



Australian Government
Productivity Commission

Barriers to Growth in Service Exports

Productivity Commission
Draft Report

August 2015

This is a draft report prepared for further public consultation and input. The Commission will finalise its report after these processes have taken place.

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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).

Opportunity for further comment

You are invited to examine this draft report and comment on it by written submission to the Productivity Commission, preferably in electronic format, by **Friday 18 September 2015**. Further information on how to provide a submission is included on the study website <http://www.pc.gov.au/inquiries/current/service-exports/make-submission>. The final report will be prepared after further submissions have been received.

Commissioners

For the purposes of this study the Commissioner is:

Angela MacRae

Commissioner

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.

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]

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the research report.

Draft

Contents

Opportunity for further comment	iii
Terms of reference	iv
Abbreviations	ix
Overview	1
Draft recommendations and information requests	33
1 Introduction	41
1.1 What has the Commission been asked to do?	41
1.2 Understanding service exports	43
1.3 What is a barrier to service exports?	46
1.4 The structure of this report	46
1.5 How the Commission conducted the study	48
2 The analytical approach	49
2.1 Barriers to service exports	50
2.2 Assessing the potential benefits of reduced barriers to service exports	55
3 Australian service exports: trends and drivers	65
3.1 Services make up the majority of the economy	66
3.2 The value of Australian service exports	70
3.3 Key trends and drivers of Australian service exports	73
3.4 Australian service export sectors	76
4 Domestic barriers to service exports	95
4.1 Investment barriers	98
4.2 Barriers to attracting skilled employees	105
4.3 Export assistance schemes	115
5 International barriers to service exports	127
5.1 Overview of international barriers	128

5.2	Cross-border data flows	130
5.3	Intellectual property	136
5.4	Licensing and standards regulations	139
5.5	International investment barriers	143
5.6	Further evidence on international barriers	148
6	Financial services	151
6.1	Managed investment schemes	154
6.2	Traditional trustee services	164
6.3	Prudential regulation	167
6.4	Taxation arrangements for financial services	172
7	Education and health services	193
7.1	Australia's international education sector	194
7.2	Barriers to education service exports	195
7.3	Australia's health service exports	215
7.4	Barriers to health service exports	217
8	Tourism, professional services and information technology	223
8.1	Barriers to, and support for, international tourism	224
8.2	Professional services	241
8.3	Information technology	244
9	Addressing international barriers to service exports	247
9.1	Introduction	248
9.2	Mechanisms for addressing international barriers	249
9.3	Trade agreements	249
9.4	Other international agreements affecting service exports	257
9.5	Mutual recognition or harmonisation of standards	258
9.6	Encouraging regulatory reform through technical cooperation	264
9.7	Further information on addressing barriers	266
A	Public consultation	267
	References	273

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
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
EFIC	Export Finance and Insurance Corporation
EMDG	Export Market Development Grants
ESOS	Education Services for Overseas Students
ETF	Exchange-traded funds
FATA	<i>Foreign Acquisitions and Takeovers Act 1975</i> (Cwlth)
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
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
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
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

Key points

- The total value of Australian service exports was \$57 billion in 2013-14 and about 17 per cent of total exports. The six services sectors covered in this study — tourism, education, financial services, professional services, information technology and health services — accounted for around 85 per cent of the total value of service exports.
 - The total value of service exports from all sectors has doubled (in real terms) over the past two decades.
 - Rising household incomes, particularly in some countries in Asia, have been an important driver of increasing global demand for services. Visitors from Asia account for much of the growth in Australian tourism and education exports over the past decade.
 - The costs of exporting services have fallen due, in part, to lower airfares and the development of internet tools including email, online video and audio calls, and electronic payment systems.
- The priority for the Australian Government should be policy reform that promotes competition and provides incentives for domestic firms, including in services sectors, to innovate and lift their productivity. Specific reforms to reduce domestic barriers to service exports 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 gateway cities of Brisbane, Melbourne and Perth and, following this, Sydney — unless a published assessment shows the costs of liberalising access to Sydney Kingsford Smith 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 affect the education, health and professional service sectors, but are particularly costly for exports of financial services in key markets in Asia such as China, India and Indonesia.
 - 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.
 - All services providers seeking to export rely on the ability to move data across borders, making data restrictions costly. The financial services 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. The Australian Government can help by putting in place a framework in trade agreements for developing mutual recognition 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.

