Senate Select Committee on Superannuation and Financial Services

Main Inquiry
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THE TREASURY

10 April, 2000

Ms Susan Morton
Secretary
Senate Superannuation and Financial Services
Select Committee
Parliament House
Canberra ACT 2600

Dear Ms Morton

SENATE SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES: TREASURY SUBMISSION

Further to our correspondence of 14 February 2000 and subsequent discussions, Treasury would like to lodge its submission to the Senate Superannuation and Financial Services Select Committee.

The attached Treasury submission only addresses part (b) of the terms of reference relating to Australia as a centre for the provision of global financial services.

I can be contacted on 6263 3937 (phone) or 6263 3866 (fax) if you wish to discuss this matter.

Yours sincerely

Godwin Grech
Markets Group

SENATE SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES

THE OPPORTUNITIES AND CONSTRAINTS FOR AUSTRALIA TO BECOME A CENTRE FOR THE PROVISION OF GLOBAL FINANCIAL SERVICES

DEPARTMENT OF THE TREASURY SUBMISSION

INTRODUCTION

Australia is well placed to develop its standing as a centre for the provision of financial services and gain a greater share of global financial business. It enjoys a number of key strategic advantages which include a stable, well-regulated financial system, a highly developed and transparent commercial environment supported by a strong legal system, a well educated workforce, relatively low cost structures and a favourable time zone between European and North American markets.

Australia's recent impressive economic performance has attracted attention and enhanced Australia's reputation globally. Not least, it promoted increased awareness of the significant progress made over recent years in the public policy framework, and the advantages Australia offers not only in its sound and transparent macroeconomic environment, but also in the dividends now being reaped by a series of microeconomic reform initiatives designed to make the economy more competitive, flexible and resilient.

The significant tax reforms to take effect with the implementation of *A New Tax System* and the business tax package will substantially bolster the already impressive public policy framework underpinning the increased financial services business undertaken in Australia. Responsible macroeconomic management and an ongoing commitment to microeconomic reform will continue to be fundamental to Australia's continued development as a global financial centre.

A well-structured and focussed promotional programme will also be important to Australia realising its full potential as a global financial centre. The Government's decision to establish the Australian Centre for Global Finance in mid 1999, will, amongst other things, allow for the development of such a programme.

The global financial services sector is highly dynamic, constantly evolving and is extremely competitive. Building a global financial centre will take time and requires ongoing commitment by government, the corporate sector and other relevant stakeholders.

AUSTRALIA AS A GLOBAL FINANCIAL CENTRE

A global financial centre is characterised by cost effective, innovative and sophisticated financial services provided to both domestic and offshore clients in areas such as banking, insurance, foreign exchange, commodities, equities and funds management by a wide range of financial service providers. These services are supported by a high standard of information technology; accounting and legal support arrangements as well as secure and efficient custodial, clearance and settlements systems.

The development of Australia as a global financial centre benefits not only the financial services sector, but also other related sectors including accounting, information technology and legal services and, indeed, the economy more generally through employment and other effects. In addition, Australian industry more broadly would stand to benefit from reductions in the cost of financing capital as a result of greater financial market liquidity, market depth, greater competition and operational efficiencies.

AUSTRALIA'S FINANCIAL SERVICES SECTOR

The Australian financial sector is not large relative to global financial centres such as New York and London. It is, nonetheless, a sophisticated and significant financial market in many respects, and it has achieved an importance or international standing in excess of its total size. In some areas it represents the largest market in the Asia Pacific region.

The Australian finance and insurance industry contributes 6.2 per cent of GDP, 1.4 per cent of total exports and employs over 340,000 people. Australia's exports of financial services (including insurance) in 1998-99 were $1.6 billion or 0.3 per cent of GDP (this has more than doubled as a per cent of total exports over the last decade).

Growth in the financial services sector has been relatively well balanced with all financial products markets increasing broadly in line with each other. This balanced growth reflects a lack of distortions and the fact that Australian financial markets, while attracting and catering to international business, have by and large developed primarily to service a diverse and large domestic economy. The challenge for Australia will be to build on this core of domestic activity to be the location of choice for high value added financial services for this time zone / region.

The substantial domestic market has allowed deep and liquid markets to develop naturally and enabled financial service providers to develop and embrace a wide range of sophisticated financial products. This is in marked contrast to some other financial centres where the use of heavy government sponsored sector specific incentives and restrictions creating barriers between international and domestic markets have assumed greater importance in developing their financial markets.

Australian financial markets are likely to continue to deepen and expand. In addition to the support provided by a strongly performing economy and sound policy framework, the following factors are relevant:

- Funds under management have grown significantly over the past decade and are forecast to continue to grow in line with the growth of superannuation assets. The value of Australia's funds under management at 31 December 1999 was $A646 billion ($US422 billion).

- Australia's foreign exchange market is ranked 9th in the world by turnover and the Australian dollar is the seventh most traded currency in the world. Australia has the advantage that its market's opening spans the hours when the US and London markets are closed.

