014d); Tourism NT (2014a); Tourism Tasmania (2014); Tourism Victoria (2014); Tourism Western Australia (2014).

## The role of government in destination marketing and major events

Governments should only seek to reduce barriers to tourism exports by providing or funding international destination marketing or major events where doing so would provide a net benefit to the community. There is an in-principle role for government provision and funding of destination marketing and major events. The benefits arising from effective destination marketing and major events (increased visitor activity) can be captured by

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many tourism-related businesses — some of which will not cater specifically to international visitors — but it is sometimes not feasible to exclude those businesses that benefit from the activity but do not contribute to the costs (chapter 4). Where businesses cannot be excluded from benefiting from the marketing or major events provided by other firms, they face an incentive to free ride, and the activity may be underprovided from the community's perspective.

### Evaluating the case for government involvement in destination marketing and major events

The failure of the market to generate an efficient outcome could result in less visitors to Australia than would otherwise be the case — although this does not necessarily imply that government involvement would generate net benefits to the community. Whether governments are justified in funding or providing such activities can only be determined on a case-by-case basis through economic analysis prior to the activity proceeding. Although there are several publicly available studies on destination marketing campaigns undertaken by Tourism Australia, there are few publicly available analyses on the destination marketing and major events provided or funded by state and territory governments.

#### *The benefits of destination marketing and major events have often been overstated*

Where evaluations are publicly available, they are often based on inappropriate analytical techniques or a poor application of the appropriate technique (box 8.2). These methodological issues can significantly overstate the net benefits from government involvement in destination marketing and major events. For example, an economic impact assessment of the 2005 Australian Grand Prix estimated that the event increased Victoria's gross state product by \$166 million. An ex-post cost-benefit analysis conducted on the Grand Prix, commissioned by the Victorian Auditor-General, estimated that the event resulted in a net cost to Victoria of \$6.7 million (VAGO 2007).

To the extent that studies have overstated the net benefits, they would have also overstated the extent to which government should be involved in providing or funding these activities. Inadequate evaluations can also mean that tourism promotion activities are not as effective as they would otherwise be — which would mean that the demand for Australian tourism services is not as high as it would be with more effective marketing campaigns.

#### *Fit-for-purpose economic analysis is needed*

There are differences in the characteristics of destination marketing and major events. Tourism Australia (sub. DR47) noted that major events tend to be large one-off events, whereas marketing programs tend to be smaller and form part of larger campaigns. Tourism Australia stated that it can be easier to attribute increases in visitation to major events than destination marketing. In addition, while destination marketing is often largely

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funded by governments, major events generally have large private benefits (such as revenue generated from tickets to access the event) that heighten the risk of crowding out, and can have a broader range of costs, including infrastructure costs such as stadiums.

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## **Box 8.2 Evaluations of destination marketing and major events**

### **Destination marketing**

Publicly available studies that have examined the effect of Tourism Australia's destination marketing have generally focused on the additional international visitor expenditure induced by destination marketing, or the increase in measures of economic activity such as GDP resulting from the marketing.

- Tourism Australia (2014c) noted that the consensus of recent studies is that Tourism Australia's marketing increases international visitor expenditure in Australia by about \$15 for every \$1 directly spent on marketing, although some individual campaigns can be higher or lower. (As discussed below, expenditure does not represent net benefits to the community from destination marketing.)
- Studies that have estimated the change in Australia's output resulting from a change in international visitor expenditure have produced varying results. Forsyth (2006) estimated that the change in output stemming from a change in international visitor expenditure is about 7–11 per cent of that expenditure, and Forsyth et al. (2014) estimated it to be about 8 per cent. Dwyer et al. (2014) estimated that the change in output is about 62–75 per cent of visitor expenditure. The difference in results between Dwyer et al. and the other two studies is largely explained by differences in modelling approaches and assumptions (although the studies use slightly different measures of visitor expenditure and output).

Measures such as increases in visitor expenditure, GDP and GSP are not the same as net benefits to the community. The net benefits to the community will normally be significantly lower than an increase in visitor expenditure as resources are used in the production of goods and services that visitors consume, and these must be paid for (Dwyer and Forsyth 1993). Similarly, a change in output does not fully account for the cost of additional inputs, such as labour and capital, that are used to produce tourism goods and services. The additional cost of those resources must be deducted from the value of the additional output to obtain a measure of the welfare gain (Dwyer, Forsyth and Spurr 2004).

### **Major events**

Independent studies of government analyses of major events have found that the analyses that are publicly released have often substantially overestimated the net benefits that result from major events (for example, Abelson (2011); Jago and Dwyer (2006); VAGO (2007)).

- Studies are often based on the assumption that all spending by visitors from outside the region is new spending in the region. This can exaggerate the additional spending induced by the event because some people may have visited the region at that time regardless of the event, or rescheduled a planned trip to the region to coincide with the event (Barclay 2009).
- Evaluations of major events generally report the estimated increase in tourism expenditure or GSP as a result of the event. For the reasons outlined above for destination marketing, this will tend to overstate the net benefits from the provision of the event.

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Assessments of the increased visitation caused by the activity also differ — destination marketing analyses often use econometric techniques to examine the effect of the marketing on visitation to Australia, while major events focus on the number of people attending the event (but these analyses should be cognisant of factors such as people who would have visited Australia irrespective of the event (box 8.2)).

Government involvement in the provision and funding of both destination marketing campaigns and major events should be subject to fit-for-purpose economic analysis prior to the marketing campaign or major event proceeding. An ex-post evaluation of the costs and benefits following the completion of the activity would provide further rigour and accountability on the use of taxpayer funds. The analyses should consider the broad range of costs and benefits associated with the activity, including the risk that government involvement can crowd out private provision (box 8.3 and chapter 4). The analyses should be based on a technique that measures the net benefits to the community, rather than metrics such as increases in visitor expenditure or output.

- Cost–benefit analysis can be used to estimate the net benefits to the community resulting from the provision of a major event or destination marketing. Cost–benefit analysis has been used to analyse some major events, including the provision of V8 supercar races in the ACT (ACTAGO 2002) and the 2005 Australian Grand Prix (VAGO 2007).
- Computable general equilibrium (CGE) analysis provides insights into the effects of destination marketing and major events, including the indirect effects, and can supplement cost–benefit analysis. While typically CGE results are reported in terms of the effect of the policy on GDP or similar metrics, some CGE models contain measures of net benefits to the community (Forsyth, sub. 6). Care should be taken to ensure CGE models are used for tasks for which they are suited and to understand the assumptions driving the results as they can be a poor fit for assessing individual projects (PC 2014b).

#### *The complexity of economic analyses can be matched to the size of the project*

Some participants raised concerns that a requirement to undertake an analysis of the costs and benefits of destination marketing campaigns could be overly burdensome, particularly for small campaigns (DFAT, sub. DR49; Tourism Australia, sub. DR47; TTF, sub. DR48). Undertaking economic analysis that is not fit for purpose risks creating an administrative burden that fully or partially swamps the value of the project and, at worst, leads to the abandonment of an otherwise sound proposition.

The risk of administrative burden does not justify calls to remove government spending on destination marketing and major events from economic analysis. Instead, it highlights the need for analysis that is appropriate in its scale and complexity so that it is commensurate with the size of the project. Undertaking detailed modelling for small low-cost projects may have net costs. For these projects, an approach such as converting estimates of visitor expenditure induced by the program to net benefits based on historical outcomes (as

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suggested by Tourism Australia (sub. DR47)) is likely to be adequate. More detailed analysis of the activity would be required for larger marketing programs or major events, given their complexity and the potential that these activities could result in large net costs to the community.

### **Box 8.3      The costs and benefits of major events**

Analyses of the costs and benefits of major events should examine a broad range of costs and benefits, which have often not been accounted for in analyses of such events. These include:

- the private costs and benefits of holding the event, including operating costs and ticket and sponsor revenue. Importantly, this should consider whether the event would be held without government support (that is, whether government support would displace private investment)
- the increased (or decreased) profitability of businesses (that are not associated with running the event) as a direct result of the event being held. This would need to consider the increase in tourism expenditure as a result of the event, including any crowding out effects, and the flow on effects of the event to the broader economy
- the costs of additional labour or capital used to produce additional tourism-related services
- the cost of infrastructure provided for the event. Major events can necessitate the construction of infrastructure, such as sporting stadiums, that are costly to build and the ongoing benefits from this infrastructure are often overestimated
- the opportunity cost of government funds
- any other external costs and benefits, such as noise and other environmental effects (Jago and Dwyer 2006).

Tourism Australia (sub. DR47) and the Tourism and Transport Forum Australia (TTF, sub. DR48) noted that evaluations of destination marketing have shown that the marketing undertaken by Tourism Australia generated net benefits for Australia in the past. The TTF stated that this analysis demonstrates that governments should continue to invest in destination marketing. While the analysis undertaken on Tourism Australia's marketing is useful for analysing the overall effectiveness of destination marketing, this does not necessarily translate into the effectiveness of future marketing campaigns.

The costs and benefits of destination marketing may change over time due to changes in technology (such as marketing techniques) and visitor preferences. Analyses of the costs and benefits of individual destination marketing campaigns are needed to ensure that resources are being allocated to where they provide the greatest net benefits to the community. Transparent cost-benefit analysis also provides information for governments that can inform future funding appropriations and for tourism agencies to allocate funds across the range of activities they undertake.

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### *Evaluations should be publicly available*

The Commission emphasises the importance of transparency in the evaluation of government provision of destination marketing campaigns and major events. Transparency ensures that governments can be held accountable for their use of taxpayer funds. There would be substantial benefits from the increased accountability and public scrutiny arising from disclosure of the costs and benefits of these activities. Such scrutiny can test the assumptions and methods used, and draw attention to where information may be missing and to any unintended effects of the activity (PC 2010b).

Non-disclosure of evaluations is typically defended on the basis that this information could be used by tourism agencies in other jurisdictions (or countries) to gain a competitive advantage — as suggested, for example, by the TTF (sub. DR48). While the Commission acknowledges this concern, it is unlikely that the costs would outweigh the benefits gained from greater transparency. Even where commercial agreements necessitate some confidentiality, all non-confidential information should be made publicly available, and information that would be commercially sensitive to release prior to the event or marketing can be disclosed following the activity proceeding.

#### RECOMMENDATION 8.1

The Australian, state and territory governments should:

- undertake a transparent analysis of the costs and benefits to Australia of government provision or funding of destination marketing or major events, both prior to funding or providing a destination marketing campaign or major event and following the activity's completion. The analysis should be fit for purpose, and the scale and complexity of this analysis should be commensurate with the value of government funding being provided to the activity
- publicly release the analyses of these costs and benefits as soon as practicable
- not provide or fund a destination marketing campaign or major event unless an analysis of the costs and benefits of the activity demonstrates that government funding is expected to provide net benefits to the Australian community.

### Funding destination marketing

In some cases, government-provided destination marketing incorporates product marketing, and is partly funded by contributions from businesses (figure 8.1). Tourism Australia's 'Best Jobs in the World' campaign was supported by around 50 commercial partners (Tourism Australia 2013), and governments have entered into joint marketing campaigns with airlines (Tourism Australia 2014d). Although tourism agencies should continue to seek industry funding on a voluntary basis, it will generally be the case that Australian destination marketing is funded from general government revenue (in contrast to major events, which are often in part funded by ticket and sponsor income).

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Government funding of destination marketing may be justified if taxpayer funding of destination marketing is part of the optimal response to a free-rider problem. Where it is feasible for governments to recover the cost of the marketing campaign from industry, there are advantages to doing so. Cost recovery sends a price signal to users of the marketing and assists government agencies to use their resources efficiently (chapter 4).

The costs of destination marketing may be recovered either from tourism-related businesses or from international visitors. In either case, cost recovery will impose costs on others.

- Recovering costs from tourism-related businesses will, to the extent that businesses raise their prices in response, impose costs on their customers — including both domestic and international visitors, and perhaps also local residents.
- Recovering costs from international visitors will impose costs on tourism-related businesses, if the higher cost of visiting Australia reduces demand for tourism products in Australia.

It is administratively difficult and costly to identify tourism-related businesses and recover the costs of destination marketing from them. Businesses in the tourism sector are extremely diverse, and the value each business derives from destination marketing varies widely. Many tourism-related businesses are small and may not necessarily identify themselves as being part of the tourism sector. Levying taxes only on easily-identified parts of the tourism sector (such as accommodation taxes that are used in cities in Europe and the United States) would be inequitable. In addition, as most tourism businesses cater to both domestic and international visitors, it would be administratively complex to determine the extent to which each tourism-related business is benefiting from international destination marketing.

Another option is to recover the costs of destination marketing through charges on inbound visitors. Visitors to Australia pay visa charges, which vary by visa type and the applicant's nationality. Additionally, the passenger movement charge (PMC) is a departure tax levied by the Australian Government on all passengers departing Australia. As the PMC is also charged to Australians travelling overseas, it is less well targeted (relative to visa charges) at those benefiting from destination marketing. Methods of cost recovery of destination marketing were considered in more detail in the Commission's research report into international tourism

Some participants, both to the Commission's international tourism research paper and to this study, considered that the levels of visa charges and the PMC are already too high. The level of border charges is considered further below.