Overview

The opportunities for Australian service providers to participate in international trade are greater than ever before. 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 cheaper 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 services 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 Services sectors

The Commission has been asked to focus on six services 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 services 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 Australian service exports. A 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 address a market failure or to meet an equity objective, but that regulations should be the ‘least burdensome’ to achieve their objective. The challenge is distinguishing between measures that are unnecessarily restrictive and those that address a market failure or meet an equity objective in the least burdensome way.

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. Domestic policies that target a market failure or equity objective may, from the community’s perspective, have costs that exceed the benefits. Governments should only introduce policies, including policies designed to facilitate service exports, where doing so would be expected to provide net benefits to the community.

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 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. In some areas, the Commission has requested further information from study participants.

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 country or 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.

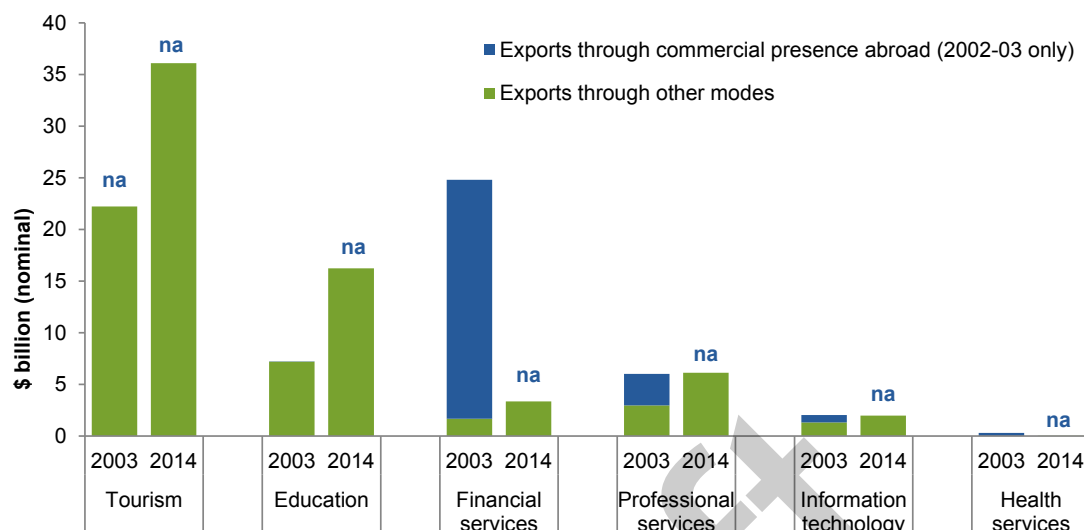
Service exports have doubled over the past 20 years

The total value of Australian service exports was \$57 billion in 2013-14 — about 17 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 in the proportion of total Australian exports that are services 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 service gross value added over the past two decades — both have doubled (in real terms) since 1993-94. The six services sectors covered in the study accounted for about \$48 billion (almost 85 per cent) of the total value of service exports from all sectors in 2013-14 (figure 1).

Education exports have grown at an average annual rate of 12 per cent over the past two decades and contributed around \$16 billion to the Australian economy in 2013-14. Just over \$7 billion was fees paid to education providers by international students studying in Australia. International students spent around \$8 billion on accommodation, food and transport while studying in Australia in 2013-14. 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.

Figure 1 Australian exports by services sector^a
2002-03 and 2013-14



^a Education-related travel (valued at \$15.9 billion in 2013-14) 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 2013-14 is too small to be visible. **na** Not available.

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.