- The Sydney Futures Exchange is the largest financial futures and options exchange in the Asia Pacific region while the Australian Stock Exchange with a market capitalisation of over $650 billion also ranks high in world terms. Both institutions have a leading edge approach to products and technology as evidenced in their adoption of screen trading.

- The introduction of legislation to remove interest withholding tax on domestic corporate debenture securities and the reduction in Government debt has given impetus to the development of the corporate debt market which has grown over 30 per cent per annum in recent years. The stock of non-government bonds on issue has increased threefold over the past four years to $64 billion as at January 2000, compared with State government securities of around $50 billion and Commonwealth government securities of around $70 billion.

- Australia's relatively small market in global terms has forced local operators to develop innovative and sophisticated financial products, as evidenced both in developments in the financial futures market and our capabilities in such areas as privatisation, derivatives and structured finance.
- Australia has also been able to recognise global trends and modify them to suit the particular circumstances of the local marketplace.
  - From virtually an infant market in 1991, Australia is now the third largest securitisation market in the world.
- The financial markets are underpinned by a strong regulatory framework aimed at ensuring appropriate risk management.

Attachment A provides further details on a range of financial service products.

AUSTRALIA'S ADVANTAGES AS A CENTRE FOR GLOBAL FINANCIAL SERVICES

Australia enjoys a number of significant advantages, which enhance its attractiveness as a destination for the provision of global financial services (see **Attachment B** for further details). These include:

- A secure business environment with a stable political system, strong economic performance and world class prudential and regulatory policy framework. These advantages are central and are discussed in detail in the following section.
- Financial markets that offer an exceptionally high standard of transparency, security and service within the Asia-Pacific region across a wide range of sophisticated products including equities, bonds, synthetics and managed funds.
  - It is noteworthy that Australian financial markets have evolved and developed naturally, without artificial assistance, providing a more secure basis for investment.

- A position within the Asia-Pacific time zone that allows Asian markets to be serviced quickly and cost-effectively. Australia spans the close of business in the United States and the opening of Europe's trading day.

- The possession of world class telecommunications and information technology markets and infrastructure.

  - The Australian telecommunications market is very competitive, and the most deregulated in Asia.

  - Increasingly, development of financial service firms is linked to world class information technology, for example the recent pressures being placed on traditional retail distribution services by e-enabled financial service providers and the race in e-broking to develop 'straight-through' processing for retail Internet broking activities. Australia has a substantial lead in the numbers and quality of IT staff.

  - Developments in technology and communication mean that distance is no longer as significant a constraint in the development of Australia's financial sector.

  - The Internet has provided effective channels of communication with existing customers and markets and the opportunity to gain access to new ones.

- A low cost, highly skilled and multilingual labour force.

  - Salaries of middle, senior and top management are much lower in Australia than in Hong Kong, Japan, Singapore, the US, the UK or Germany.

- Australian CBD office space costs a fraction of the cost of similar property in Tokyo, Hong Kong, Singapore and Beijing.

- Australia has high quality housing and urban environments, among the worlds best medical and education facilities, access to sporting, cultural and leisure facilities as well as a clean natural environment.

AUSTRALIA'S ECONOMIC PERFORMANCE AND THE POLICY ENVIRONMENT

A secure business environment has many dimensions spanning both political and economic elements. Australia's political stability has long been recognised. However, more recently, especially in the context of the Asian financial crisis, Australia has enhanced its reputation as a dynamic and resilient economy, owing in large part to the broadly based public policy framework that has been put in place over several years.

Economic Performance

The Australian economy has now grown at or above 4 per cent for the last 11 consecutive quarters — a growth rate unrivalled in the last 30 years. This has been a remarkable performance, as much of the growth has been achieved against the backdrop of the Asian financial crisis and major recession in many of our Asian trading partners.

The latest figures indicate that the Australian economy grew by a strong 4.3 per cent over the year to the December quarter 1999. Year average growth in 1998-99 was a strong 4.6 per cent, similar to the 4.8 per cent growth outcome for 1997-98.

Employment growth has strengthened and significant inroads have been made into reducing the unemployment rate. Over the 1990's, the number of people employed has risen by over 1 million or around 14 per cent, including an increase of 3.0 per cent over the year to February 2000. The unemployment rate has fallen from its peak of 11 per cent in the early 1990's; and in trend terms was 6.8 per cent in January 2000 — the lowest level since June 1990.

Inflation has been very subdued in the late 1990's. Over the 1990's, the CPI has averaged around 2.3 per cent per annum, which compares very favourably with the 1980's annual average of around 8.3 per cent. Market perceptions of Australia as a high inflation country have been dispelled.

Strong productivity growth has been a key factor in Australia's low inflation performance throughout the 1990's. Over the decade, labour productivity growth in Australia has been around 2.8 per cent per annum and higher at around 3.5 per cent per annum since March 1996.