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## Facilitating the flow of international visitors to Australia

### The effect of visa and border processing arrangements on tourism exports

Participants in the Commission's research paper on international tourism and in this study, suggested that Australia's visa application processes were more demanding and time consuming than those in comparable countries (Advance Cairns, sub. 13; Australian Tourism Export Council, sub. 16; Coors Chambers Westgarth, sub. DR34; Crown Resorts Limited (2014); National Tourism Alliance, sub. 11; Queensland Tourism Industry Council (2014); Sydney Airport, sub. DR39; TTF (2014), subs. 25 and DR48).

Of particular concern to participants were the visa arrangements for visitors from China and India. Visitors from China (and other countries including India and Indonesia) must apply for a visitor visa (subclass 600), and have been unable to complete these visas online (although the Australian Government is currently trialling online visas for Chinese citizens) (table 8.1). Visitors from many of Australia's other key tourism markets can complete the visitor visa (subclass 600) online, or are eligible to apply for an Electronic Travel Authority (subclass 601) or eVisitor visa (subclass 651), which are able to be completed online and have lower charges. Several participants recommended that electronic visas be extended to key Asian markets (Advance Cairns, sub. 13; Australian Tourism Export Council, sub. 16, attachment 1; National Tourism Alliance, sub. 11; TTF, sub. 25).

The TTF (sub. 25) also made other recommendations to reduce the complexity of entering Australia. It recommended introducing a single visa for visitors to Australia and New Zealand to reduce the cost and complexity of visa arrangements for visitors who travel to both countries on the same trip, introducing automated outbound border controls that prioritise Trans-Tasman flights — to simplify customs processes for visitors — and opening up regional airports to international services by funding border agency staff at these airports.

Study participants noted that other countries have reformed their visa processes (box 8.4). The Australian Tourism Export Council (sub. 16) noted that the reform process for Australia's visa policy has not kept pace with the rest of the world and that Australia is losing market share.

Visa and border processing arrangements are important as they determine the ease with which short-term visitors are able to enter Australia. Issues that make entering Australia more difficult than necessary will reduce the demand for Australian tourism services and other services that rely on visitors travelling to Australia.

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## Box 8.4      **Examples of international reforms to visa arrangements**

### **United States**

In 2012, the United States sought to reduce visa application waiting times. Between June 2011 and June 2012, the average visa waiting period for visitors from China reduced from about 50 days to under 10 days, and for visitors from Brazil the waiting period dropped from 120 days to 2 days. The United States increased visa processing capacity by 40 per cent in both Brazil and China (US Department of State and Department of Homeland Security 2012).

The United States has a visa waiver program, which allows visitors from 37 countries to enter the United States without a visa for stays of up to 90 days. A bill (the Jobs Originated Through Launching Travel Act) is being considered by a congressional committee to extend this program to several other countries, and to reduce visa processing times for other countries.

### **New Zealand**

New Zealand is rolling out an online visa application platform. This platform will allow most visa types to be dealt with online, including application forms, supporting documents and photographs (Immigration New Zealand 2015).

## The Australian Government is taking steps to simplify visa and border processing arrangements

The policy objective of Australia's visitor visa program is to facilitate the entry of genuine visitors, while minimising non-return rates and breaches of visa conditions (DIBP 2015m). Because visa requirements are important determinants of demand for tourism services, the requirements and restrictions attached to visa eligibility should be no more burdensome than is necessary to meet the policy objective.

The Australian Government has taken steps to simplify visa processes for Chinese citizens.

- In February 2014, the Government introduced three-year multiple entry visas for Chinese business travellers, and introduced a pilot for 10 year multiple entry visas in 2015.
- The Government has reduced document requirements for Chinese travellers, removing the requirement for any original documents as well as the requirements for English translations of supporting documents.
- The Government has launched online visa application pilots in China (December 2014), India (April 2015) and Indonesia (October 2015), and is committed to a full rollout of online lodgements to Chinese passport holders by the end of 2016.
- The White Paper on Developing Northern Australia recommended a range of visa initiatives, including a trial of 10 year visas for Chinese visitors, a trial of a visa 'fast-track' service for Chinese citizens, and allowing Chinese visitors to complete a visitor visa application form in Simplified Chinese.

**Table 8.1 Visa types under Australia's visitor visa program**

<i>Visa type</i>	<i>Visitor visa<sup>a</sup> (subclass 600)</i>	<i>Electronic Travel Authority (subclass 601)</i>	<i>eVisitor visa (subclass 651)</i>
Eligibility	All nationalities	34 'low risk' nationalities	All EU nationalities and some non-EU European nationalities
Eligible countries (of top 15 countries of origin for short-term visitors to Australia) <sup>b</sup>	China, India, Indonesia	Canada, Hong Kong, Japan, Malaysia, Singapore, South Korea, Taiwan, United States	France, Germany, United Kingdom
Cost	\$135 (plus service fee)	\$20	Free
Lodgment	Paper lodgment available to all nationalities, online lodgment being expanded to all passport types (except Somalia) (currently 197 passport types — does not currently include China, India and Indonesia, except through pilot programs)	Online lodgment	Online lodgment
Documentary evidence	Required	Not required	Not required but can be requested
Processing time service standard <sup>c</sup>	1 month	1 working day	1 working day
Validity	12-months (longer validity available), multiple entry	12-months, multiple entry	12-months, multiple entry
Maximum stay per entry	3 months (longer stay considered on request)	3 months	3 months
Permitted activity	To visit, study, or for business, depending on the visa stream	To visit, study, or for business	To visit, study, or for business

<sup>a</sup> Standard Visitor visa for offshore clients. <sup>b</sup> Visitors from New Zealand are eligible for a Special Category visa (subclass 444). <sup>c</sup> The Department of Immigration and Border Protection aims to process 75 per cent of applications within these times, although actual processing times may vary. Processing time service standards given are for typical applicants: 'low risk' visitor for eVisitor, 'high risk' tourist or business visitor for Visitor visa. Actual processing times can be lower — in 2014-15, 75 per cent of visitor visa applications lodged by Chinese passport holders offshore were processed within seven days.

Sources: DIBP (2015m, 2015o).

In addition, the Australian Government is taking steps to simplify visa and border processing arrangements more broadly.

- The Australian and New Zealand governments introduced a single visa for entry into Australia and New Zealand during the Cricket World Cup in 2015. The Australian Government is evaluating the joint visa arrangements.
- The Department of Immigration and Border Protection (DIBP) is also rolling out automated departure gates during 2015 and 2016 that will allow visitors to self-process on departure from Australia's eight major international airports (DIBP 2015a).

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- In May 2015 the Government committed additional funding for the provision of border agency services at Townsville and Sunshine Coast airports (Australian Government 2015g).

The Commission supports the steps the Australian Government is taking to simplify visa application and border processing arrangements, particularly the introduction of online visa applications for visitors from China. These steps, once fully implemented, appear likely to address many of the concerns raised by study participants.

### The level of border charges

Participants in the Commission's international tourism research paper also raised concerns that the levels of the PMC and visa charges were deterring visitors to Australia (BARA 2014; Flowers 2014; QTIC 2014; Tourism NT 2014b; TTF 2014). In this study, the Australian Tourism Export Council (sub. 16), the National Tourism Alliance (sub. 11), Sydney Airport (sub. DR39) and the TTF (subs. 25 and DR48) recommended that the PMC and visa charges be reduced. The National Tourism Alliance stated that 'visa fees should not exceed the cost of providing essential border protection and immigration services to international visitors and Australian residents' (sub. 11, p. 9), and Sydney Airport (sub. DR39) supported the hypothecation of the PMC to border services.

The DIBP and the Customs and Border Protection Service have stated that '[the PMC] now constitutes general taxation. There is no longer a nexus between the direct costs of passenger facilitation and the PMC revenue collected' (2014b, p. 5). Similarly, visa charges are not set on a cost-recovery basis (DIBP 2014b). As neither the PMC nor visa charges have a cost-recovery objective, the appropriate level of the charges need not solely reflect the cost of providing services — the level should also reflect considerations such as the Australian Government's revenue requirements, alternative sources of taxation and the effect of the charges on the Australian community as a whole.

Evidence on the effect of visa charges and the PMC on the Australian community as a whole is mixed. The International Air Transport Association (2013) estimated that abolishing the PMC would increase visitor numbers and consequently the tourism sector's contribution to GDP by about \$1.7 billion annually. Forsyth (sub. 6) estimated that it is likely that Australia gains overall from the PMC, as the increase in government revenue more than offsets losses to the tourism sector.

Border fees and charges were reviewed in 2015 by the DIBP and the Customs and Border Protection Service. Following this review, the Australian Government made changes to border charging arrangements in its 2015-16 budget. These included increasing the cost of the subclass 600 visitor visa from \$130 to \$135 (which affects visitors from countries such as China, India and Indonesia). There was no increase in charges for electronic travel authority and eVisitor visas. Other recommendations of the review, including those in relation to premium border processing services, remain under government consideration. As

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border fees and charges have been reviewed in 2015, and the review has not been publicly released, the Commission has not made recommendations on this area in this study.

### Is there scope for premium processing arrangements at the border?

The prospect of premium processing arrangements at the border being offered to short-term visitors on a cost recovery or commercial basis was raised by participants in this study. The arrangements could include concierge services, priority visa processing and off-terminal clearances (Australian Tourism Export Council, sub. 16, attachment 1; National Tourism Alliance, sub. 11; Sydney Airport, sub. DR39; TTF, sub. 25). These types of services are provided in other jurisdictions such as Dubai, Singapore and the United Kingdom (Australian Tourism Export Council, sub. 16, attachment 1; TTF, sub. DR48). Premium border processing services in Australia are currently provided on an ad hoc basis.

Increasing the provision of premium border processing arrangements would have benefits for the tourism sector, potentially including increased visitor numbers to Australia, and increased visitor satisfaction. There would also be benefits for other service exporters that provide their services face-to-face, such as some education service providers.

A position paper on premium border processing services was released for consultation in November 2014 as part of the review of border fees and charges discussed above. The position paper noted the DIBP does not currently have a cost recovery framework in place for premium border processing, but supported the introduction of one. The position paper noted that ‘by applying cost recovery arrangements, border agencies would be able to resource this service adequately and as requested by clients, without standard passenger clearance processes being interrupted or strained in meeting these expectations within current resources’ (DIBP and ACBPS 2014a, p. 6).

Participants were broadly supportive of premium border processing services being provided on a cost recovery basis. The National Tourism Alliance noted that ‘... enhanced passenger processing options that go beyond standard service should be priced at the level of cost recovery to government’ (sub. 11, p. 16). The Export Council of Australia (sub. DR52) and the TTF (sub. DR48) were also supportive of introducing a cost recovery model — although the Export Council of Australia noted that the Department should be mindful of any small and medium enterprises affected by the charges. The Commission is supportive of moves to provide these services, or to facilitate the provision of these services by the private sector where they can be provided without undermining the objective of visa and border protection processes. These services should be charged for, in line with the Australian Government’s guidelines for cost recovery (Department of Finance 2014) as the benefits of these services are predominantly captured by the user of the services. Charging for the services would also enable premium services to be provided without undermining the ability of the DIBP to undertake its standard visitor clearance processes.

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#### RECOMMENDATION 8.2

The Department of Immigration and Border Protection should establish a framework to charge users of premium border processing services, in line with the Australian Government's guidelines for cost recovery.

### International air services arrangements

Access to international aviation markets is restricted unless governments have negotiated air services arrangements. Among other things, air services arrangements set out which routes airlines can fly and their capacity entitlements (the number of seats or flights that can be operated on a particular route), and some arrangements require airlines to submit ticket prices to aeronautical authorities for approval. As in all markets, restrictions on access to aviation markets *can* act as an impediment to competition between airlines which will affect the price and availability of international air services.

The Australian Government has negotiated bilateral air services arrangements with 94 economies (DIRD, sub. 28, attachment A) (box 8.5). Under most of Australia's air services arrangements, access (capacity) is restricted for international airlines flying to and from airports in the major gateways of Brisbane, Melbourne, Perth and Sydney, but is unrestricted to other Australian airports — a policy referred to as the regional package. Under the regional package, access is also restricted to secondary airports in the major gateways of Melbourne and Sydney (Avalon Airport and the proposed airport at Badgerys Creek, respectively), yet not to the secondary airports in Brisbane (Gold Coast and Sunshine Coast airports), which are treated as regional gateways.

#### The effect of air services arrangements on service exports

During consultations for the Commission's tourism research paper and in submissions to this study participants raised concerns about insufficient aviation capacity entitlements to airports in Australia's major gateways. Austrade (2014c), Perth Airport (2014) and Sydney Airport (2014, sub. DR39) stated that a lack of capacity within some bilateral arrangements was constraining international air services and limiting competition between airlines on a number of routes, including routes between Australia's major gateways and Fiji, Hong Kong, Malaysia, the Philippines and Qatar (figure 8.2).<sup>1</sup> With the exception of Fiji, Australian airlines are not similarly constrained. In other markets, including China,<sup>2</sup>

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<sup>1</sup> Additional capacity entitlements were negotiated with the Philippines in May 2015 and with Qatar in September 2015, although Qatar Airways has committed to adding additional daily flights to Sydney as of March 2016. This would bring the proportion of entitlements used on the Qatar side of the bilateral to 100 per cent.

<sup>2</sup> Capacity entitlements were renegotiated with China in January 2015. Prior to this, capacity was constrained for Chinese airlines flying to and from Australia's major gateways.

