

Senate Select Committee on Superannuation and Financial Services

Main Inquiry Reference (b)

Submission No. 14

Submittor: Dr George Gilligan
Logan Research Fellow
Faculty of Business & Economics
Dept of Business Law & Taxation
Monash University
Wellington Road
CLAYTON VIC 3168
 - (03) 9905 5560
 - (03) 9905 9111



Dr George Gilligan
Logan Research Fellow

Tel: + 61 3 9905 5560
Fax: + 61 3 99059111

E-Mail: george.gilligan@buseco.monash.edu.au

FACULTY OF BUSINESS AND ECONOMICS
DEPARTMENT OF BUSINESS LAW AND TAXATION
Wellington Road
Clayton
Victoria 3168 Australia
Tel: +61 3 9905 9100
Fax: +61 3 9905 9111
Email: enquiries.blbt@buseco.monash.edu.au

12 May 2000

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

Dear Ms Morton

Re: Inquiry into Superannuation and Financial Services

Thank you for your invitation to make a submission to the Committee's inquiry. Given my areas of research interest, my comments relate only to part (b) of the Senate Select Committee's terms of reference:

"..the opportunities and constraints for Australia to become a centre for the provision of global financial services.."

If the Committee requires more information on any of the issues raised in this submission, I am happy to provide whatever assistance I can.

Yours sincerely

Dr George Gilligan
Logan Research Fellow

**SUBMISSION BY Dr GEORGE GILLIGAN, LOGAN RESEARCH FELLOW,
DEPARTMENT OF BUSINESS LAW AND TAXATION, MONASH
UNIVERSITY TO THE SENATE SELECT COMMITTEE ON
SUPERANNUATION AND FINANCIAL SERVICES RE:**

(b) the opportunities and constraints for Australia to become a centre for the provision of global financial services.

Background

I am a criminologist who has taught at the universities of Cambridge, Exeter, La Trobe, Melbourne, Monash and Middlesex. My research projects and publications focus on the regulation of the financial services sector, white-collar crime and organised crime. I do not feel qualified to comment on parts (a) and (c) of the Select Committee's inquiry, so I will confine my observations to factors influencing how Australia might develop as a centre for providing global financial services.

Introduction

It is important to stress that under conditions of late-modern capitalism the world and national economies are becoming more internationalised and interdependent, and the financial services sector has been in the vanguard of these trends. The process of internationalisation of financial markets has been motivated by complex sets of interactive forces, of which liberalisation of domestic and international markets and continuing innovation in information technology have been the most important. They have transformed fundamentally the capabilities of financial institutions and others to manage investment portfolios and other financial activities in all parts of the world. One consequence of these developments is that regulatory structures and processes also are becoming more internationalised and it is within this context that the Australian financial services industry and this Select Committee seek to expand Australia's role as a provider of global financial services.

What factors can help improve Australia's status as a provider of global financial services?

The question of what specific factors shape Australia's capability to act as a provider of global financial services is the key issue regarding part (b) of the Select Committee's Inquiry. Regarding this issue, the Committee has heard already, and will continue to hear, testimony from a range of distinguished and expert Australian professional sources. I thought it might be useful to introduce a small element of an overseas perspective, so I contacted a colleague in the United States (US) who is a senior securities regulator with more than twenty years experience and asked him what he saw as the key factors affecting Australia's growth as a provider of financial services. He considered the following to be significant:

- Investor confidence in the rule of law
- Lack of government corruption
- Integrity of the market professionals
- Substantial domestic investment
- First class telecommunications
- Avoidance of excessive government or industry regulatory expense
- Appropriate taxation
- Appropriate regulatory system

This is by no means an exhaustive list, but it is a useful exercise to ponder how Australia is currently situated regarding these specific issues, and then consider other influences that are either opportunities or constraints on Australia's further development in this area. By and large Australia scores well on the issues listed above:

- **Investor confidence in the rule of law** Generally both within Australia and internationally, there are substantial levels of investor confidence regarding the rule of law. The determination of Australian regulatory authorities to maintain these high levels of confidence was illustrated in the actions taken against Nomura International plc for market manipulation.¹ However, a series of recent judicial decisions,² have caused uncertainty regarding the integrity of the national scheme of corporations law in Australia and it is imperative that this situation is resolved speedily, as one of the many negative consequences of this uncertainty is that investor confidence in Australia may be undermined.

Recommendation: The Select Committee should contribute towards efforts to increase regulatory certainty regarding Australia's national system of corporation law

- **Lack of government corruption** Australia is undoubtedly one of the least corrupt countries in the world and has a distinguished record for honest and open government at both state and federal levels. This reputation is strengthened by the regulatory efforts of agencies such as the Australian Securities & Investments Commission (ASIC) and the Australian Prudential Regulatory Authority (APRA), and the transparency of the markets run by the Australian Stock Exchange Limited (ASX) and the Sydney Futures Exchange (SFE).
- **Integrity of the market professionals** It is extremely difficult to produce comparative empirical measures regarding the integrity of market

¹ ASIC v Nomura International plc (1999) 17 ACLC 55.