- Despite strong employment growth and rising real wages, real unit labour costs have placed little upward pressure on labour costs due to increased productivity.

The Australian economy has the potential to sustain growth of around 3.5 to 4 per cent over the early years of this decade, supporting Australia's reputation as a dynamic economic performer with a vibrant financial system. As foreshadowed in the Mid-Year Economic and Fiscal Outlook, Australia's economic growth is expected to continue at a solid pace in 1999-2000, with further growth in employment and reductions in the unemployment rate. Business investment is forecast to continue to grow; business confidence and company profitability remain solid; and inflation is expected to remain within the Reserve Bank's 2 to 3 per cent band.

The Policy Framework

Australia's strong economic performance is the result of sound and transparent macroeconomic policies and an economy which has been made more flexible and resilient through an ongoing reform agenda. The policy framework now in place, along with the tax reform elements to be implemented over the next year or so, together provide a strong basis for enhancing Australia's development as a global financial centre. Improvements in the policy framework span both the operation of macroeconomic policies as well as the Government's microeconomic reform agenda.

- The credibility of Australia's fiscal policy has been improved by the adoption of a clearly articulated and demonstrated medium-term framework — to achieve fiscal balance, on average, over the course of the economic cycle — as well as the legislated Charter of Budget Honesty.
  - Consistent with this objective, the fiscal balance is expected to be 0.8 per cent of GDP in 1999-2000, taking into account more than $1 billion of previously unexpected expenditure associated with East Timor.

- The credibility of Australia's monetary policy was further enhanced in August 1996 by the joint Statement on the Conduct of Monetary Policy agreed between the Treasurer and the Governor of the Reserve Bank of Australia. The statement recognised the Bank's independence in the conduct of monetary policy (as provided by statute) and formalised the target of keeping inflation between 2 and 3 per cent, on average, over the economic cycle.

- The benefits of the Government's ongoing structural reforms in both the product and financial markets are demonstrated in an improved productivity performance and by the ability of Australian exporters to diversify their sales and adapt to change in recent years.

  - Throughout the 1990's significant reforms were made through the National Competition Policy initiative as well as to various infrastructure services that include water, gas, electricity, postal services, telecommunications and transport and also decentralisation of the labour market since 1996.

- The Wallis reforms to the financial system have produced a world class regulatory and prudential policy environment for the financial services sector.

  - The Wallis reforms have provided a more consistent regulatory framework for financial institutions; a framework that will help promote greater competition and market efficiency.

  - The reforms have been hailed by the International Monetary Fund as 'a package of path breaking reforms, which puts Australia at the forefront of international practice'.

- The Corporate Law Economic Reform Program (CLERP) is also providing Australia with a new framework that will deliver consistent regulation across financial products, financial service providers, markets and clearance settlement facilities, whilst maintaining market integrity and investor protection.

- The various industrial relations reforms which have been implemented since 1996 has resulted in more flexible workplace arrangements and contributed to productivity improvements and a very significant reduction in the number of days lost due to industrial disputation. In the last calendar year, Australia lost fewer working days to industrial disputation than at any time since 1913.

Tax Reform

The introduction of the *A New Tax System* from 1 July 2000 and the various business tax reform initiatives, represent a substantial overhaul of the Australian tax system. These reforms will play a major role in enhancing the competitiveness and overall operating efficiency of the Australian economy — and therefore Australia's attractiveness as a location for global financial services.

A 10 per cent broad-based goods and services tax (GST) will apply from 1 July 2000. At the same time, personal income tax rates will be significantly reduced so that 80 per cent of the population will pay no more than 30 cents in the dollar in personal income tax. The GST will replace a number of existing taxes including a number of inefficient taxes impacting on the financial services sector.

In June 1999, Commonwealth, State and Territory leaders endorsed an *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* which provides for the transfer of all goods and services tax (GST) revenues to the States and Territories (the States).

Access to the GST revenues allows the States to abolish, and not reintroduce, Financial Institutions Duty and stamp duty on quoted marketable securities from 1 July 2001, and debits tax, by 1 July 2005 subject to review by a Ministerial Council comprising Commonwealth and State Treasurers.

This will reduce the costs on the financial sector and the exports of financial services will be GST-free.

The Government has also announced the *New Business Tax System*, which contains various reforms to provide Australia with internationally competitive business tax arrangements. The package will reduce the company tax rate from 36 per cent to 34 per cent for the 2000-01 income tax year and 30 per cent thereafter, improve incentives for saving and investing, and reduce compliance burdens.

The business tax reforms will provide Australia with a company tax rate lower than most OECD countries, including the United States, and more in line with the rates of other countries in the Asia Pacific region. This improvement in our tax competitiveness will make Australia more attractive to foreign investors, including companies wanting to use Australia as a base for the provision of financial services.