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Indonesia and South Korea, capacity entitlements are not being fully used either by foreign airlines or Australian airlines, although in most cases there is significantly more unused capacity for Australian airlines than there is for foreign airlines. Capacity entitlements are generally negotiated on a reciprocal basis between bilateral partner countries. Where Australian airlines are not seeking to operate services in a particular market, especially from large tourism source markets for Australia, the use of capacity entitlements will likely be disproportionately weighted toward foreign airlines.

In commenting on the Australian Government's policy position of negotiating capacity ahead of demand, <sup>3</sup> Sydney Airport (sub. DR39, p. 8) noted that:

... ongoing delays in bilateral capacity negotiations, which have fallen behind demand in many key growth markets, restrict the level of access to the Australian market from foreign carriers, preventing any further growth from international visitors.

The Department of Infrastructure and Regional Development is firmly of the view that the approach of restricting access to Australia's major gateways has provided negotiating leverage to obtain improved rights for Australian airlines, while ensuring capacity is sufficient for existing demand. In its submission to the draft report, the Department acknowledged that there are markets (Fiji, Hong Kong and Qatar<sup>4</sup>) where airlines are not currently able to add services to and from Australia's major gateways. The Department (sub. DR51, p. 1) goes on to say that negotiations with these partner countries have been 'prioritised and, subject to agreement with those countries, are likely to be held in the coming months' but provided no indication as to when foreign airlines seeking additional access from these markets could expect to be able to gain such access.

Where capacity is constrained by air services arrangements, airlines cannot operate additional services to and from Australia's four major gateways in response to actual or anticipated growth in demand. Further, where capacity is expected to soon be constrained, airlines will not choose to operate additional services to airports in these markets, and other airlines may be prevented from entering the market. Actual or anticipated capacity constraints in aviation markets will result in higher prices for international flights to and from Australia if they restricts market entry and impedes competition.

As airfares comprise a large part of the total cost of a short-term visit to Australia and a smaller, but still sizeable, part of the total cost of a longer term visit, fares that are higher than they otherwise might be will affect demand for service exports, particularly tourism and education. Higher airfares also increase the costs for other service exporters who rely on face-to-face delivery of their service.

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<sup>3</sup> A key feature of the Australian Government's international air services policy framework has been to seek to ensure that capacity available to foreign and Australian airlines under Australia's bilateral arrangements remains ahead of demand (Australian Government 2009).

<sup>4</sup> As noted above in footnote 1, additional capacity entitlements were negotiated with Qatar in September 2015.

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**Box 8.5 Australia's air services arrangements**

Australia's air services arrangements include 'open skies', open capacity and other arrangements. Australia's agreement with New Zealand, under the Single Aviation Market, goes further than any of its other arrangements and includes open skies as well as cabotage rights.

**Open skies arrangements**

Open skies arrangements involve unrestricted access to and from a country, and via and beyond (fifth freedom rights) to third countries for passenger services. Open skies also allow cargo to be carried between two countries without the flight originating or terminating in the airline's home country. In practice, open skies arrangements do not involve full liberalisation. Australia has signed one open skies agreement with the United States. The agreement does not allow Australian airline passenger flights between the United States and another country without the flight originating or terminating in Australia, and it does not provide cabotage rights (ICAO 2013).

**Open capacity**

Open capacity arrangements involve unrestricted access to and from a country as well as some fifth freedom rights. Australia has open capacity arrangements with some countries including Japan, Singapore and the United Kingdom. For example, Australia's agreement with Japan allows for Australian airlines to operate unlimited passenger services to and from Japan (except to and from Haneda airport). The agreement includes some fifth freedom rights, including to China and Europe, although capacity is restricted for these services (Albanese 2011; DIRD 2015).

**Other arrangements with pre-determined entitlements**

Australia's other arrangements provide market access within pre-determined entitlements, which usually include some restrictions on capacity and fifth freedom rights. In most cases, these arrangements include unrestricted access to all international airports in Australia other than the airports in the major gateways of Brisbane, Melbourne, Perth and Sydney. For example, Australia's arrangement with Indonesia allows for Australian airlines to operate 25 000 seats per week in each direction between Australia's major gateways and Indonesia (DIRD, pers. comm., 8 July 2015). Unrestricted access is available for Australian and Indonesian airlines travelling to and from all other Australian airports (DIRD 2015).

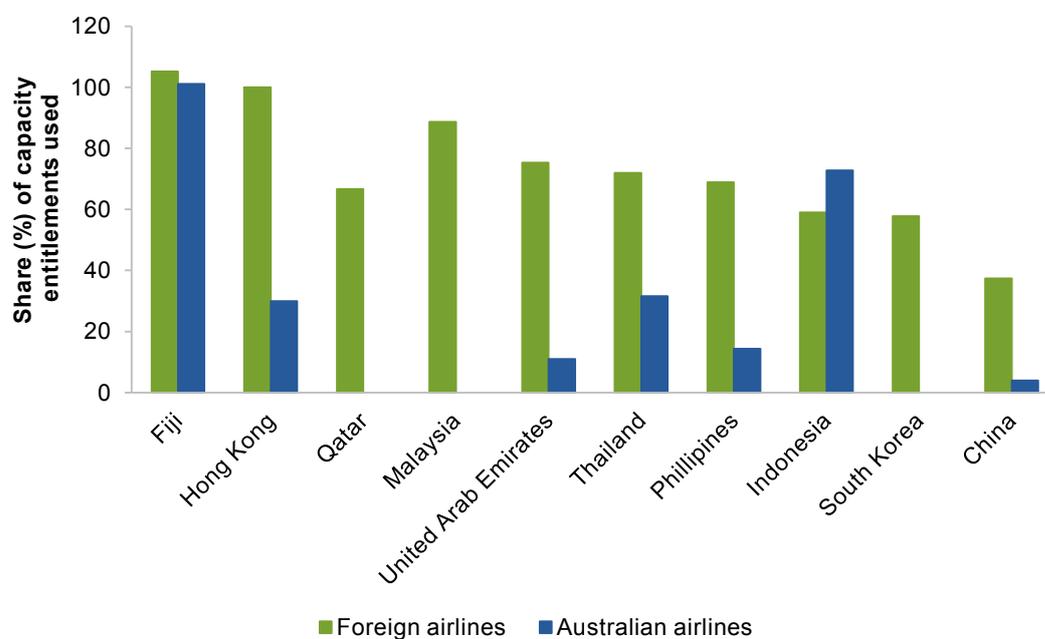
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**Further liberalisation of Australia's international air services arrangements could lower travel costs**

Further liberalisation through open skies or open capacity bilateral arrangements, with the Australian Government continuing to work toward a multilateral approach in relevant international forums, would be expected to provide the greatest net benefits to the Australian community. Where liberalisation through open skies or open capacity arrangements cannot be agreed, the Australian Government could provide unrestricted access to foreign airlines operating services to and from Australia's major gateways.

Figure 8.2 **Proportion of international aviation capacity entitlements expected to be used by foreign and Australian airlines, March 2015 to October 2015<sup>a</sup>**

Australia's largest uplift/discharge markets by passenger traffic<sup>b</sup>



<sup>a</sup> Capacity entitlements indicate the number of flights or seats airlines are entitled to operate under the relevant bilateral air services arrangement. Capacity used indicates the maximum scheduled capacity based on the 2015 Northern Summer timetable and does not necessarily reflect the number of seats filled. Capacity entitlements for China are separated into two dedicated pools. The first pool (26 500 weekly seats) is for services between Australia's major gateways and China's major gateways (Beijing, Shanghai, Guangzhou) — around 66 per cent of these entitlements are currently in use by airlines from China. The second pool (also 26 500 weekly seats) is for services between Australia's gateways and all other cities in China — around 8 per cent of these entitlements are currently in use by airlines from China. Australian airlines do not operate flights to and from South Korea, Malaysia and Qatar. <sup>b</sup> Data are provided for the 15 largest uplift/discharge markets. There are five countries within these markets where Australia has in place open capacity or open skies arrangements and hence there are no capacity constraints — these are the United Kingdom, the United States, New Zealand, Singapore and Japan.

Sources: DIRD (sub. 28; pers. comm., 8 July and 13 July 2015); Truss, Robb and Colbeck (2015).

### *Potential benefits of further liberalisation*

Whether providing unrestricted access to airports in Australia's major gateways would deliver net benefits to the Australian community depends on the extent to which existing arrangements are constraining market behaviour — and the costs those limits impose. As outlined in figure 8.2, there are unused capacity entitlements within some of Australia's bilateral arrangements — suggesting that further liberalisation would have little effect on market outcomes in those markets, unless the constraint was expected to be binding in the near-term. In other markets such as Fiji, Hong Kong and Qatar, capacity limits are binding

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and could be impeding more efficient market outcomes and reducing demand for Australian service exports.

The actions of foreign airlines in response to increases in capacity entitlements provide an indication of the effect that limits (and the relaxation of limits) within bilateral arrangements can have. For example, prior to the increase in capacity entitlements under the Australia-Qatar bilateral arrangement in September 2015, Qatar Airways was using 100 per cent of the entitlements available to airlines from Qatar. Less than a week after the increase in entitlements was announced by the Australian Government, Qatar Airways committed to flying a daily direct service from Doha to Sydney (from 1 March 2016) (Qatar Airways 2015). The addition of this service will once again bring the proportion of entitlements used on the Qatar side of the bilateral arrangement to 100 per cent.

Reducing restrictions on foreign airlines' access to Australia's major gateways would be expected to increase competition in aviation markets and put downward pressure on airfares. Greater competition could enhance economic efficiency by encouraging airlines to reduce their costs and to innovate and expand services. Additional capacity entitlements may also enable airlines to reduce their costs through greater economies of scale. Passengers would benefit from any lowering of airfares, and from greater choice of airlines and air services to a wider range of destinations. These benefits flow both to people travelling to Australia from other countries and to Australians travelling abroad. While the tourism sector, in particular, would be expected to benefit, benefits would also accrue to other service export sectors where providers rely on face-to-face delivery of their service — either in Australia or overseas.

An example of the potential benefits from increasing capacity entitlements was outlined in the Australian Government's recent announcement of the increase in capacity between Australia and Qatar. The Minister for Infrastructure and Regional Development stated that extra flights would boost Australia's tourism sector, and the Minister for Trade and Investment stated that the arrangements would provide greater market accessibility for Australian exporters (Robb, Truss and Colbeck 2015).

There is no guarantee that additional air services will be provided to particular airports if unrestricted access is granted, as airline route decisions are ultimately based on the commercial interests of airlines. Providing unrestricted access would, however, simplify airlines' and airports' assessments of what services to operate and enable decisions to be driven solely by commercial considerations.

Providing unrestricted access to all secondary airports in the major gateways would also help to mitigate the effects of long-term physical capacity constraints at major gateway airports that cannot be alleviated through efficient investment at those airports.

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### *Potential costs of further liberalisation*

Opening markets to increased competition may impose costs — most notably on Australian airlines — that need to be carefully considered when evaluating whether further liberalisation of air services arrangements would be expected to improve the wellbeing of the Australian community as whole.

The potential costs associated with providing unrestricted access to the major gateways include a loss of profits for Australian airlines if they are not able to maintain their position in the market due to greater competition or lower airfares. Some of these lost profits, however, would be borne by shareholders from other countries, depending on the extent of foreign ownership, which is substantial for both Qantas and Virgin Australia. Further, any loss of profits from a reduction in airfares is likely to be offset by the increase in consumer surplus from the fare savings flowing to existing travellers and from additional passengers (both Australians travelling abroad and visitors to Australia) being able to access air services due to the lower airfares. Additional passenger traffic would also offset any loss of profits of Australian international airlines, the extent of such an offset being a function of a range of factors and their interactions.

Providing unrestricted access may also have costs if it results in a loss of negotiating leverage for the Australian Government and if as a consequence it is unable to secure beneficial outcomes for Australian airlines in future air services negotiations. The Department of Infrastructure and Regional Development stated that:

Access to the major gateway airports forms the majority of the limited ‘negotiating coin’ available to Australia. Except in some circumstances involving 5<sup>th</sup> freedom beyond rights to the Pacific and Trans-Tasman, it is the only ‘negotiating coin’. (sub. 28, p. 5)

The Department (sub. DR51) further stated in its submission to the draft report that providing unrestricted access to foreign airlines would directly affect future negotiations, including the Australian Government’s ability to negotiate open skies or open capacity arrangements. Similarly, Virgin Australia considers that providing unrestricted access would impose heavy costs stemming from the ‘Australian Government’s loss of leverage that would have otherwise been used in future air services negotiations to obtain additional rights for Australian carriers’ (sub. DR42, p. 3).

The value of any leverage lost from providing unrestricted access to Australia’s major gateways should not be overstated. As noted earlier, Australian airlines are not currently using all of their capacity entitlements under many of the bilateral arrangements shown in figure 8.2 (although as noted by Virgin Australia (sub. DR42) the dynamic nature of the global aviation industry may see these rights utilised over time).

While there could be additional access rights (such as beyond rights) that the Australian Government may wish to obtain for Australian airlines, the objective of any negotiations should be to achieve the greatest net benefits for the Australian community. Although restrictions provide leverage for the Australian Government to gain rights in foreign

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markets for Australian airlines, these same restrictions can constrain wider benefits to the Australian community from granting foreign airlines greater access to the Australian market. Where restrictions to airports in Australia's major gateways are maintained to provide leverage for the Australian Government, the benefits this leverage provides should be transparently weighed against the costs — the foregone community-wide benefits of providing unrestricted access to particular airports.