² The most significant recent judicial decisions in this area have been: *Re Wakim; ex parte McNally* (1999) 73 ALJR 839; (1999) 31 ACSR 99; 17 ACLC 1055; *Bond v The Queen* [2000] HCA 13; and *The Queen v Hughes* [2000] HCA 22.

professionals in financial centres around the world.³ However, it is reasonable to assert that market professionals in the Australian financial services sector enjoy a reputation for high standards of integrity.

- **Substantial domestic investment** There has been a surge in participation in financial services and share ownership by Australian citizens in recent years as shown in the table below which is derived from data gathered by the Australian Stock Exchange.⁴

Country	Direct share ownership	all forms of share ownership
Australia	41%	54%
USA	32%	52%
New Zealand	31%	48%
UK	30%	40%
Canada	26%	38%
Germany	13%	25%

- However, although Australia has the highest rates of share ownership in the world with 41 per cent of the population in direct share ownership and 54 per cent owning shares when managed investments are taken into account, Australians are more passive investors than their American counterparts. For example, in 1998 more than 35 per cent of Americans' financial assets were held in shares or managed investments, up from 24 per cent in 1992 and the figure is probably higher in 2000.⁵ These transformations in share ownership in recent years in developed economies mean that many more people are affected by, and interested in, the activities of financial markets than twenty, ten, or even five years ago. Consequently there is a growing need for Australians of all ages to become more aware of how financial services markets function and this educative goal should be a priority for the industry and government. Similarly, the issue of **critical mass** is vital to the growth of Australia's financial services sector. If more Australians become active investors then Australian markets will

³ In fact there is almost a complete absence of comparative material on this important topic. Currently I am conducting a comparative analysis (based on empirical field work) of how regulatory and industry professionals in six different countries perceive standards and patterns of compliance with financial services regulation in their jurisdictions. One element of the study is that it will produce broad indicators relating to the integrity of market professionals in different countries. The importance of cultural factors upon regulatory compliance within an industry such as financial services should not be underestimated. For a case study of the UK on this issue see: G.P. Gilligan, *Regulating the Financial Services Sector*, Kluwer Law International, London, 1999.

⁴ Australian Stock Exchange Ltd., *Share Ownership 2000*, Melbourne, 2000.

⁵ "The age of acquisitiveness", *The Australian Financial Review*, 10 April 2000, p.44

grow and this is likely to encourage higher levels of inward capital to both Australia's financial markets and its providers of financial services.

Recommendation: The Select Committee should lobby for increased public education programmes regarding financial services, building on the efforts of ASIC, ASX and other organisations.

- **First class telecommunications** Australia has a well-developed system of telecommunications and its exchanges operate sophisticated automated clearing systems. If the mooted alliances (discussed in more detail below) between Australian exchanges and overseas counterparts do occur, then telecommunications capability within the Australian financial services sector should improve further.

Recommendation: Given likely developments in e-commerce globally and especially in relation to financial services, improvements in Australia's telecommunications should be a core priority for Government economic strategy.

- **Avoidance of excessive government or industry regulatory expense** In most countries, most businesses are likely to complain that it costs too much to meet government and industry regulatory requirements. Securities markets play a key role in a mixed capital economy and in order to protect the public interest they are one of the most conspicuously regulated areas of most economies. In Australia there have been significant efforts in recent years (e.g. the Corporate Law Economic Reform Program - CLERP) to try and simplify various regulatory regimes, but there is a popular perception that the costs of regulatory compliance should be reduced.

- **Appropriate taxation** Taxation is always an important political issue, but it has been perhaps the most important in Australia in recent times. The impending Goods and Services Tax (GST) is a fundamental reform and there has been criticism of how it is likely to impact on Australia's capability as a provider of global financial services. Australia has a reputation as a "high tax" country and this impedes its development as a finance centre. Capital Gains Tax issues can be a major factor in investment decisions by overseas institutions and Australia must try to be competitive in this area. Taxation issues are critical to the success of finance centres and competition can be fierce between different countries. This has been evident in recent times in the disputes between the United Kingdom (UK) and its European Union (EU) partners on this issue and it is informative for Australia as it seeks to raise its status as a provider of global financial services. Taxation competition is especially important for the offshore finance industry.⁶ For example, Dublin has expanded rapidly as a finance centre in recent years due mainly to its innovations regarding taxation issues and offshore finance.

⁶ Indeed the genesis for the establishment of the Eurodollar markets in London in the mid 1960s was the introduction in the US of the Interest Equalization Tax in 1963.