Capital gains tax will also be reformed so that individuals and superannuation funds pay no more than 24.5 per cent and 10 per cent tax, respectively on capital gains on assets held for more than 12 months. This will remove impediments to efficient asset management, improve capital mobility and make Australia's capital gains tax internationally competitive. The changes took effect from 21 September 1999.

The business tax reforms will make Australia an extremely cost-effective location for conducting financial service activity in the Asia time zone.

Complimenting these reforms are initiatives announced by the Government in the *Investing for Growth* statement which have now been brought into effect by the *Taxation Laws Amendments Act (No.2) 1999* and are of particular relevance in promoting Australia as a financial centre.

The measures extend the eligibility for institutions wishing to become an Offshore Banking Unit. Funds managers, life insurance companies, including providers of custodial services, are now eligible to apply for offshore banking unit status. The range of eligible OBU activities has also been extended. Australia now has an effective OBU regime, which will contribute to the continued development of liquid domestic capital markets, particularly in the context of bullion, hedge funds and foreign exchange.

Interest withholding tax exemptions have been widened to include debenture issues by resident companies in Australia. This wider exemption will promote development of the domestic corporate debt market and open up this market to international investors. In this regard, the changes will facilitate greater depth and liquidity in both the local and Kangaroo bond markets.

Australian investors in certain US foreign investment funds will no longer be subject to annual taxation on the undistributed income of the US funds, including the unrealised capital gains of those funds. New exemptions are available for FIF interests in: entities that are treated as corporations and are subject to tax on their worldwide income under the US Internal Revenue Code of 1986; regulated investment companies; and real estate investment trusts (REITs) taxed as partnerships.

THE FINANCIAL CENTRE INITIATIVE

In recognition of the importance of effectively promoting Australia as a global financial centre, the Government allocated $7 million over two years in the 1999-2000 Budget to fund a number of financial centre initiatives.

The initiatives announced by the Prime Minister in May 1999, included the establishment of the Australian Centre for Global Finance (Centre), based in Sydney as the key responsible agency for progressing the financial centre strategy; the re-opening of a Treasury regional office in Singapore and the establishment of a Regulatory Advisory Committee.

Since the initiative was launched, there have been a number of companies in the financial services sector that have expressed an intention to move operations to Australia.

AUSTRALIAN CENTRE FOR GLOBAL FINANCE

The Centre was set up to develop and implement a program that enhanced Australia's position as a global financial centre. The Centre aims to promote awareness and a better understanding of Australian financial markets. It also provides the Government with policy advice on the issues which enhance Australia's attractiveness to global capital, including through education and training. The Centre also provides a vehicle for high level dialogue between the Government and financial service sector both foreign and domestic.

Even in the first few months of operation, it has provided a 'one stop shop' for foreign financial service organisations wishing to retain, develop and expand Australian and Australian based Asia Pacific business dealing with matters as diverse as visa applications and offshore banking unit authorisations.

Consistent with its objectives, the Centre's core business units are promotion, policy, information and analysis, and education and training.

Promotion

Central to the work of the Centre is the need to overcome the outdated impressions of Australia and its business and finance sectors. It is the challenge of the Centre's promotional campaign to alter these perceptions and to replace them with a vision of Australia as a vibrant and internationally attractive centre in the Asia Pacific time zone.

The Centre's promotion strategy involves:

- The development of key messages for a broad audience in the international financial services.
- A focussed promotion campaign to targeted investment prospects.
- Maximising the effectiveness of the Minister and other key Government figures in promoting Australia as a financial service centre.
- The monitoring of Australia's competitive advantages.

As part of its overall strategy, the Centre is coordinating its promotional efforts with other State and Federal government departments and agencies in order to capitalise to the greatest possible extent on opportunities to promote Australia as the most attractive destination for international financial activity in the region. The strategy will include a clear implementation program for working with Invest Australia.

Centre Web Site

In recognition of the importance of technology to the emerging future of financial service organisations and to assist with the promotion of the initiative, the Centre has developed a state of the art web site. The Treasurer and the Minister for Financial Services and Regulation launched the Centre's web site (www.globalcentre.asn.au) in Melbourne on 1 December 1999.

The web site details the Australian economic, business and regulatory environments as well as the domestic financial sector. It also contains information on the Asia Pacific, Australia's comparative position in the region, research and training and links users to a number of other useful sites.

Events

The Centre's strategy in part seeks to build on existing initiatives in relation to the Olympics program, Australia's growing presence in the World Economic Forum and our participation in the Celebration of Federation in London in July 2000.

The Centre is developing a highly targeted marketing strategy predominantly focussed on direct approaches to leading institutions at the strategic influencer and CEO levels and high level bi-lateral meetings with individual corporations.

As part of this strategy, the Minister has undertaken visit programs to Hong Kong in April 1999, to Europe and North America in July 1999, to Singapore and Japan during September 1999, to Europe during October 1999 and to North America in March 2000.