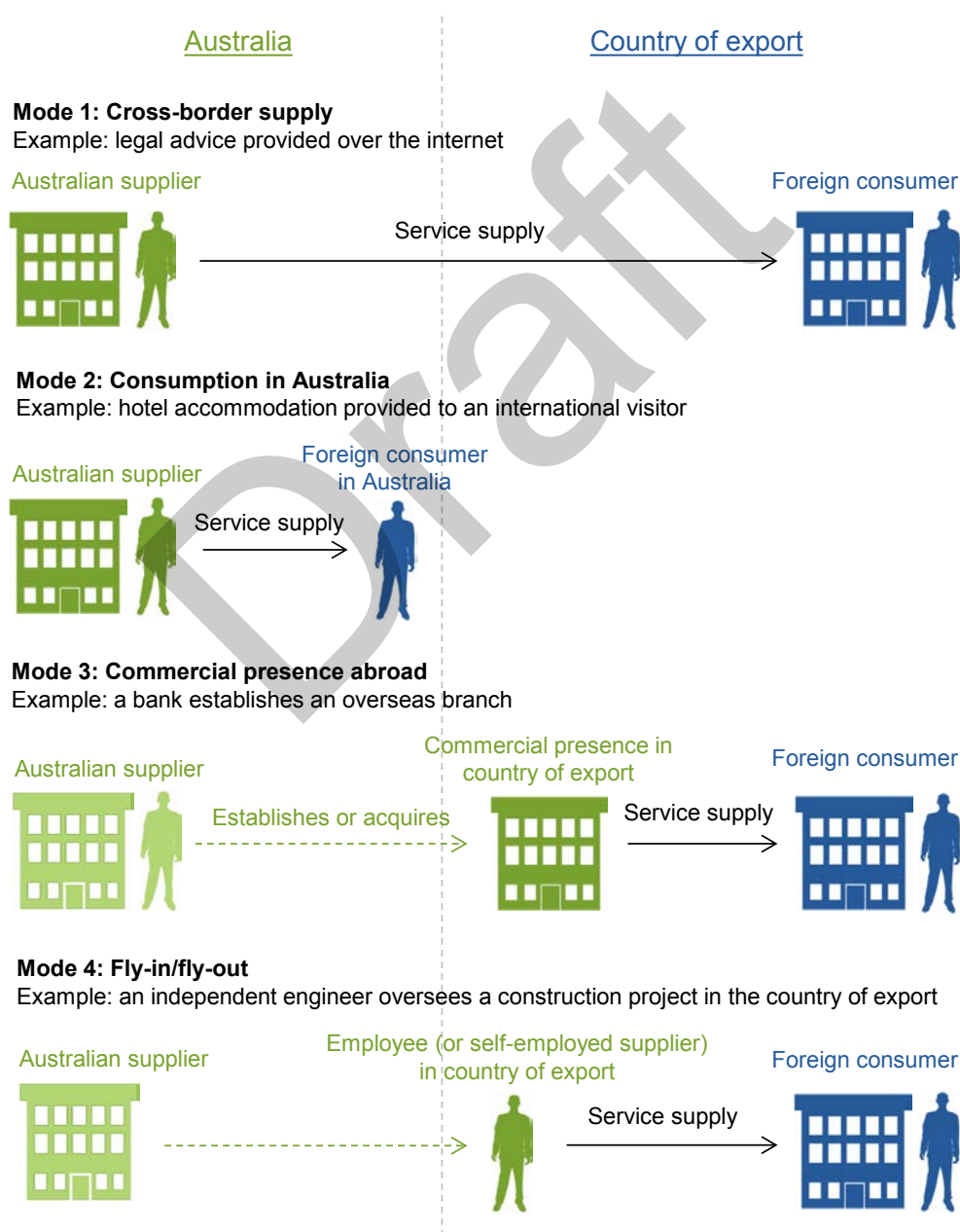
Services used as inputs in the production of goods typically account for a significant proportion of the value of goods exports and, as a result, gross measures of exports understate the contribution of services to total exports. Australian services sectors are estimated to have accounted for about 41 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.