*A staged approach to further liberalisation*

The Commission considers that, with perhaps the exception of Sydney Kingsford Smith Airport (Australia's largest airport), the benefits to the Australian community from providing unrestricted access to any of the airports in Australia's major gateways would outweigh the costs arising from any loss of negotiating leverage for the Australian Government.

The Commission proposes that access to airports in Australia's major gateways be liberalised in a staged way. To begin with, the Australian Government should, as soon as practicable, provide (through negotiated amendments to its international air services arrangements) unrestricted access for foreign airlines flying to and from Brisbane, Melbourne and Perth airports, as well as secondary airports in all of the major gateways.

In its submission to the draft report, the Department of Foreign Affairs and Trade (DFAT, sub. DR49) outlined an approach to implementing unrestricted access to the major gateway airports. It stated that a practical approach would be to phase the removal of Australian airports from their major gateway status. DFAT further stated that visitor volumes or international aircraft movement volumes could be used as the determining metric for order of removal (this would likely result in Perth's reclassification first, then Brisbane, followed by Melbourne).

Following the provision of unrestricted access to Brisbane, Melbourne and Perth gateways, the Australian Government should provide unrestricted access to Sydney Kingsford Smith Airport, unless a published assessment demonstrates that the costs of doing so would outweigh the benefits to the Australian community.

**RECOMMENDATION 8.3**

As soon as practicable, the Australian Government should provide (through negotiated amendments to its international air services arrangements) unrestricted access for foreign airlines flying to and from Brisbane, Melbourne and Perth airports as well as all secondary airports in Australia's major gateways. Following this, the Australian Government should provide unrestricted access to Sydney Kingsford Smith Airport unless a published assessment demonstrates that the costs of unrestricted access would outweigh the benefits to the Australian community.

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### *Assessing the national interest when negotiating air services arrangements*

The Australian Government's policy objective for international aviation is to balance the interests of the Australian aviation industry and those of the broader community. In its written comments to the Commission's tourism research paper, Austrade (2014c) reported that tourism stakeholders have expressed a desire for greater transparency from the Australian Government as to how the national interest was derived and the dialogue that occurred during negotiations. Sydney Airport (2014, sub. DR39) stated that the Government's negotiating approach lacks transparency and it is unclear how the national interest is determined. It considered that a more transparent approach be adopted that considers the benefits to passengers of increased capacity. While acknowledging that a process is in place to assess the costs and benefits of individual air services arrangements, DFAT (sub. DR49) stated that it supports broadening the assessment to include benefits to the community in addition to any effects on Australian airlines.

When negotiating an air services agreement, the Australian Government should undertake an assessment of all relevant costs and benefits of more open international air services markets. This assessment should include the benefits to the Australian community arising from lower airfares or access to a wider range of outbound travel destinations, as well as any effects that granting and obtaining additional rights may have on Australian airlines. The assessment of the costs and benefits of the negotiated outcome should be publicly released as soon as practicable. This would help to boost the confidence of stakeholders that the range of costs and benefits are being appropriately weighed, and that decisions are being made in the interests of the broader community.

In its submissions to this study, the Department of Infrastructure and Regional Development considered that a transparent cost-benefit analysis was unlikely to advance Australia's interests — as 'public disclosure of Australia's negotiating positions would compromise future rounds of negotiations, particularly in challenging negotiations' (sub. 28, p. 5). It further stated (sub. DR51) that there was limited scope to provide more detailed analysis, beyond public communication of the outcome of negotiations and high level advice to stakeholders on the main unresolved issues. The evidence provided to the Commission does not lead it to share this view.

#### RECOMMENDATION 8.4

When negotiating an air services agreement, the Australian Government should undertake an assessment of all relevant costs and benefits of more open international air services markets, including benefits to the Australian community arising from lower airfares or access to a wider range of outbound travel destinations, as well as any effects on Australian airlines. The Australian Government should publicly release its assessment of the costs and benefits of the negotiated outcome as soon as practicable.

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## 8.2 Professional services

Professional services refer to a range of different professions, including accounting, architecture, engineering and legal professions (chapter 3). Professional service providers face international barriers to export (chapter 5 and figure 8.3). The OECD services trade restrictiveness index illustrates the level of barriers to professional service exports — although this and similar indices are subject to data and methodological limitations (chapter 2). There is substantial variation in the types and ‘height’ of the barriers faced across countries, particularly for accounting and legal services. Some countries have relatively open markets for professional services. Others, such as Turkey and India, place substantial restrictions on the ability of foreign professionals to operate in those countries (Grosso et al. 2014b).

Professional service providers often provide their services face-to-face, and export via the temporary movement of people overseas (chapter 3). Barriers to this mode of export can include burdensome visa requirements and licensing regulations. These barriers, and other international barriers relevant to the professional services sector, such as investment barriers, are discussed in chapter 5.

Relative to Australia’s major trading partners, Australia’s barriers to the import of professional services are low (figure 8.3). Of the countries considered in figure 8.3, the OECD trade restrictiveness index shows that Australia has the lowest barriers for trade in legal services, the second lowest barriers for trade in accounting services, and the third lowest barriers for trade in engineering services.

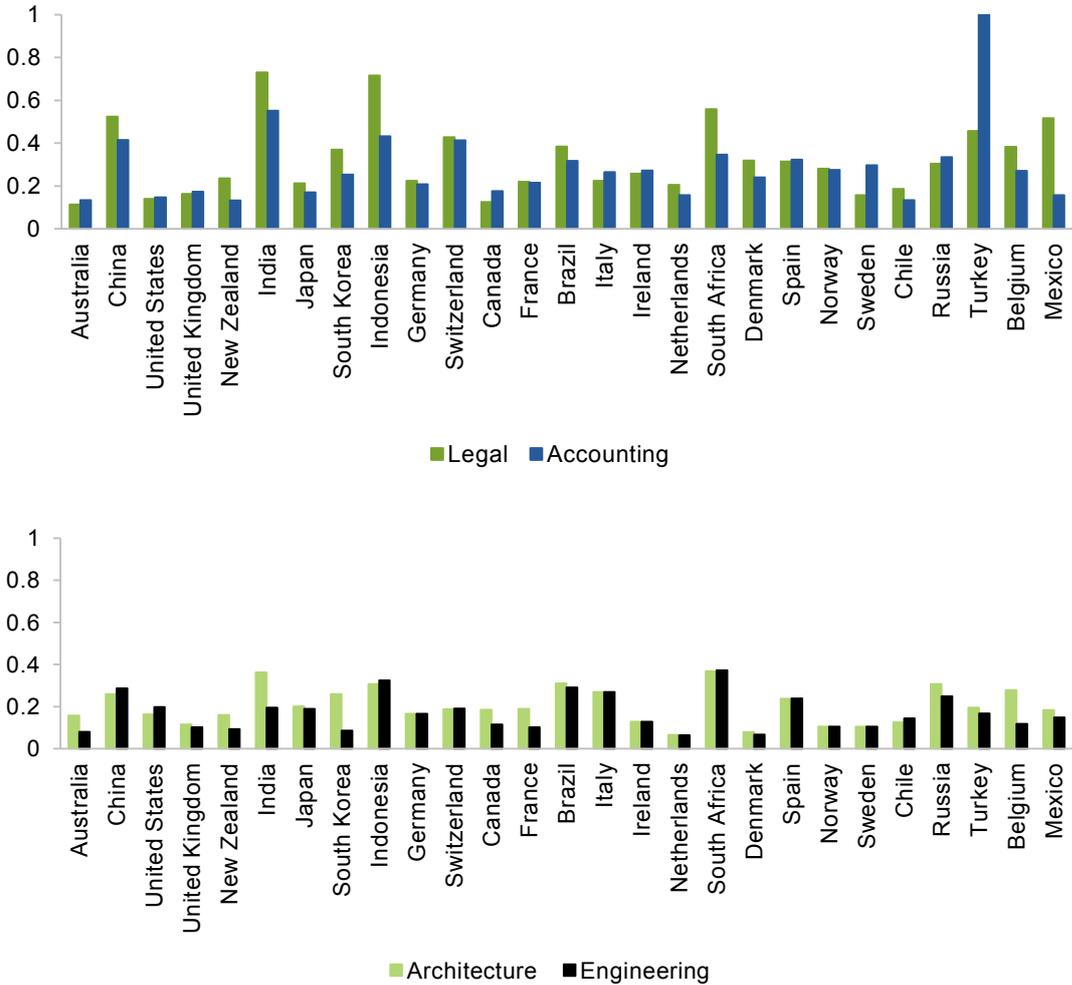
- For engineering services, Australia’s relatively low barriers can in part be explained by the lack of a mandatory system of registration in most states and territories in Australia — unnecessary and burdensome registration requirements can be a restriction on trade for professional services (chapter 5).
- For legal services, the Law Council of Australia (sub. 26) considered that Australia provides liberal terms of market access. For the practice of foreign country law in Australia, foreign legal service providers do not need to obtain a full practicing certificate, are subject to less onerous requirements than those wishing to practice Australian law, and there are no quantitative restrictions on the foreign provision of legal services in Australia (LCA, sub. 26).
- When discussing regulation for architecture services, Cox Architecture described Australia as having a ‘free and open market’ (sub. 2, p. 3).

### The registration of engineers in Australia

The requirement for engineers to be registered to operate varies globally. In countries such as the United Kingdom, registration is not mandatory, although registration is required for the use of titles such as Engineering Technician. In other countries, notably South Korea, Japan and some states in the United States, registration of engineers is mandatory. In

Australia, there is currently no national scheme requiring registration to practice as an engineer. Queensland is the only state where engineers are required to be registered to operate. Organisations such as Engineers Australia and Professionals Australia operate voluntary registration schemes for engineers.

**Figure 8.3 International barriers faced by professional service sectors<sup>a</sup>**  
 Countries in the OECD database that are in Australia’s top 40 trading partners and Australia



<sup>a</sup> Countries are ordered from left to right by the value of service exports from Australia. Index scores range from 0 to 1, where 0 indicates that a country’s service sector has no barriers to foreign service providers, and 1 is completely closed to foreign service providers. The data were collected at the end of 2013. The index does not account for specific concessions such as regional trade agreements or mutual recognition agreements, and does not include barriers that exclusively apply to mode 1 or mode 2 supply. The index also does not account for restrictions on cross-border data flows or protection or enforcement of intellectual property rights for the sectors included in this figure. Accordingly, the index may provide a distorted view of differences in barriers across countries if some countries have more barriers not included in the database than other countries.

Source: OECD (2015b).

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Noting that mandatory registration of engineers has not been acceptable to a succession of Australian governments in the past, Engineers Australia recommended that the Australian Government recognise and endorse that engineering only be practiced by ‘competent practicing engineers that belong to a formal professional standards regime ...’ (sub. 3, p. 4). The National Engineering Registration Board, supported by bodies including Engineers Australia and Professionals Australia, has previously called for mandatory registration of engineers (NERB nd). The Board commissioned ACIL Tasman to examine the benefits of a mandatory registration system for engineers. ACIL Tasman (2012) estimated that there would be significant benefits associated with a mandatory registration scheme due to improvements in quality.

The Commission considered the issue of mandatory registration of engineers in some detail in its inquiry into public infrastructure (PC 2014b). The Commission noted that there may be problems regarding poor engineering practices in some jurisdictions. The Commission found that it was not clear that mandatory registration of engineers is the best way forward to address poor engineering practices. There is little evidence that mandatory registration has resulted in net benefits for Queensland, where non-compliance with registration requirements remains an issue. The estimates provided by ACIL Tasman are heavily based on assumptions about the value of ‘botched’ projects avoided each year, whereas in reality ‘the effect of registration would be complex and difficult to estimate’ (PC 2014b, p. 586). The Commission concluded at that time that further evidence was required to recommend that mandatory registration should be expanded to other jurisdictions.

The case for mandatory registration would be stronger if it improved the ability of Australian engineers to export their services. This may be the case if engineers registered under a mandatory registration scheme had their registration more easily recognised overseas than under a voluntary registration scheme, thus improving their mobility and reducing the costs of exporting services. The Commission has received insufficient evidence to suggest that mandatory registration would facilitate the negotiation of further mutual recognition agreements, or improve the mobility of Australian engineers. Voluntary registration arrangements, such as that operated by Engineers Australia, can be (and have been) recognised internationally through mutual recognition agreements.

The Commission remains of the view that further evidence is needed to recommend that mandatory registration of engineers would have net benefits for Australia.

## **A uniform national law for legal professionals**

Regulation of the legal profession is the responsibility of the state and territory governments. State and territory governments have regulations designed to protect consumers of legal services, and ensure a minimum quality of legal services. These regulations vary across states and territories.

The Council of Australian Governments (COAG) has attempted to progress a ‘uniform law’ — a national system of legal regulation. COAG released draft legislation for public

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consultation in 2010. Although there was initial support from state and territory governments for the implementation of a national scheme, the Legal Profession Uniform Law has only been adopted in New South Wales and Victoria (the law commenced in both jurisdictions in July 2015).

### The costs and benefits of a national approach to legal regulation

There are potential benefits to service exports from a national approach to legal regulation. The Law Council of Australia considered that uniform national regulation would assist with international trade negotiations.