Another element of this targeted approach has been the preparation of detailed briefings on the advantages that Australia's financial sector offers within the global finance market.[1] Other elements of the Centre's marketing strategy include:

- Advertising, including participation (sponsorship) in supplements in major overseas papers, journals etc.
- Ambassadorial dinners.[2]
- Suggesting proposals for the most effective use of key Government figures, for example the Prime Minister, Treasurer and the Minister for Financial Services and Regulation.
- Conferences and seminars.
- Round table forums and similar.
- Trade shows.
- Active media programs – editorial etc.[3]

Policy

Considerable effort has already been put into developing a strong policy framework aimed at ensuring a strong, sustainable economic performance. As discussed above, a number of policy initiatives specifically aimed at enhancing Australia's attractiveness as a global financial centre were also implemented in mid 1999.

Nonetheless, the Government recognises that there is a need for ongoing vigilance in identifying policy issues which may inhibit the development of Australia as a centre for

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[1] Initially this took the form of a 20 page booklet ***Australia your centre for global financial services in the Asia-Pacific.*** This material will now be replaced by material sourced from the Centre website and modular designed, client specific materials addressing in detail all of Australia's comparative advantages as a base for Asia-Pacific operations.

[2] These might involve 10-12 financial sector executives, 50 per cent of whom have substantial Australian operations and the balance being people in the process of making a decision.

[3] These initiatives would seek to leverage off the work of the Centre and continue to generate favourable coverage for Australia and the Centre's objectives in outlets such as the ***Economist, Forbes,*** the ***Financial Times,*** the ***Wall Street Journal, Barons, Fortune*** etc.

global financial services. The Centre has been active in creating opportunities for dialogue with a range of experts on various financial centre related policy issues.

Information and Analysis

The Centre is also seeking to develop and communicate a better understanding of the Australian financial services industry, its impact on the Australian economy and its standing in a global and particularly regional context. This aspect of the Centre's work is directed at informing the domestic debate, addressing wrong or outdated perceptions of Australia at home and in the international media and providing input to the Centre's promotion strategy.

This work will involve the Centre developing over time a comprehensive and targeted information infrastructure and vehicles for disseminating this information. As part of this work, the Centre will be producing a series of studies on the financial services industry. This work will draw on both private and public sector expertise and will involve a focussed consultative process.

Research, Education and Training

The importance of education, research and training, and in particular the availability of adequate numbers of skilled personnel, have been recurring themes in the development of the 'Australia as a financial centre' concept. The Government has articulated the broad aim of establishing and/or enhancing the reputation of Australia as a centre of excellence in the provision of education, training and research to the financial services industry, and related sectors. In formulating an approach, the Centre has recognised that there already a large number of established research bodies and institutions, and, private and public education and training providers (as well active corporate participants).

At the most basic level, Australia needs to ensure the right mix and level of skills are available to meet the demands of new entrants to, and existing participants in, the Australian market, particularly having regard to the high international mobility of senior financial sector personnel.

A comprehensive schedule of consultation has been put in place by the Centre to assess a range of key factors in determining an appropriate and achievable strategy for implementation. These include, but are not limited to:

- industry attitude and needs;
- Federal and State Government policies and programs already in place;
- research, education and training initiatives currently in place under the auspices of the wide range of education and training providers in Australia;
- current and potential skills base available;
- international recognition and standing of existing Australian courses and qualifications;
- employment statistics of Australian graduates;
- competition in this area from other countries;
- elements of success in brand recognition of world renowned institutions in specific disciplines; and
- knowledge/attitudes/choices of school leavers in relation to the financial services area as a viable and attractive career choice/path.

Partnerships between the financial sector, government and the tertiary sector appear to be common to a number of recognised global financial centres such as London and New York.

While the Government has articulated a broad aim in relation to strengthening the partnership approach in this country, and some cooperative work is underway between industry and government (for example industry sponsored PhD students at the Sydney Futures Exchange), there is little coordination of activity or general knowledge of actual programs or opportunities.

Overall the industry has had a minor role in determining directions for relevant research or training, and this is one aspect of the comprehensive strategy development that is being considered in the Centre.

As an example of the type of program that may be considered for long term support by the Government, the Australian Centre for Global Finance has initiated an Honours/Fourth Year Scholarship program in the year 2000. The program is for university students in a range of academic disciplines that are relevant to the financial services sector. Whilst this is a new initiative, it will be carefully reviewed during this year to assess its impact and effectiveness. The program is supporting eight students in 2000.

SINGAPORE TREASURY OFFICE

The Treasury Office in Singapore has been re-opened as part of Australia's High Commission. The role of the office is to assist in improving the quality of advice on regional economic and financial developments to the Government.

REGULATORY ADVISORY COMMITTEE

The Regulatory Advisory Committee has also been established to assist the work of the Centre through considering financial centre regulatory and promotion issues. The Committee is made up of the Treasury (Chair), the Reserve Bank of Australia, the Australian Prudential Regulatory Authority, the Australian Securities and Investments Commission, the Australian Competition and Consumer Commission, the Australian Bureau of Statistics, the Australian Taxation Office and the Australian Centre for Global Finance.