The four modes through which services are exported are shown in figure 2. Unlike exports through other modes, service exports through commercial presence abroad are not included in Australia's balance of payments data — the predominant mode for financial service 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. 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. The ABS is currently reviewing its statistical output related to international accounts and expects to announce any decisions by September 2015. Assessment of Australia's service exports would be much enhanced should more comprehensive statistics become available — particularly in relation to the commercial presence abroad of Australian service providers.

Figure 2 **Modes of exporting services**



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 since 2012 growth in global service exports has outpaced Australian service exports). 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 demand for service exports. 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 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, although in 2014 the dollar remained about 12 per cent above 2004 levels.

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

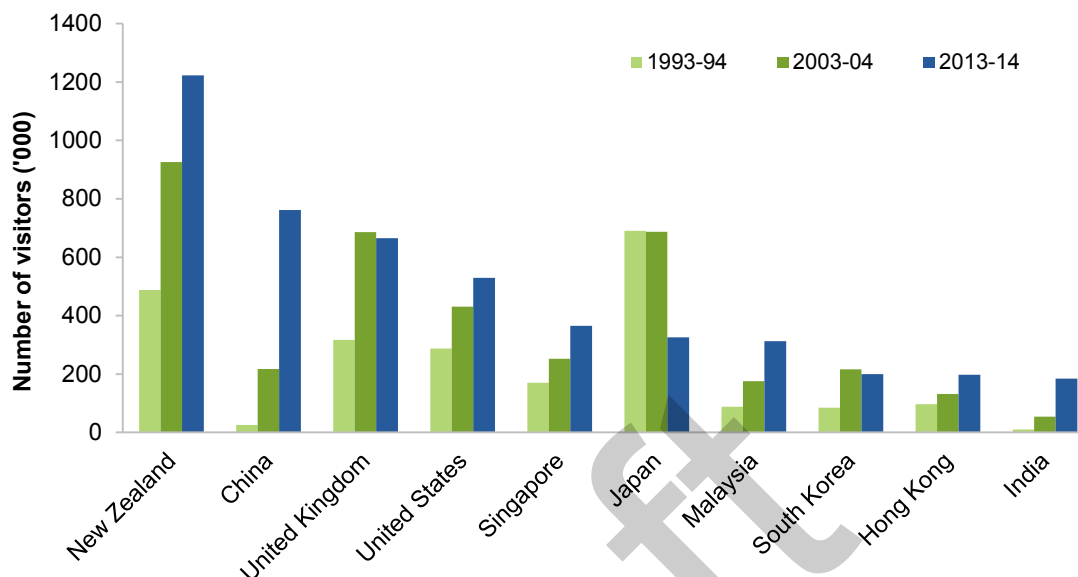
Rapid income growth in Asia is a primary driver of service exports from Australia. Real household incomes in China, for example, increased from about US\$190 per capita in 1980 to about US\$7600 per capita in 2014. Markets in Asia have been the fastest growing for Australian service exports, particularly China, which recorded average annual growth in the value of service exports of 12 per cent over the past ten years. 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 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 2013-14. Increased migration to Australia could have contributed to this growth, as friends and relatives of migrants may visit them in Australia.

Figure 3 Short-term visitors to Australia^a

Top ten source countries in 2013-14



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

Students from Asia accounted for about three quarters of all international student enrolments in Australia in 2014. In that year, students from China and India accounted for the largest proportion of enrolments — 26 per cent and 11 per cent respectively. Over the past decade, developing countries in Asia accounted for most of the growth in Australian education-related travel exports. 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 States and the United Kingdom, are running international destination marketing and other programs focused on attracting visitors from China. The United Kingdom, Thailand and India 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 heavily in onshore and offshore education services. Countries in Asia and the Middle East are developing world-class capacity in higher education and research, and 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 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. In 2011, about one fifth of international students gained permanent residency on graduation. The Australian 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 tourists’ 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 providers 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 study participants 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 fund 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' — 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 in three ways: 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, the United Kingdom, Indonesia and

Malaysia. 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, Thailand, Singapore and South Korea — 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 a more sophisticated market with countries specialising in types of care or procedures. For example, holidays and medical care are packaged together in Malaysia and 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. Australia also compares well on other aspects of quality such as the prevalence of antibiotic resistance rates, state of the health care system and safety measures.