Being able to present a single set of requirements, which are no more burdensome than necessary, for the practice of law throughout Australia would place Australia in a stronger position at the negotiating table ... (sub. DR46, p. 2)

The Law Council of Australia also noted that inconsistencies in regulations can increase the costs of operating across Australian jurisdictions, which may be an issue for service exports if it limits the scale and competitiveness of Australian law firms.

Many of the benefits of the uniform law are likely to have been achieved in the operation of the uniform law between Victoria and New South Wales, which account for 70 per cent of the legal profession (PC 2015a). There is also a degree of uniformity in the approach to assessing foreign lawyer qualifications and registration across jurisdictions (which is likely to be the main issue that would affect mutual recognition agreements). The Law Admissions Consultative Committee has released uniform principles for assessing overseas qualifications, which are used by state and territory assessment boards, although the Committee notes that these principles are complied with in a 'wide variety of ways' (LACC 2010, p. 4).

In its inquiry into access to justice arrangements, the Commission suggested that other jurisdictions should observe the operation of the reforms in Victoria and New South Wales and enter the arrangements if the uniform law proves successful (PC 2015a). As the uniform law has only been recently introduced in Victoria and New South Wales, the Commission remains of this view.

### Limited liability partnerships for law firms

The Law Council of Australia (sub. DR46) raised the possibility of limited liability partnerships being an allowed structure for law firms in Australia, which combine the limited liability of companies with the flexibility offered by a partnership structure. Many countries around the world, including the United States and the United Kingdom, allow limited liability partnership structures for law firms. Currently, state and territory legal profession acts limit the structures for law firms to either partnerships or incorporated practices.

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The Law Council of Australia (sub. DR46) stated that the lack of a limited liability partnership structure for law firms in Australia puts Australian firms at a disadvantage relative to countries where this structure is available. In addition, the Law Council of Australia (sub. DR46) stated that allowing a limited liability partnership structure would more easily allow Australian law firms to form business relationships with global law firms.

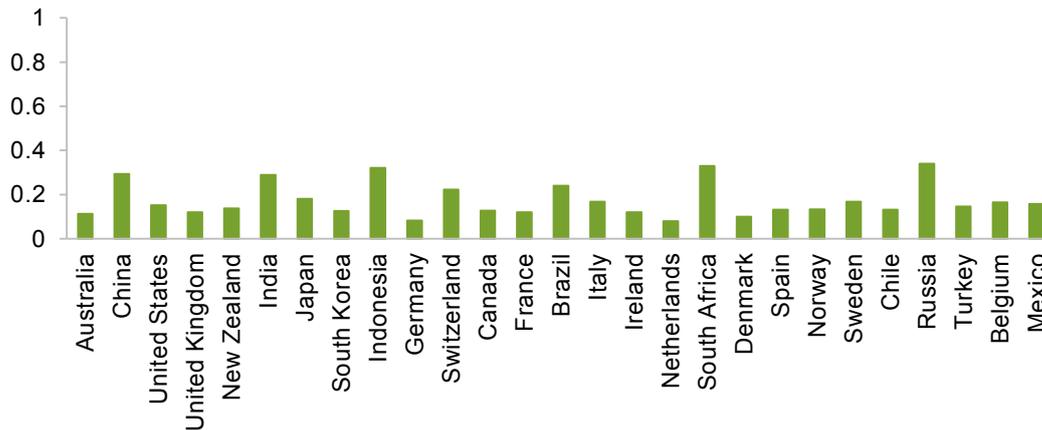
While new business structures may allow law firms more flexibility and potentially lower costs, it is important to ensure that the domestic market for legal services is not adversely affected by reform. The former president of the Law Council of Australia has noted that several factors must be examined when considering the introduction of alternative business structures, including that the interests of consumers are properly protected, that the structure does not compromise the ethical obligations of legal practitioners toward their clients, and that the structure is in the public interest (Ward 2011). A full assessment of the effect of an alternative structure of law firms on the domestic market is beyond the scope of this study.

### **8.3 Information technology**

Australia's information technology (IT) sector includes services such as hardware and software consulting, software licencing, data processing, cloud, and database services. About two thirds of the value of Australia's IT exports in 2013-14 were hardware and software consulting services, although this excludes IT services provided through commercial presence abroad (chapter 3).

The Australian Information Industry Association (AIIA, sub. 7) identified domestic barriers facing Australia's IT export sector. The AIIA stated that there is a deficit of skills and labour in the IT sector, and that there is a need for greater government support for IT exporters. These issues are examined in chapter 4. The IT sector also faces a range of international barriers to export, that vary in type and height across countries (figure 8.4).

**Figure 8.4 International barriers faced by the computing sector<sup>a,b</sup>**  
 Countries in the OECD database that are in Australia's top 40 trading partners and Australia.



**a** Index is for computer and related services. **b** Countries are ordered from left to right by the value of service exports from Australia. Index scores range from 0 to 1, where 0 indicates that a country's service sector has no barriers to foreign service providers, and 1 is completely closed to foreign service providers. The data were collected at the end of 2013. The index does not account for specific concessions such as regional trade agreements or mutual recognition agreements, and does not include barriers that exclusively apply to mode 1 or mode 2 supply. The index also does not account for restrictions on cross-border data flows or protection or enforcement of intellectual property rights for the sector included in this figure. Accordingly, the index may provide a distorted view of differences in barriers across countries if some countries have more barriers not included in the database than other countries.

Source: OECD (2015b).

The dominant driver of the OECD indices for computing services relate to restrictions on the movement of people — which can include restrictions on the number of software engineers permitted to practice in a country, or curbs on the duration of stay in a country (Nordås et al. 2014). Australia's barriers for the import of computing services are at about the same level as comparable countries such as the United States and the United Kingdom, and generally reflect cross-sector measures such as restrictions on foreign investment and visa arrangements (chapter 4). The IT sector can also face barriers relating to the enforcement of intellectual property rights and restrictions on cross-border data flows. These international barriers to the export of services are examined in chapter 5. The Commission has not been presented with nor identified any barriers specific to the export of services from the IT sector.

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## 9 Addressing international barriers to service exports

### Key points

- International barriers to Australian service exports are a result of policy settings in other countries, both at and behind the border. Addressing these barriers requires commitment and action from governments in other countries.
- The Commission has identified three areas where the Australian Government should seek to influence the reduction of international barriers.
  - Cross-border data flows — the Australian Government should work through trade negotiations and in international forums, including APEC, to ensure that standards for the movement of data across borders are internationally consistent, and that measures impeding cross-border data flows are the least restrictive necessary to address privacy or security concerns.
  - Licensing and standards for service providers — the Australian Government can help to address barriers arising due to differences in, and duplication of, licensing and standards regulations by putting in place a framework to support the development of mutual recognition agreements through trade or other agreements. To help ensure commitment to the progression of mutual recognition agreements, the framework should involve an adequately resourced implementation working group and include representatives from relevant regulators and the government agency responsible for policy matters in the specific service sector.
  - Investment — the Australian Government can use trade negotiations to address barriers that impede service providers from establishing a commercial presence abroad, although behind-the-border barriers to investment can be difficult to identify and address.
- Complementary to each of the above actions is Australian Government support through technical assistance and cooperation initiatives that serve to strengthen domestic policies and regulations in other countries.

Evidence outlined in previous chapters indicates that there are four key international barriers to service exports that are reducing demand for Australian service exports, and raising the costs of providing Australian service exports.

- *Cross-border data flows* — there are impediments to the flow of data across borders, an integral enabler of service export operations for many service sectors. A number of countries restrict data flows by requiring data to be stored and in some cases processed onshore. Financial service providers are intensive users of data hubs and cloud computing services, which rely on cross-border data flows, making them especially affected by restrictions on the movement of data (chapter 5).

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- *Intellectual property rights* — violations of intellectual property (IP) rights in export markets affect some service providers, such as architects, engineers and software service providers. There are instances where service providers have incurred costs — in the form of foregone sales or the costs of diverging from their preferred mode of service delivery — as a result of IP violations (chapter 5). Issues around enforcement of IP are being considered by the Commission in a separate inquiry.
  - *Licensing and standards* — professional service providers, including in the legal, accounting, engineering and architecture professions are affected by licensing regulations that are unnecessarily burdensome. The legal service market in India has been highlighted by study participants as an area where large gains from reducing barriers could be achieved (chapter 5). Financial service providers are also affected by differences in, and duplication of, regulatory standards and licensing arrangements for financial services (chapter 6).
  - *Investment* — international barriers to Australian service firms establishing a commercial presence in another country take many forms, including foreign equity limits, restrictions on the form of commercial presence, and screening and approval arrangements. Barriers to Australian firms establishing a commercial presence abroad are particularly high for financial, education and health services (chapter 5).

A key challenge in addressing international barriers to Australian service exports is that international barriers relate to policy frameworks in the destination country, both at and behind the border. These policies are not always put in place for the primary purpose of impeding trade in services but may have the incidental effect of protecting local firms from competition. Removal of these barriers requires commitment and action from governments of other countries.

The focus of this chapter is how the gains to Australia from the reduction of international barriers to service exports can be realised, and what mechanisms the Australian Government could use to encourage other countries to reduce their barriers. Mechanisms for reducing international barriers range from informal exchange of information, technical assistance and cooperation through intergovernmental networks and organisations, and adoption of international standards and mutual recognition agreements (MRAs), to more formal cooperation through international agreements and treaties, such as trade agreements and tax treaties.

Realising benefits from trade depends on governments committing to further reducing barriers *at and behind* the border. No one mechanism will be sufficient to address international barriers to services trade.

Also important is the removal of barriers within Australia that serve to reduce the productivity of Australian businesses, including service providers. Pursuing domestic policy reforms on a unilateral basis is likely to deliver large gains for the Australian community (chapter 4). Not only does domestic reform strengthen the productivity and competitiveness of Australian service providers but it may assist the Australian Government in its discussions in international forums to remove barriers to service exports in other countries.

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## 9.1 Using trade agreements to address barriers to service exports

Australia has pursued services trade liberalisation through multilateral, regional, plurilateral and bilateral trade negotiations (DFAT, sub.31). The World Trade Organization's (WTO) General Agreement on Trade in Services (GATS) is the only set of multilateral rules covering international trade in services (box 9.1).

### Box 9.1 The General Agreement on Trade in Services

The GATS was agreed under the auspices of the WTO and has been in force since 1995. It covers all internationally traded services, with the exception of services provided to the public in the exercise of public authority and international aviation (traffic rights and associated services). The GATS recognises the right of members to regulate the supply of services within their territories to meet national policy objectives and states that members should ensure that measures affecting trade in services are administered in a reasonable, objective and impartial manner. It also seeks to ensure that domestic regulations (qualifications requirements and procedures, technical standards, and licensing requirements) are based on objective and transparent criteria, and are only as burdensome as required to ensure the quality of the service.

The GATS contains two sets of legal obligations governing market access and national treatment, with member economies free to designate the sectors in which they will assume obligations.

- *Market access* provisions are aimed at progressively eliminating (through negotiations) measures that limit: the number of service providers; the value of services transactions; the number of operations or quantity of output; the number of natural persons supplying a service; the type of legal entity or joint venture; and the participation of foreign capital.
- *National treatment* provisions contain the obligation to treat foreign service providers and domestic service providers in the same way. The provisions allow the possibility of different treatment being accorded to foreign service suppliers compared with domestic service providers but states that in these circumstances the conditions of competition should not be modified in favour of domestic service providers.

A fundamental feature of the GATS is the most favoured nation (MFN) obligation, which requires a country to grant to all its trading partners the conditions it grants to its 'most favoured' trading partner. The GATS recognises that MFN may not be possible for every service activity and allows scope for MFN exemptions.

Sources: DFAT (sub. 31); WTO (2006, 2011).

WTO rules allow countries to form bilateral, regional or plurilateral trade agreements. Preferential trade agreements<sup>1</sup> (also commonly referred to as free trade agreements) are now widespread and have emerged due to difficulties in reaching agreement to further liberalise services trade at the multilateral level. The Australian Government has nine preferential trade agreements in force, with ASEAN countries (including New Zealand),

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<sup>1</sup> Preferential trade agreements entail the exchange of 'concessions' (or preferences) between partner countries to the agreement (PC 2010a).

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Chile, Japan, Malaysia, New Zealand, Singapore, South Korea, Thailand, and the United States. An agreement with China was signed in June 2015. Another four agreements are currently being negotiated — two bilateral (with India and Indonesia) and two regional, the Regional Comprehensive Economic Partnership Agreement (RCEP) and the Pacific Agreement on Closer Economic Relations (PACER Plus). Negotiations on the Trans-Pacific Partnership Agreement (TPP) were concluded in October 2015. The proposed TPP includes market access and other provisions for a number of service sectors, including financial, professional, education, health and e-commerce and telecommunications services (DFAT 2015o). The Australian Government is also a party to negotiations on a plurilateral services-only trade agreement, the Trade in Services Agreement (TiSA) (discussed below).

## **Experience with trade agreements to address barriers to services trade**

Some participants in this study considered that trade agreements are a necessary precursor to facilitating opportunities for service providers seeking to export (including ANZ, sub. 23; Association of Australian Convention Bureaux, sub. 15; Tasmanian Government, sub. 29). The Australian Financial Markets Association (AFMA) (sub. 14) and Standards Australia (sub. 9), for example, stated that trade agreements have facilitated trade in services and investment. To the extent that trade agreements are successful in opening up goods trade, including by eliminating or reducing tariffs, they can also facilitate further service exports.