CONSTRAINTS AND CHALLENGES

It is important to appreciate that Australia's development as a global financial centre is a gradual process that will require an ongoing commitment by all relevant stakeholders. It is a 'brick by brick' construction exercise that will take time.

Although Australia enjoys a number of important strategic advantages, it does face a number of constraints and challenges. Our continued development as a global financial centre will to a large extent depend upon our effectiveness in responding to these. This does not only involve efforts by government, but by all stakeholders.

The major, on-going challenge for Australia is to ensure that it maintains responsible macro and micro economic policies — the basis for strong, sustainable growth. The retention of an efficient, competitive and open economy will require a willingness to adjust to change and address distortions as they become evident. Within that overall goal, there are a number of areas that are of particular importance to the development of Australia as a financial centre.

While major steps have been taken to establish a world class prudential and regulatory policy framework, continued efforts will be needed to maintain and improve that framework — particularly in the context of a rapidly changing financial sector, driven by technological development and increased internationalisation. This is reflected, for example, in the continued implementation of the efficient regulation of the financial services sector and the further development of prudential supervisory arrangements for the financial sector.

Ensuring that we maintain an internationally competitive, efficient, equitable and certain tax system is also an important part of the policy challenge. While Australia should not, and cannot, seek to replicate the tax concessions offered by some of our competitors, it is important for our tax system to remain competitive.

The business tax reforms, including the decrease in the corporate tax rate, will significantly enhance Australia's competitive position, particularly vis-à-vis countries such as the United States and United Kingdom - and consequently promote increased capital flows as well as make us a more attractive location for financial service operations. The new corporate tax rates will also bring us closer in line with other countries in the Asia Pacific region.

It is commonly argued that the aggressive tax policies of a number of our financial centre competitors pose a constraint on Australia's financial centre ambitions. In this regard, it is likely that Australia will continue to face aggressive international tax competition, particularly from our key regional competitors who rely on tax incentives for the development of their financial centres.

There are, however, limits to our ability to compete on tax grounds and well-recognised dangers in even attempting to do so. It is also important not to lose sight of the fact that tax considerations are but one factor in determining location or business decisions. A tax reform package that improves our competitiveness in a global context, provides for greater efficiency and, importantly, is fiscally sustainable, is likely to prove more effective in the long term and contribute to the overall environment of certainty and stability that business seeks.

The further development of efficient communications networks is also crucial for the future development of the financial sector — and the economy more broadly. Australia has always had to contend with the tyranny of distance in its economic development. Modern communications and technological innovations have certainly made a significant impact in reducing the significance of this barrier and will continue to do so. As noted earlier, Australia also has advantages in this sector relative to its key competitors. However, our physical distance from the key global markets will continue to present challenges. This will require an ongoing commitment to competitive market structures in the communications sector and investment in the sector which will enable technological innovations to be exploited. It is just as important that we will also have to continue to work hard at developing and maintaining our international business networks.

In conclusion, it should be noted that the policy challenge for Australia does not only relate to our domestic policy arrangements.

Despite the intensity of the regional and international competition in the market for global financial services, it is in the interests of all participants for the total Asian Pacific financial services sector 'pie' to increase. The larger the market for global financial services, the greater the opportunities will be for those who are competitive in the provision of global financial services.

All countries with an interest in the global financial services sector, should therefore be seeking to put in place policy frameworks that facilitate the growth of the financial services sector. In this regard, it will be important for Australia to work with countries in the region to improve regulatory and policy frameworks to support regional economies and markets.

The Treasury
April 2000

ATTACHMENT A

OVERVIEW OF THE AUSTRALIAN FINANCIAL SECTOR

The Australian financial sector is a significant market in its own right, with turnover rising by 11 per cent to more than $A38,400 billion (about $US26,000 billion) in 1998-99. Australia's exports of financial services (including insurance) in 1998-99 were $1.6 billion, 0.3 per cent of GDP and 1.4 per cent of total exports (up five fold in nominal terms on a decade earlier).

Equities

The Australian Stock Exchange operates the premier market for listed equity securities in Australia.

- At the end of February 2000, the domestic market was capitalised at over $A658 billion ($US404 billion) and was ranked 13th in the world in December 1999 (highest in the Pacific, excluding Japan).
    - The market capitalisation of overseas companies on the ASX was around $A181 billion ($US111 billion) at the end of February 2000.
- The domestic market is home to liquid trading in the securities of around 1300 listed entities. Listed companies include a number of well known Australian-based multinational corporations, including National Australia Bank, News Corporation, Fosters Brewing, BHP, Telstra, Qantas and Lend Lease Corporation.

In 1998, the ASX demutualised to become a 'for profit' organisation, and was one of the first exchanges in the world to list on its own market.