Recommendation: The Select Committee should lobby for Australia's competitive position as a finance centre to be accorded a high priority in policy debates on taxation.

- **Appropriate regulatory system** Leaving aside debates about taxation, the core regulatory structure relating to Australia's financial services sector (post Wallis Inquiry),⁷ with ASIC, APRA and the Reserve Bank as the key players is a good model in my view. It is appropriate that the apex of regulatory structures in the Australian financial services sector should have a public agency character and regard for prudential supervision. However, it is important to ensure that the competitive priorities of the industry also are prioritised in the development of regulatory policy. Increasing levels of secondment of individuals between industry, regulatory agencies and government departments would be mutually beneficial and help promote cohesion in regulatory praxis.

Recommendation: There should be a continuing emphasis on initiatives that can raise Australia's competitiveness through coordinated financial services industry: government liaison and evaluation at both policy development and operational levels.

So, it can be seen regarding the subjects briefly discussed above that Australia is well placed to expand its role as a finance centre. Other important factors include:

- **Strategic alliances** There has been much comment about the potential that Australia's position as a *trading time-zone* offers and Australia does complement the conventional trading hours of established finance centres in Europe and North America. However, the *trading time-zone* advantages of Australia may have been overstated and the *critical mass* issue in Australian financial markets discussed earlier is probably of more importance. The relatively small size (in global terms) of Australia's population and financial markets, allied with its relative isolation geographically, renders it somewhat isolated in terms of global political and economic strategic partnerships in comparison to EU Member States for example. Consequently, it is eminently sensible in a globalised financial sector for Australian exchanges and financial institutions to seek strategic-alliances-around-the-world. Recent developments in this area include the announcement of a merger of equals between the London Stock Exchange and Frankfurt's Deutsche Boerse "...to create a new company to be called iX. In addition, iX and Nasdaq have signed a memorandum of understanding to create a pan-European, high growth market."⁸ This has specific significance for Australia because of proposals by the ASX to link with the merged London-Frankfurt exchange.⁹ The ASX also is considering a merger with the New Zealand Stock Exchange.¹⁰ These

⁷ *Financial System Inquiry Final Report* (the "Wallis Report"), Australian Government Publishing Service, Canberra, 1997.

⁸ <http://www.londonstockexchange.com/about/releases/03-5-00.htm>.

⁹ I. Ries, "ASX takes step into Europe", *The Australian Financial Review*, 10/5/00, p.1.

¹⁰ J. Boyle, "Trans-Tasman exchange merger also on the cards", *The Australian Financial Review*, 10/5/00, p.22.

developments are sensible strategies for the ASX to consider, but these types of cooperative arrangements between exchanges can be difficult to finalise. For example, iX may now be a reality but in September 1999 (14 months after the London: Frankfurt alliance was first announced), *The Economist* declared that the ‘...alliance between the London and Frankfurt stock exchanges is dead in all but name.’¹¹ Subsequent developments attest to the fact the death of this deal was greatly exaggerated, but it took a long time to complete the deal and the ASX may face similar difficulties regarding its global strategies. Certainly in the past the SFE has experienced some difficulties in its efforts to engage in joint venture agreements. However, substantive international cross-holdings and mutual interests represent the most realistic pathway for Australian exchanges to become global players in financial services.

Recommendation: The Select Committee should support (in principle) the globalising strategies of Australian exchanges and financial institutions (including cross-equity ownership), subject to appropriate national interest guidelines.

- **Skills differentiation** This is an area in which Australia may have an edge over some of its competitors regarding the provision of global financial services. Australia can provide a highly educated multicultural workforce with diverse sets of professional, technical and language skills. The relative salary costs to organisations of the Australian labour force is low in comparison to other advanced economies. However, the future needs of Australia as it seeks to become a greater provider of global financial services may have to be factored as a priority into government immigration policies.
- **Environmental factors** Australia as a centre for providing global financial services can offer substantive benefits in comparison to many of its competitors. These include urban environments that provide a high quality of social, cultural and professional life at moderate cost compared to cities such as London, New York and Tokyo. Office costs in the Central Business Districts of Australian capital cities are low on an international scale.
- **The sensible management of risk and promotion of risk taking** As a final comment, the challenge for the Australian Government, the Australian financial services sector and relevant regulatory agencies in promoting Australia as a global provider of financial services, is to create structures and processes that balance the protection of national interests and the prudentially organised management of risk within financial services with globally integrated markets that seek to maximize entrepreneurial use of capital. This requires a wholistic cooperative approach that appreciates that there can be a mutually sustaining symbiosis between market capitalism, ethics and law.

**Dr George Peter Gilligan,
May 2000**

¹¹ ‘The quick and the dead’, *The Economist*, 18/9/00, p.88.