Participants pointed to few instances where trade agreements had assisted them in their export activities. One example, referred to by ANZ (sub. 23), was Australia's trade agreement with South Korea, which lifted South Korea's restriction on cross-border data flows. Cross-border data flows are important to ANZ's 'hub strategy' for its Asia-based operations, which includes storage of customer data (chapter 5).

Other participants and observers have suggested there has been limited progress in opening up services markets through trade agreements (Hoekman and Mattoo 2011; Mamdouh 2014). The Financial Services Council (FSC), while supportive of the use of trade agreements for improving market access, stated that Australia has a poor record of realising the benefits of bilateral trade agreements, and that:

There are limits on the extent of regulatory change [free trade agreements] can achieve. They are legal agreements primarily concerned with removing discriminatory treatment for foreign operators, or 'levelling the playing field'. They can create frameworks for measures to support regulatory integration and reform. Ultimately implementation is undertaken by regulators of the governments concerned. (sub. 20, pp. 27–8)

Market access provisions in trade agreements can be used to address barriers for services trade, including some investment barriers, such as foreign equity and ownership restrictions, and joint venture requirements (box 9.2). However, even if full market access has been granted, foreign suppliers may still find it difficult under prevailing regulations to

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provide their service in another market (WTO 2011). Behind-the-border barriers, such as excessively complex licensing processes, may affect the ability and willingness of foreign providers to export services (chapter 5). AFMA (sub. 14) stated that Australia's preferential trade agreements have addressed many barriers to the supply of financial services at the border but that barriers to trade behind the border may still be significant.

### **Box 9.2 Addressing investment barriers in trade agreements**

Trade agreements include provisions to address investment barriers, such as foreign equity and ownership restrictions, and joint venture requirements. For example:

- financial services — under the China–Australia trade agreement, China has committed to allow Australian insurance providers access to China's statutory third-party liability motor vehicle insurance market, without form of establishment or equity restrictions (DFAT 2015d).
- professional services — under Australia's trade agreement with South Korea, Australian accountants are able to establish offices in South Korea to provide accountancy services on Australian and international tax and accounting law, and will, by December 2019, be able to work and invest in South Korean tax or accounting corporations (DFAT 2015f; sub. 31).
- health services — under the China–Australia trade agreement, Australian medical service providers will be able to establish wholly Australian-owned profit-making aged care institutions throughout China, and wholly-own hospitals in some provinces (DFAT 2015b).
- foreign ownership limits have also been relaxed under trade agreements. For example, under the Malaysia–Australia trade agreement, Malaysia permits majority Australian ownership of companies in a range of service sectors, including insurance, accounting services, and education services (DFAT 2013).

Investment (and other market access provisions) contained within preferential trade agreements may not achieve additional market access beyond that granted under the GATS or from domestic reforms. Even where this is the case, preferential trade agreements may 'lock in' existing levels of market access and hence prevent reversion to more restrictive measures.

Many barriers to investment are behind the border, making them difficult to identify and address. Participants have noted that investment barriers that restrict market access at the border persist in countries where Australia has signed trade agreements (including in China, Japan and Thailand) (chapter 5).

Preferential trade agreements typically contain provisions that aim to address behind-the-border barriers to services trade. Some agreements include provisions that either mandate or encourage greater transparency of regulations affecting services (DFAT, sub. DR49). A number of Australia's preferential trade agreements also include specific chapters relating to policy areas that affect service provision, such as competition policy, intellectual property and electronic commerce.

Commitments on regulatory cooperation in trade agreements are also aimed at encouraging regulatory reform and integration over time. For example, Australia's agreement with China includes a commitment for the Australian Prudential Regulation Authority (APRA) and the China Banking Regulatory Commission to cooperate on a range of matters, including the development of prudential frameworks (DFAT 2015c). The

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ASEAN-Australia-New Zealand agreement established a work program on economic development that included assistance for agencies in Cambodia, Laos and Myanmar to assess the effects of their laws and regulations affecting trade in services (DFAT 2009).

It is difficult to directly address all behind-the-border barriers to services trade through trade agreements given the range of rules and regulations that govern service provision. Trade agreements can, however, provide frameworks to progress further liberalisation and to establish supplementary measures, such as mutual recognition and harmonisation of standards (discussed below).

### **Opportunity for more transparent analyses of trade agreements**

The Commission has highlighted issues regarding preferential trade agreements in previous reports. In the 2013-14 Trade and Assistance Review, the Commission noted that diverse preferential trading arrangements add to the complexity of international trade and investment, are costly and time consuming to negotiate, and add to the compliance costs of firms and administrative costs of governments. Complexity stems from the divergent market access and national treatment commitments for services activities across agreements, as well as from the diversity of approaches used to determine the origin of goods and services — which in a services context is used to ‘deny benefits’ to service providers from countries not party to the agreement (PC 2015i) (box 9.3). In commenting on variation in commitments between preferential trade agreements, DFAT (sub. DR49) noted that the variation reflects negotiated outcomes, taking into account varying practices and priorities on the part of the negotiating partner countries, both in relation to willingness to enter into trade commitments and the level of liberalisation.

The Commission has also pointed to some matters contained within preferential trade agreements, such as those relating to IP (chapter 5) and investor state dispute settlement provisions, that risk imposing net costs on the community (PC 2010a, 2015i). The complexity of preferential trade agreements and the potential for provisions to impose net costs on the community presents a strong case for a more publicly transparent analysis of the expected net effects of the proposed agreement to be undertaken.

The Commission’s view on the effectiveness of preferential trade agreements — outlined in a number of previous reports, including a 2010 study into bilateral and regional trade agreements and annual Trade and Assistance reviews — is that they are not as effective in improving national welfare as unilateral action to eliminate trade barriers or multilateral trade and investment liberalisation (PC 2010a). A multilateral approach to addressing barriers to service exports was supported by the Australian Services Roundtable (ASR) (sub. 30), which stated that multilateral trade agreements through the WTO have the greatest potential to increase Australia’s trade in services. The ASR also stated that due to the slow progress at the multilateral level there is a need to pursue plurilateral, regional and bilateral agreements and proposed that Australia focus on negotiating a services plurilateral agreement.

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### Box 9.3 Rules of origin for services

Rules of origin are incorporated into preferential trade agreements to restrict access to tariff and other preferences to goods and services deemed to originate from parties to the agreement. Without such rules, there would be an incentive to import goods and services from a third country into one of the member countries to take advantage of the negotiated preferences offered in the agreement.

Rules of origin for services in trade agreements generally seek to delineate the origin of the service supplier or investor. The effect of the rules is to deny non-party owned or controlled companies access to the provisions negotiated in trade agreements.

Most of Australia's bilateral agreements have adopted a services and investment origin rule requiring *substantial business operations* in the territory of the party, although the meaning of 'substantial' is not clearly defined. This means that a non-party service supplier or investor engaging in substantial business operations in a member state may also benefit from the agreement. There are some exceptions to this. For example, Australia's agreement with New Zealand requires that a service or investment must not be *indirectly* provided by a person of neither member State. Another example is Australia's agreement with Japan, which stipulates that an enterprise may be denied the benefits of the agreement if it is majority owned by a non-party.

Source: PC (2015i).

## The implementation of preferential trade agreements

During consultations and in submissions to this study, participants raised concerns about aspects of the implementation of preferential trade agreements. Participants indicated that they would like to see greater communication from the Australian Government of the potential opportunities for service exports following the signing of agreements (AIIA, sub. 7, ASR, sub. 30, Cox Architecture, sub. 2, Export Council of Australia, sub. 32). The Australian Information Industry Association (sub. 7), for example, proposed that the Australian Government sponsor information and awareness raising activities related to the implementation of trade agreements. Other concerns raised by participants, including the FSC (sub. 20) and the ASR (sub. 30), related to implementation of specific aspects of trade agreements. The ASR said that the capacity for greater harmonisation between Australian financial services licencing and capital requirements appears to exist within several trade agreements yet few, if any, firms have been able to take advantage of these clauses. Issues associated with progressing mutual recognition and harmonisation of standards, including under trade agreements, are discussed below.

At the conclusion of trade negotiations, interested stakeholders are briefed on what was achieved to assist businesses in utilising the agreements (DFAT, sub. 31). The Australian Government also announced in the 2015 Budget that it will provide \$24.6 million to promote business understanding of the recently concluded preferential trade agreements with China, Japan and South Korea. This includes funding for the delivery of seminars with businesses throughout Australia, and trade agreement 'kits', which will include fact

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sheets and video presentations made available for local councils, industry groups and others to deliver their own education activities (Australian Government 2015a; Robb 2015). Some participants suggested that similar measures should be extended to Australia's other trade agreements (AIIA, sub. 7; Export Council of Australia, sub. 32).

There is a case for government bodies to provide information to service providers where the information is already being collected during the course of other efforts to improve the effectiveness of government activities. Beyond clearly communicating the detailed outcomes of trade negotiations (including through published analyses of the effects of agreements, as noted above), identification of commercial opportunities flowing from trade agreements is more appropriately placed with private firms and industry associations, such as the Export Council of Australia (box 9.4).

#### **Box 9.4      Export Council of Australia online trade agreement tool**

In June 2015, the Export Council of Australia in partnership with ANZ and Hunt & Hunt Lawyers launched a freely available online tool designed to help Australian exporters navigate Australia's preferential trade agreements. The tool provides information on Australia's trade agreements, enables users to search for a selection of exported products either by country or by industry, and provides information on how to do business overseas. The Export Council of Australia also runs workshops targeted at small to medium-sized enterprises interested in building their business internationally and exploring opportunities from Australia's trade agreements. Topics covered in the workshops include a checklist of non-tariff barriers and a market entry and trade agreement tool.

*Sources:* Export Council of Australia (2015a, 2015b).

### **Interaction between trade agreements and international tax treaties**

In addition to trade agreements, other agreements and treaties can be used to address issues relating to trade in services. Tax treaties are used to address double taxation, which has been raised by participants as a barrier to exporting (chapter 6). International air services agreements are also used to regulate international aviation markets (chapter 8).

Australia has a network of 44 bilateral tax treaties with its trading partners (chapter 6). The principal purpose of tax treaties is to address barriers to investment flows between countries by reducing or eliminating double taxation caused by overlapping tax jurisdictions. Tax treaties typically do this by providing guidelines for the allocation of the international tax base between the country where an investment takes place (the source country) and the country of the investor's residence (the residence country).

In instances where tax treaties are not in effect, or fail to substantially ameliorate the problem of double taxation, the taxation burden can create a disincentive to invest across national borders. Participants in this study noted that this disincentive could be a barrier to service exports, even when exporting to a nation with which Australia has a trade

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agreement. AFMA (sub. 14) claimed that the take-up of opportunities under past trade agreements has been undermined by the terms of the tax treaties with those nations. As a solution, AFMA called for the coordination of the negotiation of trade agreements and tax treaties. The FSC (sub. DR43) similarly stated that tax arrangements between jurisdictions can mean that trade agreements cannot be utilised. It proposed that tax treaties be updated as a standard step in the trade agreement process.

The Australian Government Treasury — the agency responsible for negotiating tax treaties — has indicated that trade agreements are one of the factors that it takes into account in advising government on Australia’s tax treaty negotiation priorities (pers. comm., 24 June 2015). The Commission is broadly supportive of continuing to give priority to negotiating, or renegotiating, tax treaties with nations with which Australia has trade agreements. Doing so helps reduce the barriers associated with double taxation and reinforces the intent of trade agreements. Australia’s most recent trade agreement, with China, includes a provision stating that parties shall review their bilateral taxation arrangements having regard to mutual economic objectives and international taxation standards.

There is reason to be cautious about greater coordination if it involves taxation arrangements being negotiated *within* trade agreements. Taxation arrangements have far wider implications than those related to service exports (or trade more generally) and should be considered from an economywide perspective (chapter 6).

## The Trade in Services Agreement

As noted above, Australia is part of a group of countries negotiating a services-only trade agreement — the TiSA.<sup>2</sup> The group of countries party to the TiSA collectively account for about 70 per cent of global trade in services (DFAT, sub. 31). The objective of the TiSA is to negotiate an agreement that: is compatible with the GATS; will attract broad participation; and will support and feed back into multilateral trade negotiations (DFAT, sub. 31). The TiSA is expected to cover all service sectors and modes of supply and introduce new trade rules where there has been significant development since the WTO Uruguay Round. DFAT’s website states that:

... new and enhanced disciplines similar to chapters in [free trade agreements] will outline additional commitments that will apply to all parties. The negotiations currently include financial services, ICT services (including telecommunications and e-commerce); professional services; transport services; delivery services; energy services; temporary entry of business persons; government procurement; and new rules on domestic regulation to ensure regulatory settings do not operate as a barrier to trade in services. (2015g)

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<sup>2</sup> The TiSA parties currently comprise: Australia, Canada, Chile, Chinese Taipei, Colombia, Costa Rica, the European Union (representing its 28 Member States), Hong Kong, Iceland, Israel, Japan, Liechtenstein, Mauritius, Mexico, New Zealand, Norway, Pakistan, Panama, Paraguay, Peru, South Korea, Switzerland, Turkey, the United States and Uruguay (DFAT 2015j).