Futures

The Sydney Futures Exchange (SFE) is the largest financial futures exchange in Asia (in terms of trading volume) and is ranked 12th in the *Futures Industry* top 40 global futures and exchanges (in terms of futures volume). The SFE's turnover in 1998-99 was over $A10.2 trillion (over $US6.4 trillion).

- The SFE offers direct access to the New York Mercantile Exchange and trades futures contracts over a diverse range of underlying commodities, including three and ten year Government bonds, 90-day bank bills, electricity and the Australian Share Price Index.

There is also a strong and sophisticated over the counter market for futures contracts in Australia. These contracts are more tailored than exchange-traded futures, as they are negotiated between individual parties.

Foreign Exchange

The Australian dollar is the 7th most traded currency in the world.
In April 1998, the Australian Foreign Exchange market was ranked 9th in the world by turnover.

- Aggregate daily average turnover of all currencies in 1998-99 was $A77 billion (over $US48 billion), up by 50 per cent over 3 years.

The truly global nature of the world foreign exchange market means the Australian dollar can be traded against virtually any currency in the world, 24 hours a day.
Australia also has the advantage that its market is open when the US market is closed.

Fixed Interest

Between June 1995 and January 2000, the Australian bond market has increased in size by over 14 per cent to around $A188 billion ($US123 billion).

Non-Government Debt Securities (Long Term)

Australia has a small, but vibrant and fast-growing corporate bond market, with both domestic and offshore institutions issuing in the Australian market. Issues of Australian denominated debt by overseas institutions are often referred to as the 'Kangaroo Bond' market.

- Domestic non-government bond issuance has almost tripled since June 1995 to $A64 billion (US$41 billion) in January 2000.

- The major issuers were asset backed corporate issuers ($A22 billion), financial institutions ($A20 billion), other corporates ($A13 billion) and non-residents ($A9 billion).

Government Debt Securities (Long Term)

Although Australia has a deep and liquid market for the trading of high grade Government debt securities, in recent times the value of Government bond issuance has declined from $A146 billion in June 1995 to $A126 billion ($US81 billion) in January 2000. This reflects continuing budget surpluses.

Banking

Australia's banking sector is efficient, innovative and competitive, and is structured around four major retail banks holding over 64 per cent of total retail deposits, a small number of regional banks, and a large number of smaller institutions. There are also a significant number of foreign banks mainly involved in investment banking, although some offer retail-banking services.

- As at January 2000 there were 50 authorised banks in Australia, of which 36 were foreign owned and 14 were domestically owned.

- As at 31 December 1999, there were 108 money market corporations or merchant banks operating in Australia which provided around 4 per cent of total financial intermediary assets. These institutions are predominantly involved in wholesale and investment banking and around half their assets are owned by foreign banks (as at June 1999).

Managed Funds

The value of Australia's funds under management at 31 December 1999 was $A646 billion ($US422 billion), (an increase of 6 per cent over the past 6 months, and 15 per cent over the past 12 months).

- The industry expects total funds under management will continue to increase rapidly and approach $US900 billion (on current exchange rates) by 2003.

The largest increase in funds managed by institutions over the 6 month period ending 31 December 1999, was in superannuation funds, up $A15 billion (7 per cent) to $A247 billion (consolidated).

- Growth in Australian superannuation assets is the second fastest among the OECD.

Both the total size of funds under management and recent growth rates in the Australian sector compare favourably with developments in other countries in the region.

- The Monetary Authority of Singapore recently released information indicating that at end June 1999, — total discretionary funds under management were around $US83 billion — less than one quarter of the size of the Australian market.

- According to a recent article in the Asian Wall Street Journal, Hong Kong Investment Funds Association reported $US121 billion funds under management at end April 1999 (indicating that the market is less than one third the size of the Australian market).

Life Insurance

Life insurance companies, through statutory funds, offer a range of risk, long term savings and retirement income products to the public.

- In March 2000, there were approximately 100 entities that were supervised by the Australian Prudential Regulation Authority under the *Life Insurance Act 1995*.
- As at December 1999, life insurance companies managed over $A177 billion and at that time this accounted for around 30 per cent of total managed funds in Australia.

- The majority of assets held by life insurance companies are managed on behalf of superannuation funds (ie around 82 per cent of the asset held in life insurance companies' statutory funds as at June 1999).

General Insurance

General insurance (which includes all insurance and reinsurance other than life and health insurance) is a mature, diversified, highly competitive industry with strong prospects for future growth.

- In February 2000, there were 159 general insurers in the private sector licensed under the *Insurance Act 1973*, with many of these being specialist or niche companies in the industry.

Total assets for the general insurance industry at the end of September 1999, were $57 billion for the private sector. Private sector premium revenue for the year to September 1999 amounted to $14.7 billion, up 2.5 per cent on the previous year.

ATTACHMENT B

AUSTRALIA'S ADVANTAGES AS A CENTRE FOR GLOBAL FINANCIAL SERVICES

Time zone

Australian business hours span the closing of those in the US and the opening of business in Europe. Close of business (at 6:00pm) in New York is 9:00am in Australia (Eastern Standard Time) while the commencement of the business day (8:00am) in London is 6:00pm in Australia (Eastern Standard Time).