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.

As is the case for tourism and education, demand for medical tourism is affected by the ease with which visitors are able to obtain the requisite visa. The Commission is seeking information on the extent to which current visa arrangements are affecting medical tourism in Australia.

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 25 000 out of 340 000 international enrolments) in Australian higher-education courses in 2013. 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

Professional service exports, such as architecture, engineering services and legal services tend to follow investment flows. 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. 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. Exports of other professional services can also follow infrastructure investment (box 3).

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 Europe, Asia and the Middle East. Currently, the firm's most significant international markets are 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 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 the 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.

The cost of exporting services is falling

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 electronic payment systems have greatly reduced the costs of delivering a range of services. 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 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 trading financial services that are now commonly traded online such as insurance, loans and brokerage. 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. Education institutions that follow this online model 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 2013-14, 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.

More than three quarters of the value of Australian financial service exports through commercial presence abroad was in English speaking countries — New Zealand, the United Kingdom, the United States and Singapore. English is also widely used in Hong Kong's sizable financial service sector, another important market for Australian service providers.

... and presenting export opportunities for Australian IT providers

Information technology consultancy services accounted for about two thirds of Australia's total information technology service exports in 2013-14 (\$1.3 billion). Exports of software licenses were significant in that year too, valued at a little over \$250 million. Technological advances, such as improvements in battery 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.

Exporters are benefiting from lower airfares

Service providers that rely on face-to-face modes of delivery, such as some Australian engineers or lawyers, have benefited from the declining price of travel, which 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 cost international 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.

Capturing the opportunities for growth in service exports

Barriers to service exports can take many forms — they are often indirectly applied through domestic regulations, may be discretionary in their administration, lack transparency and are difficult to quantify. The many different forms of barriers, and their cross-cutting nature, make an examination of the costs and benefits of further trade liberalisation — and informing the prioritisation of government effort — complex.

The Commission has identified three sectors that face sector-specific barriers to exporting — tourism, education and financial services. Information technology, professional services and in some cases health services are predominantly (although not exclusively) affected by more general barriers that affect all sectors. These more general barriers to service exports include restrictions on cross-border data flows, recognition of professional qualifications and the enforcement of intellectual property rights in overseas jurisdictions.

Tourism and education exports rely on sound domestic policy arrangements

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 agreements 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 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 activities can only be determined on a case-by-case basis through economic analysis prior to the activity proceeding. The complexity of the economic analysis should be commensurate to the value of government funding being considered and the analysis should be released publicly as soon as practicable. An ex post evaluation of the costs and

benefits following the completion of the activity, 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). Businesses in the tourism sector are extremely diverse (and may not even identify as being a service exporter), as is the distribution of the benefits arising from the additional visitor activity.

In contrast to the tourism sector, there is less of a case for government involvement in marketing and promotion of the higher education sector where the larger providers 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, unrestricted access (capacity) is provided to foreign airlines flying to and from all international airports in Australia other than the major gateway cities of Brisbane, Melbourne, Perth and Sydney — a policy referred to as the regional package. Under the regional package, access is restricted to secondary airports in the major gateway cities 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. Constraints on the ability of airlines to access Australia's major gateway cities could be impeding more efficient market outcomes and reducing demand for Australian service exports.

Providing foreign airlines with unrestricted access to operate services to and from all of Australia's major gateway cities would be expected to facilitate greater service exports, in the tourism sector but also in other service sectors where service providers rely on face-to-face delivery of their service. Australians travelling overseas would benefit from being able to travel at a potentially lower cost and/or from better quality and more frequent air services to a wider range of destinations. Providing unrestricted access to all secondary airports in the major gateway cities would also help to mitigate the effects of long-term physical capacity constraints at major airports that cannot be alleviated through efficient investment at those airports.