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The extent to which the TiSA will generate additional opportunities for Australian service providers depends on whether it is able to achieve a level of services liberalisation above that which has already been achieved, including through the GATS and Australia's existing preferential trade agreements with TiSA participants. Australia currently has trade agreements with some TiSA participants (Chile, Japan, New Zealand, South Korea and the United States). Australia is also engaged in other negotiations that involve TiSA (and non-TiSA) countries, such as the TPP and RCEP. As noted by DFAT:

Many of the current parties already have relatively open services markets. Locking in existing market access would provide certainty for Australian services suppliers. As participation continues to expand, the TiSA could offer significant additional benefits, particularly for Australian business if countries from our region join and liberalise to meet the level of ambition. (sub. 31, p. 19)

The TiSA does not currently include some of the key countries where Australian service exporters operate and where barriers to service exports have been identified in this study, such as China, India and ASEAN countries, although China has indicated an interest in joining the negotiations (DFAT 2015j). Expansion of the TiSA to include other countries could provide additional benefits to Australian service providers.

The prospects for the TiSA feeding back into multilateral trade negotiations have been questioned. Sauvé (2014) argued that the greater the architectural dissonance between the TiSA and the GATS, the harder the eventual migration to the WTO could prove to be. Marchetti and Roy (2013) argued that any preferential access in services can be costly to non-parties because it may provide lasting advantages to first movers that might be hard to reverse through subsequent extension of access to other countries.

There is little publicly available information on the provisions being negotiated in the TiSA. This makes it difficult for the Commission to comment on the likely effectiveness of the agreement, and indeed, whether there are any provisions that could potentially result in net benefits (or net costs) for Australia.

One area of relevance for services trade where the TiSA could address barriers for Australian service exporters relates to cross-border data flows. Rules for the transfer of data are being considered as part of TiSA negotiations (DFAT 2015g; EC 2015b). Given that restrictions on cross-border data flows are a wide-ranging impediment to international trade (chapter 5), addressing such restrictions through broadly-based trade negotiations is an important option. Principles for addressing impediments to cross-border data flows are discussed further below. If the TiSA results in the harmonisation of disparate provisions contained within existing trade agreements, such as levels of market access, it may also achieve benefits for Australian service providers.

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## 9.2 Addressing barriers to licensing and standards through mutual recognition agreements

Mutual recognition can help address barriers arising from licensing and standards regulations. Mutual recognition involves two (or more) countries agreeing to allow service providers to practice in their country if the provider meets the other country's licensing, standards, or qualifications requirements. The benefits of mutual recognition agreements include a reduction in costs (through lower regulatory compliance costs) for service providers seeking to establish export operations. AFMA (sub. 14, p. 21) noted that 'mutual recognition of regulatory standards is an effective way for governments to apply international regulatory frameworks in a way that minimises extra-territorial impacts and potential impediments to the cross-border supply of financial services'. ANZ (sub. DR45) was also supportive of MRAs, noting that they assist companies that face different regulatory regimes across nations and reduce barriers to new and potential entrants. There are also costs associated with MRAs, including costs associated with developing, implementing and administering MRAs (box 9.5).

### Box 9.5 Potential benefits and costs of mutual recognition

By reducing regulatory compliance costs for service providers, mutual recognition agreements (MRAs) can help facilitate market access and promote competition between local and foreign providers. Consumers can benefit from greater choice of service providers and from lower prices. Another potential benefit arises from the examination of the differences in regulation between countries that occurs during the process of establishing an MRA and determining equivalence of licensing arrangements. Such examination could lead to improvements in regulatory approaches and potentially help to address impediments that arise due to licensing arrangements that go beyond what is necessary to meet their policy objectives. For example, the signing of the North American Free Trade Agreement (between Canada, Mexico and the United States) and the associated process of establishing MRAs for professional services, led to a number of reforms in Mexico. These reforms included the introduction of American standards for engineering programs, and new regulations in the accounting profession to create examination and experience requirements prior to certification (Sa and Gaviria 2011).

There are also costs associated with MRAs and it will not always be the case that mutual recognition is in the community's best interests. The costs include: administrative costs incurred by governments, regulators and professional bodies in negotiating, implementing and overseeing MRAs; difficulties implementing regulatory reform if MRAs involve joint decision making procedures between countries; and risks that regulators will not implement mutual recognition as agreed. There could also be other factors outside the scope of the MRA, such as taxation arrangements, that mean that service exports are still impeded despite an MRA having been implemented.

For mutual recognition to be successful, each country must have a high degree of confidence in the regulatory outcomes achieved under each other's laws (PC 2015h). When two or more countries have similar cultures, values and standards of living, then their regulations will likely address many of the same objectives. This is one of the reasons why the MRA for goods and occupations between Australia and New Zealand has worked well (PC 2003, 2015h).

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There may be reasons why regulations differ across countries. Countries may be at different stages of development and have different views on acceptable levels of risks, for example, in relation to health and safety. Local conditions may also differ, for example environmental conditions, which may necessitate different regulatory standards. Technical assistance to help countries implement best practice regulation (discussed later) may be necessary to address substantial and unnecessary differences in regulations between countries before mutual recognition can occur.

## **Experience with mutual recognition agreements in service sectors**

MRAs in the service sector have been established by governments, professional bodies and regulators (chapter 5). Governments have also helped to facilitate MRAs through trade agreements and other international forums, such as APEC. Some of Australia's trade agreements include a framework for progressing MRAs through a working group or committee (box 9.6). Trade agreements can play a role in facilitating MRAs but they do not guarantee an MRA will be successfully implemented or drawn on by service providers.

Responsibility for negotiating and managing MRAs often sits with professional bodies and government agencies, rather than being the direct responsibility of governments themselves. As noted by DFAT:

Dealing with these [recognition of qualifications, accreditation, registration and/or licensing] issues in services chapters of Free Trade Agreements (FTAs) can be complex due to the differences in how professional services are regulated from one country to another and one profession to another. Some countries rely on self-regulation by industry, others regulate at the central level or the sub-central level or combine elements of self-regulation and government regulation. Where industries self-regulate, it is not usually possible for governments to make hard commitments on mutual recognition as it is outside of their power to implement and enforce. (2015l, p. 2)

Professional bodies should have the incentive to progress an MRA where foreign service providers are already operating in the relevant Australian service market and where an MRA would benefit members of the professional body — in terms of reduced compliance costs and/or greater access to foreign markets. As noted in chapter 8, relative to Australia's major trading partners, Australia's barriers to the import of professional services are low.

There are reasons professional bodies may not have an incentive to progress MRAs. These include limited awareness at the professional level of the possibilities provided by MRAs, and/or lack of well-resourced and representative professional associations. There could also be concerns within professional associations that the benefits of MRAs for member service providers may be outweighed by the potential costs of increased competition from foreign suppliers. As noted by Nielson (2004), MRAs tend to be demand driven and it is difficult to create demand where there is no, or limited, interest in accessing overseas markets, or where there is no skill shortage in the home country. As outlined below, there are actions that the Australian Government can, and has, taken to help facilitate implementation of MRAs.

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### Box 9.6 Provisions for mutual recognition in trade agreements

Some of Australia's preferential trade agreements including with China, Malaysia, Singapore, South Korea and the United States, include a framework for progressing mutual recognition agreements (MRAs) for professional services. Although the agreements differ, they typically state that each party will encourage the bodies responsible for licensing and qualifications to explore possibilities for mutual recognition, including through the development of mutually acceptable standards and criteria for licensing or registration. Some of the agreements also establish a working group that, among other things, is to report on progress and/or provide recommendations on mutual recognition to a committee responsible for reviewing implementation of services aspects of the relevant trade agreements.

A number of MRAs have been established for professional services as a result of Australia's trade agreements.

- Under Australia's trade agreement with South Korea, an MRA was signed in 2015 between Engineers Australia and the South Korean Government. The MRA provides professional recognition of Australian engineers in South Korea (DFAT 2015e).
- Under Australia's trade agreement with the United States, an MRA was signed in 2008 between the Texas Board of Engineers and Engineers Australia that permits mutual recognition of chartered professional engineers and includes provisions for recognition of technologists and associates (Engineers Australia 2008; sub. 3).
- CPA Australia and the Institute of Certified Accountants in Singapore signed an MRA under the framework in Australia's trade agreement with Singapore (DFAT 2004).

Implementation of MRAs can be challenging given the complexity of regulations that relate to services. The difficulties associated with establishing MRAs were highlighted by Engineers Australia (sub. 3). It stated that even though the Australia–United States trade agreement included provisions for MRAs, Engineers Australia has found it necessary to negotiate arrangements with individual states — to date, one agreement (with Texas in 2008) has been signed (box 9.6). Engineers Australia (sub. 3, p. 4) stated that 'Australia's trade in engineering services would benefit considerably by increasing the importance of mutual recognition agreements for professional services, and elevating the level at which they are dealt with, in all free trade agreements when they are revised as well as including them in new agreements'.

Working groups and committees established under trade or other agreements can help to facilitate collaboration between regulators and professional bodies that could lead to the development of MRAs or harmonisation of standards. ANZ (sub. 23) pointed to the trade agreements with South Korea and Japan as having achieved significant gains by improving clarity and strengthening regulator consultation. The FSC (sub. DR43) stated that in negotiating trade agreements, best practice should be to establish financial services committees to progress implementation of the agreements, including MRAs. It identified the Financial Services Committee under Australia's trade agreement with the United States as a useful template (FSC, sub. 20). This Committee comprises representatives from the Australian and US Treasury Departments, the Office of the US Trade Representative and US Department of Commerce. The Committee is responsible for supervising implementation of

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the financial services chapter of the trade agreement and for considering ways to further integrate each country's financial service sectors. Australia's trade agreements with China and Japan also include the Australian Securities and Investments Commission (ASIC) and APRA as representatives (as necessary) on the financial services committees established under these trade agreements. The FSC stated that it was imperative that regulators such as ASIC be involved in discussions and implementation of MRAs (pers. comm., 15 July 2015).

Given the costs and complexity associated with establishing MRAs, the potential benefits of MRAs need to be clear before embarking on a process of developing and implementing an MRA. Effective industry consultation is needed to identify areas where MRAs would be of use and if the benefits associated with establishing an MRA outweigh the costs. There is a risk that MRAs will not be effective in addressing barriers to service exports if they are established without input from relevant service industry bodies. As noted by DFAT (sub. DR49), this risk should not materialise where MRAs are established by the relevant service industry authority.

The Trans-Tasman MRA (TTMRA) for the registration of occupations agreed between Australia and New Zealand highlights the need for effective governance arrangements to support MRAs. Although the TTMRA has been found by the Commission to be working well, in its 2015 review of the MRA (within Australia) and the TTMRA, the Commission proposed a number of reforms to strengthen governance arrangements (box 9.7).

**Box 9.7      Effective governance is needed to support mutual recognition agreements**

The Commission's report on the mutual recognition arrangement between Australia and New Zealand and the Mutual Recognition Agreement (within Australia) found that the schemes are generally working well, but there are specific problems that risk eroding the benefits of the schemes. Of particular concern was weak oversight and coordination among the participating jurisdictions. This resulted in: occupation-registration bodies not always implementing mutual recognition as required; few individuals exercising their right to challenge the decisions of regulators; the Cross Jurisdictional Review Forum (the body responsible for monitoring the schemes and responding to reviews) not meeting for almost four years; and the Forum failing to update Ministerial Declarations of occupational equivalence in Australia.

The Commission recommended a number of reforms to improve governance of the schemes. An important element of the proposed reforms is to strengthen the role of the Cross Jurisdictional Review Forum by, for example, giving it more specific responsibilities, timeframes, outputs, and reporting requirements. The Commission also proposed that individual jurisdictions improve oversight of how their regulators implement the schemes. Where they do not already do so, governments should set clear expectations for how regulators implement mutual recognition. Regulators should also be required to report in their annual reports information on the number of licences granted under mutual recognition and whether any decisions have been reviewed by a tribunal under the mutual recognition legislation.

*Source:* PC (2015h).

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## Facilitating the development of mutual recognition agreements

The Australian Government can support the development of MRAs by establishing a framework for progressing MRAs when it negotiates trade or other agreements — as it has done under some trade agreements (box 9.6). Cooperation on MRAs need not only occur under the umbrella of a trade agreement and can also take place through other agreements or arrangements, for example through international forums such as APEC, as well as collaboration and cooperation between responsible agencies.

The establishing framework should include clear actions and timeframes for an implementation working group to report on its progress to the committee responsible for overseeing implementation of the agreement. The framework should also include a process for consulting with industry stakeholders.

To help ensure commitment to the progression of MRAs that are in the interest of the Australian community, the implementation working group should be adequately resourced and involve representatives from relevant regulators and the government agency responsible for policy matters in the specific service sector. For example, the relevant regulators and government agency responsible for progressing MRAs in the financial service sector include ASIC, APRA and the Australian Government Treasury. Similar arrangements would be established to progress MRAs for service providers in other service sectors. The working group should engage closely with industry stakeholders to encourage the development of MRAs.

### RECOMMENDATION 9.1

The Australian Government should put in place a framework to support the development of mutual recognition agreements as part of, or following, the inclusion of mutual recognition provisions in trade or other agreements. The framework should include clear actions and timeframes for an implementation working group (that is adequately resourced and involves relevant regulators and government bodies) to report on its progress to the committee responsible for overseeing implementation of the agreement. The framework should also include a process for consulting with industry stakeholders.