Telecommunications

Australia's telecommunications services are globally competitive and a deregulated market is continuing to generate further cost reductions.

- The cost of international phone calls from Australia has fallen significantly in recent years. For example, the charge per minute of a call to the United States or United Kingdom at peak rates has fallen by over 70 per cent since June 1997.

- In 1997, total spending in the telecommunications market in Australia was US$16.9 billion, compared with US$152 billion in Japan, US$3.7 billion in Singapore, and US$8.8 billion in Hong Kong[4].

Australian consumers are among the most advanced and sophisticated users of information and communication technologies in the world. Australia has more computers per capita than any other country in the region and is second only to the USA in per capita ownership in the world. It also has the largest number of Internet service providers per capita in Asia.

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[4] Invest Australia (1999) *A Wealth of Opportunities*, Department of Industry, Science and Resources: Australia, p. 20.

- In 1997, total spending in the IT market in Australia was US$16.6 billion, compared with US$164.7 billion in Japan, US$3.7 billion in Singapore and US$3.2 billion in Hong Kong[5].

- In 1998, Australia had 431 computers per 1000 population, compared with 344 in Singapore, 310 in Hong Kong and 272 in Japan[6].

- In 1998, Australia had 41.95 connections to the Internet per 1000 population, compared with 13.45 in Singapore, 20.09 in Hong Kong, and 11.03 in Japan[7].

Labour force

Professional and highly skilled employee's salaries are cost competitive in the region.

- Salaries for professionals and executives in Australia are more than 27 per cent lower than in Singapore, more than 45 per cent lower than in Tokyo and up to 58 per cent lower than in Hong Kong[8].

Australia has a well-qualified workforce.

- 42 per cent of 20 to 24 year olds Australians are enrolled in higher education compared with 38 percent of Singaporeans, 30 per cent of Japanese and 21 per cent of the Hong Kong population[9].

- The 1998 Quality of Skilled Labour Survey (rating from 0 to 10, with 0 being the best) rated Australia at 2.9 compared with Singapore at 4.1, Hong Kong at 4.3 and Japan at 3.6[10].

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[5] ibid.

[6] ibid.

[7] EMF Foundation (1999) *World Competitiveness Yearbook*, Geneva: The Foundation, p. 441.

[8] Invest Australia (1999) *A Wealth of Opportunities*, Department of Industry, Science and Resources: Australia, p. 30.

[9] EMF Foundation (1998) *World Competitiveness Yearbook*, Geneva: The Foundation.

[10] 10 Invest Australia (1999) *A Wealth of Opportunities*, Australia: Department of Industry, Science and Resources, p. 19.

- The 1998 Availability of Skilled Labour Survey (rating from 0 to 10, with 0 being the best) rated Australia at 4.1 compared with Singapore at 4.8, Hong Kong at 4.5 and Japan at 3.0[11].

- Australians possess a wide diversity of language skills covering both European and Asian languages. Around 2.5 million Australians (15 per cent of the population) speak a language other than English at home and 800 000 Australians speak an Asian language[12]

Office Space Costs

The cost of prime CBD office space in Australia is significantly lower than that of similar property in Tokyo, Hong Kong, Singapore and Beijing. Outer metropolitan industrial land prices in Australia are among the cheapest in the region, yet are fully supported by telecommunications, utilities and transport infrastructure.

- As at 30 June 1998, the cost per square metre of prime office space in the CBD was, between US$57 and US$392 in Australia, compared with US$427 and US$610 in Tokyo, US$884 and US$1284 in Hong Kong, and US$447 and US$527 in Singapore[13]

- As at 30 June 1998, the cost per square metre of industrial property was between US$30 and US$84 in Australia, compared with US$130 and US$222 in Tokyo, US$167 and US$189 in Hong Kong and US$144 and US$173 in Singapore[14].

- In 1998 the electricity costs per kWh for industrial clients was, US$0.056 in Australia compared with US$0.056 in Singapore, US$0.145 in Japan and US$0.105 in Hong Kong[15].

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[11] ibid.

[12] ibid.

[13] ibid., p. 32.

[14] Ibid.

[15] EMF Foundation (1999) *World Competitiveness Yearbook*, Geneva: The Foundation, p. 437.

Superior quality of life

- Australia's quality of life is regarded as one of the best in the world. It rates (on a scale of 0 to 10, with 10 equalling the highest quality of life) as 9.188, compared with Singapore at 8.00, Hong Kong at 6.211 and Japan at 6.016[16].

- The cost of living in Australia is significantly lower than other countries in Asia. The Cost of Living Index (New York City=100) lists Australia as 94.30 compared with Japan at 142.05, Hong Kong at 131.38 and Singapore at 104.16[17].

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[16] ibid., p. 505.

[17] ibid., p. 365.