The Commission has not been presented with, nor found, any evidence that demonstrates that restricting access to any airport in Australia's major gateway cities delivers net benefits (through negotiating leverage or otherwise) to the Australian community, with perhaps the exception of Sydney Kingsford Smith Airport — Australia's largest airport. Allowing foreign airlines to access Australia's major gateway cities on an unrestricted basis would be expected to deliver net benefits to the Australian community, including service exporters.

The Commission proposes that access to Australia's major gateway cities be liberalised in a staged way. To begin with, the Australian Government should, as soon as practicable, provide unrestricted access for foreign airlines flying to and from Brisbane, Melbourne and Perth airports, as well as secondary airports in all of the major gateway cities. 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 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 Australian passengers 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 which, given their importance as drivers of demand for these services, are considered barriers to exports. The issues raised predominantly related to the process of obtaining visitor visas, particularly for visitors from China, and the streamlined visa processing (SVP) arrangements for international students.

It is important that the requirements and restrictions attached to visa eligibility are 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 differentiated border processing arrangements, such as priority visa processing and off-terminal clearances, being offered to visitors on a cost recovery or commercial basis. There is currently only limited cost recovery of differentiated passenger facilitation services, and differentiated services are provided on an ad hoc basis. Charging for the services, in line with the Australian Government's guidelines on cost recovery, would enable differentiated services to be provided without undermining the ability for 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 eligible 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 their effect 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.

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 launching of the Quality Indicators for Learning and Teaching online platform, which will draw on surveys of student experience, graduate outcomes and employer satisfaction (scheduled for August 2015).

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 streamlined visa processing. 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. 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 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 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.

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.

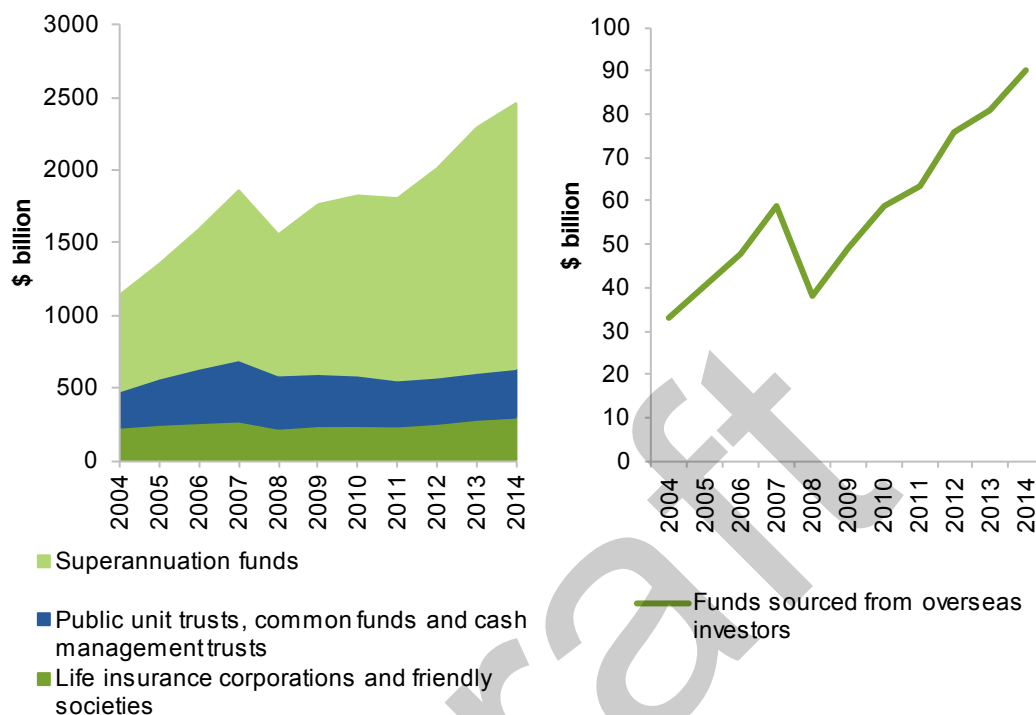
Exports of financial services — an opportunity in waiting?