## 9.3 Developing a consistent approach to regulating cross-border data flows

The development or adoption of international standards is one way of addressing barriers to service exports (box 9.8). The Australian Government Treasury, with Standards Australia, is leading an APEC project to harmonise standards for the movement of data across APEC economies (Bilson 2015; Standards Australia, sub.9). The project is expected to be completed by December 2016 and is intended to make recommendations for

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the development and implementation of a proposed standards-related work program supported by national standards bodies. The project will include consideration of relevant technical standards (such as those relating to data management and interchange) and will discuss issues surrounding security and privacy of data (APEC 2015g). An issues paper released in September 2015 identified lack of uptake and adoption by stakeholders of voluntary international standards, inconsistencies in policy and regulation among APEC economies, and large knowledge gaps as the three biggest cross-border data flow issues for businesses (APEC 2015b).

The APEC cross-border data flows project is an opportunity for the Australian Government to help ensure that rules and regulations governing the flow of data (including those that apply in Australia) are developed in a consistent — and least restrictive — way. Given the technical focus of this project, additional efforts from governments will be needed to encourage the removal of measures that unnecessarily restrict cross-border data flows, such as data localisation requirements.

**Box 9.8      Can international standards help address barriers to service exports?**

The development and adoption of international standards relating to services can help to avoid differences in regulations across countries. Greater consistency can enhance regulatory certainty and reduce the upfront and ongoing costs for Australian service providers doing business in multiple countries. Some participants in this study stated that the Australian Government and relevant regulators should take international standards into account when implementing regulations and policies that may affect trade in services, particularly financial services (AFMA, sub. 14; FSC, sub. 20). Standards Australia (sub. 9) pointed to the importance of participation in the development of international service standards as part of a multifaceted approach to identifying and removing barriers to trade.

A number of international bodies are involved in setting international standards, including APEC, the International Organization for Standards, the Basel Committee and the International Financial Reporting Standards Foundation (chapter 5).

There may be good reasons for diverging from international standards where local circumstances differ. For example, Australia's conservative approach to risk in its prudential regulation, considered overly burdensome by some stakeholders, was recognised by others as beneficial in maintaining the stability of Australia's financial system, including during the global financial crisis (chapter 6).

Australia's participation in international standard setting, through Standards Australia, relevant regulators and government bodies, is important to help ensure that international standards relating to services are designed in a way that reflects Australia's interests. The development of standards relating to issues such as cross-border data flows can also help to avoid the emergence of new barriers to services trade.

The Australian Government should continue to work through international forums, such as APEC, and in trade negotiations (including the TiSA) to encourage the removal of measures that unnecessarily restrict cross-border data flows. This work should focus on ensuring that measures restricting cross-border data flows are the least restrictive necessary

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to address privacy or security objectives, and are only applied where other remedies (such as contracts or laws to ensure data stored offshore meets data protection standards, chapter 5) could not achieve the same objective at a lower net cost.

RECOMMENDATION 9.2

The Australian Government should work through trade negotiations and international forums to ensure that:

- standards and regulations for the movement of data across borders are internationally consistent
- any government measures relating to cross-border data flows are the least restrictive necessary to address privacy or security objectives.

The Australian Government should also work through relevant international forums to ensure that restrictions on cross-border data flows are only applied where other remedies (such as contracts or laws to ensure data stored offshore meets data protection standards) could not achieve the same objective at a lower net cost.

## 9.4 Promoting regulatory reform through technical cooperation

The complexity of regulatory issues relating to services trade and the predominance of behind-the-border barriers highlight the importance of effective regulations and institutional arrangements relating to services. The Australian Government can help to address barriers to services trade by providing technical assistance, either bilaterally or through international forums, to improve the ability of governments to establish the institutions and governance frameworks needed to support good practice regulation of services. This requires efforts that promote regulations in other countries that are effective in dealing with market failures relating to services and ensuring that equity objectives are met.

Participants were supportive of efforts to encourage a greater understanding between countries of the benefits of good regulatory arrangements and institutional structures for services trade. ANZ stated that:

... stronger agreement between countries in the region to support more liberal services trade and align regulatory structures would be valuable. A general understanding or agreement between countries, which sets a long-term aim of greater services liberalisation, could underpin and guide further negotiations. This could be done through APEC. (sub. 23, p. 6)

Over the longer term, improving the ability of regulators and policy makers in other countries to adopt good practice regulatory arrangements may facilitate unilateral liberalisation of barriers to services trade in other countries. Technical assistance can be complementary to efforts to achieve services liberalisation through trade agreements. As stated by DFAT:

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Services trade and investment liberalisation is a high priority for Australia within APEC. DFAT's investment work in APEC is aimed at improving the enabling 'behind the border' environment for Australian services exports and investors and complements the legally binding commitments secured through trade negotiations. (sub. 31, p. 22)

Technical assistance can be provided in a number of ways including through:

- direct cooperation with other countries, including training for local officials, the exchange of information between policy and regulatory bodies, and exchange of government officials with other countries. For example, the Government Partnerships for Development program funds Australian public service sector organisations to partner with public sector organisations in developing countries. The aim of the activities funded under the program is to improve the ability of counterpart public service sector organisations to undertake and support government-related functions (DFAT 2015k)
- formal agreements between countries, such as economic cooperation and development agreements. Some initiatives have been included within trade agreements, such as the work program on economic development under the ASEAN–Australia–New Zealand trade agreement. The European Union has signed economic partnership agreements with African, Caribbean and Pacific Island regions. These agreements include, among other things, provisions that support the development of infrastructure necessary for trade. Some stakeholders have argued that economic partnership agreements have been ineffective as a development tool and rather are an instrument aimed at securing market access in developing countries (OPPD 2012)
- participation in international forums and organisations to encourage international regulatory reform. For example, the OECD has developed guidance to help countries design and implement policies relating to foreign investment that address national security concerns in a way that has the smallest possible effect on investment flows (chapter 5). APEC also plays a role in supporting services trade reform, including through its Group on Services (box 9.9). The Australian Government is leading work in APEC to build capacity in good practice regulation to facilitate trade and investment in specific sectors. This work has included hosting good practice regulation workshops to encourage unilateral reform in a number of service sectors (DFAT, sub. 31).

There could be benefits from Australia participating, through its regulators and policy makers, in technical assistance programs. Technical assistance that leads to more open service markets in other countries, and/or reduces the costs associated with Australian service providers operating in other markets, benefits Australian exporters and the Australian community more broadly. Further gains to the Australian community could be achieved if cooperation relating to services also leads to improvements in Australian domestic policy arrangements.

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**Box 9.9      Examples of APEC work to encourage reform in service sectors**

**APEC Group on Services**

APEC's Group on Services (GOS) works on trade and investment liberalisation issues related to trade in services, and coordinates APEC's work in this area. The GOS works in collaboration with four service-related APEC Working Groups: telecommunications and information; transportation; tourism; and energy. Current activities of the GOS include expansion of the Services Trade Access Requirements Database, which identifies requirements to trade and invest in other APEC economies. Another project relates to enhancing provider mobility in cross-border education in the APEC region. Work of the GOS led to the development of the APEC Strategy on Movement of Business People, which includes principles relating to, and actions that could contribute to, the facilitation of entry and temporary stay, and the movement of business people. Actions flowing from this strategy include further development of the APEC Architect and APEC Engineer Initiatives (APEC 2015f).

**APEC Economic Committee**

The APEC Economic Committee works to remove structural and regulatory obstacles that inhibit cross-border trade and investment and create behind-the-border barriers to doing business. This work focuses on promoting structural reform within APEC, including through improvements to institutional frameworks, regulations and government policies (APEC 2015e). The 2014 APEC Economic Committee report on good regulatory practice (part of the annual reporting of the Committee) outlines principles of good regulatory practice. These principles relate to transparency and public consultation, internal coordination and rulemaking activity and regulatory impact assessment (APEC 2014a).



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## A Public consultation

In keeping with its standard practice, the Commission has actively encouraged public participation in this study.

- Following receipt of the terms of reference on 4 March 2015, an advertisement was placed in major Australian newspapers in Australia and a circular was sent to identified interested parties.
- An issues paper was released on 2 April 2015 to assist those wishing to make a written submission. Following the release of the issues paper, 32 submissions were received.
- A draft report was released on 12 August 2015 and 20 submissions were subsequently received: a total of 52 submissions were received throughout the study (table A.1).
- As detailed in table A.2, consultations were held with representatives from Australian, state and territory government departments and agencies, academics, service industry peak bodies, and Australian service exporters in each of the service sectors covered in this study.
- A questionnaire on barriers to service exports in Australia was also conducted. A total of 29 organisations responded to the questionnaire (table A.3) of which 14 are public and contained in appendix B.

The Commission thanks all parties who have contributed to this study.

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**Table A.1 Submissions<sup>a</sup>**

<i>Individual or organisation</i>	<i>Submission number</i>
Advance Cairns	13
Association of Australian Convention Bureaux (AACB)	15
Australia and New Zealand Banking Group (ANZ)	23, DR45
Australian Business Deans Council (ABDC)	21, DR44
Australian Council for Private Education and Training (ACPET)	8, DR38
Australian Financial Markets Association (AFMA)	14, DR37
Australian Information Industry Association (AIIA)	7
Australian Institute of Professional Education (AIPE)	22
Australian Services Roundtable (ASR)	30
Australian Tourism Export Council (ATEC)	16
Corrs Chambers Westgarth	DR34
Cox Architecture Pty Ltd	2
Department of Foreign Affairs and Trade (DFAT)	31, DR49
Department of Infrastructure and Regional Development (DIRD)	28, DR51
Dr Chaikin, David and Brown, Eve	DR50 #
Dr Maddock, Rodney	DR35
Engineers Australia	3
English Australia	19, DR36
Export Council of Australia (ECA)	32, DR52 #
Financial Services Council (FSC)	20, DR43
Prof. Forsyth, Peter	6
Independent Schools Council of Australia (ISCA)	24
Insurance Australia Group (IAG)	10
Insurance Council of Australia (ICA)	12
International Student Experience Association (ISEA)	4, DR40
Intran Australia	DR33 #
Law Council of Australia (LCA)	26, DR46 #
Name Withheld	1 *
National Tourism Alliance	11
Overseas Students Ombudsman	5
Service Skills Australia	27 #
Standards Australia	9
Sydney Airport	DR39
Tasmanian Government	29
Tourism and Transport Forum Australia (TTF)	25, DR48
Tourism Australia	DR47 #
Universities Australia	17
University of Tasmania	18 #
Virgin Australia Group of Airlines	DR42
Western Australian Department of State Development	DR41

<sup>a</sup> An asterisk (\*) indicates that the submission contains confidential material NOT available to the public. A hash (#) indicates that the submission includes attachments.

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## Table A.2 Consultations

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### *Individual or organisation*

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#### **Adelaide**

South Australian Department of State Development  
South Australian Tourism Commission

#### **Brisbane**

Queensland Department of State Development  
Queensland Department of the Premier and Cabinet  
Queensland Department of Tourism, Major Events, Small Business and the Commonwealth Games  
Queensland Treasury  
The Wesley Hospital

#### **Canberra**

ACT Chief Minister, Treasury and Economic Development Directorate  
Australian Information Industry Association  
Australian Trade Commission (Austrade)  
Dr. Dee, Philippa  
Department of Education and Training  
Department of Foreign Affairs and Trade  
Department of Health  
Department of Immigration and Border Protection  
Department of Industry and Science  
Department of the Prime Minister and Cabinet  
Engineers Australia  
Law Council of Australia  
Treasury

#### **Hobart**

Tasmanian Department of Education  
Tasmanian Department of State Growth

#### **Melbourne**

Australia and New Zealand Banking Group (ANZ)  
Chai, Jason  
Deloitte Touché Tohmatsu Limited  
Denton, John  
Epworth HealthCare  
International Education Association of Australia  
Law Institute of Victoria  
Place Associates  
Professionals Australia  
Prof. Davis, Kevin  
Royal District Nursing Services  
Tourism Victoria  
Victorian Department of Economic Development, Jobs, Transport and Resources  
Victorian TAFE International

(continued next page)

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**Table A.2** (continued)

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*Individual or organisation*

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**Perth**

Curtin University

Navitas

Western Australian Department of Commerce

Western Australian Department of State Development

Western Australian Department of the Premier and Cabinet

**Sydney**

Australian Financial Markets Association

Australian Prudential Regulation Authority

Australian Securities and Investments Commission

Australian Services Roundtable

Australian Taxation Office

Commonwealth Bank of Australia

Consult Australia

Cox Architecture Pty Ltd

DEC International

Export Council of Australia

Financial Services Council

Insurance Council of Australia

NSW Department of Premier and Cabinet

Ramsay Health Care

Russell Investments

Westpac Banking Corporation

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## Table A.3 Questionnaire respondents

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*Individual or organisation*

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**ACT**

Independent Schools Council of Australia

**New South Wales**

Altios Australia

Australian Immigration Pty Ltd

Colonial First State Investments Limited

DEC International

DocsCorp Pty Ltd

International House Sydney

Macquarie University

Optiver Australia

Russell Investments

SMEC

Southern Cross University

StudyNSW, NSW Department of Premier and Cabinet

TAFE Directors Australia

Westpac Banking Corporation

**Queensland**

Adagent Pty Ltd

**South Australia**

Bellberry Limited

SACE Board of South Australia

TAFE SA

The University of Adelaide

**Victoria**

Academia International

Curtin University

JP Morgan

MEGT Australia

Monash University

Place Associates

RMIT University

The Imperial College of Australia

Victorian TAFE International

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