The provision of financial services is Australia's largest service sector — contributing almost \$135 billion (gross value added) to the economy in 2013-14. 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 funds are investment structures that pool together funds from hundreds or even thousands of investors. Types of managed funds include superannuation funds, life insurance corporations and managed investment schemes. While the value of foreign funds under management in Australia 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 managed funds, relative to about \$90 billion (3.7 per cent) in managed funds domiciled in Australia.

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



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.

A retail managed investment scheme (schemes that are not exclusively targeted at wholesale investors such as pension funds) may meet the regulatory conditions necessary to offer interests in the scheme in Australia, but this does not mean that fund managers can offer interests in that scheme internationally. For example, to offer interests in a foreign managed investment scheme to a Singapore investor, the scheme must meet the registration requirements of the Singapore regulator, have a representative that is a Singapore resident or a company registered in Singapore, and comply with the Singapore Code on Collective Investment Schemes. 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 internationally.

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 New Zealand, Singapore and South Korea (other countries may join). Once commenced in early 2016, the ARFP will allow fund managers to market managed investment schemes that meet the passport rules (as regulated by their home regulator) in the other passport countries.

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 of managed investment schemes. In addition to the potential effects on financial service exports, the ARFP is likely to benefit Australian investors, through lower fees and increased opportunities for portfolio diversification.

Australian financial service providers will be competing with ARFP jurisdictions that have more favourable tax arrangements, particularly 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. Withholding taxes apply to Australian payments of interest, dividends, royalties and payments from managed funds. Submissions to this study from the financial sector have called for simpler and lower rates of withholding taxes. The Financial Services Council also called for a concessionary rate to be applied to Managed Investment Trusts participating in the ARFP, for the purpose of making Australian financial service providers more competitive with providers from other ARFP countries that have more favourable tax arrangements such as 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 a concessionary rate, would only create further distortions in an already complex system, and is not justified on the basis that the current rate is uncompetitive with other jurisdictions participating in the passport.

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 the variation is efficiency-enhancing, more uniform rates of withholding tax are likely to

reduce the distortions associated with treating different types of investments differently for tax purposes. The Australian Government should seek to simplify Australia's regime of withholding taxes by pursuing 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 a complex issue that 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 has just been implemented (1 July 2015), but the regime should be reviewed once it has been in place long enough to assess its effectiveness (but no later than 2020), 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, while it would be expected to increase the flexibility of fund managers to meet investor demands, options should be evaluated with an eye to their taxation implications and the possibility of inadvertently creating distortions in the domestic market.

The Tax White Paper also 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 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 (box 4). Barriers to international investment can take a number of forms — for example, limits on foreign equity, investment screening and approval conditions, requirements for joint ventures or local incorporation, and the need to engage local directors — that can have a range of effects on service exports.

Many barriers to investment are behind-the-border measures making them difficult to identify, but are particularly high in financial services in several large Asian developing countries, most notably in India and China. Barriers to investment in financial services in Indonesia are also among the highest applying in Australia's major trading partners.

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.

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 Indonesia, India 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. In Indonesia, foreign higher education institutions must operate in partnership with an approved Indonesian higher education institution.
- Foreign ownership of health research centres, private maternity hospitals, and general or public hospitals is prohibited in Indonesia.

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 stakeholders 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. The 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.

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. 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–NZ 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.

As a general rule, trade agreements are of limited use in directly addressing barriers that are behind the border. They can, however, provide a framework to establish supplementary measures such as mutual recognition agreements (MRAs) or standards harmonisation, discussed below. 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.

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

The Commission has identified three cross-cutting international barriers to service exports — cross-border data flows, licensing and standards, and the enforcement 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 — that may have other remedies including legally binding contracts or legislation — but can also have 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 is 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 — at a cost that can be in the tens of millions of dollars — and any ongoing efficiency penalty.

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 emerging 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 unless clients provide written consent. 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 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 as beneficial in the context of 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 mutual recognition arrangements 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 mutual recognition arrangements.

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.

The responsibility for negotiating and managing MRAs often sits with professional bodies and government agencies, rather than being the direct responsibility of governments themselves. The Australian Government can help facilitate the development of MRAs by establishing a framework for progressing MRAs when it negotiates trade agreements. To improve the prospects of an MRA being successful in facilitating services trade, the establishing framework should include clear actions and timeframes, involve relevant regulators and government bodies, and include a process for consulting with industry stakeholders. 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 regulators.

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.

Intellectual property rights will benefit some service exporters ...

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 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 (including negotiations on the Trans-Pacific Partnership). Two of Australia's bilateral trade agreements (with Chile and the United States) have wider coverage than the Trade-Related Aspects of Intellectual Property Rights (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 Australian Government should focus on multilateral or plurilateral international negotiations, including through the WTO, World Intellectual Property Organization and APEC, when seeking to encourage enforcement of IP rights in export markets. The Australian Government should not seek to include IP provisions in future trade agreements unless a published economic assessment shows that the effects of any provisions, including on Australian consumers, generate overall net benefits to the Australian community.

Sound domestic policy arrangements are vital

Service exports, and trade flows more generally, are intrinsically linked to regulatory and policy settings in Australia. Domestic policy and regulation 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. Pursuing comprehensive domestic policy and regulatory 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. Importantly, reforms can be undertaken in Australia's best interest, using regulation that addresses efficiency or equity objectives in a way that is no more burdensome than necessary. Where these 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. 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.

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

Some areas of reform would lead to benefits across the Australian economy, as well as for businesses that export services. Improving development approval processes for private infrastructure investment — including by ensuring that planning and zoning systems are not overly prescriptive — would better enable tourism-related businesses to innovate and adapt to changes in demand. 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 is an in-principle case for government bodies to provide information to businesses where the information is collected anyway in order to improve the effectiveness of government activities. 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.

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). Where there is no market failure, EFIC's involvement will not create additional economic or export activity *unless* the price of its financial services fails to cover the full economic cost of provision, in which case recipient firms are being unjustifiably subsidised by taxpayers.

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 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

Policy settings that give priority to specific industries disadvantage other, potentially more competitive activities. For example, allocating priority for government assistance with training to five industries (chosen on the basis of their export growth potential) under the Industry Skills Fund disadvantages sectors that are not given priority, such as tourism. There are issues

around the methods used to select priority industries and questions as to whether an approach based on selectivity affords net benefits to the community.

Similarly, 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 where they address a market failure, or where they meet an equity objective, and the benefits to the community of providing the grants would be expected to outweigh the costs.

Determining domestic policy and regulation 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 the services sectors and could impose substantial costs.

Policy changes to allow temporary immigrants to access public services (such as health cover and subsidised education) for the purpose of increasing service exports would carry the risk of encouraging people who may need medical care and/or who have many children to seek temporary residency in Australia as a means to access high quality public services — the costs involved would likely outweigh any benefit to service providers. Extending concessional access to public transport for international students in New South Wales and Victoria would not carry the same risks, and peak education bodies have argued that this could increase international student numbers in Australia. There would be merit in these states reviewing the case for concessional public transport for international students, utilising data on the use of discount fares introduced since 2012.

Draft

Draft recommendations and information requests

Domestic reform priorities

DRAFT 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.

DRAFT 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 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 project 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.

DRAFT 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.

DRAFT RECOMMENDATION 4.4

Australian, state and territory governments should not extend temporary immigrants' 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.

DRAFT 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.

DRAFT 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.

DRAFT RECOMMENDATION 4.7

Where the administrative and compliance costs of identifying and charging the beneficiaries do not outweigh the benefits arising from improvements in resource allocation, 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.

DRAFT RECOMMENDATION 4.8

The Minister should amend the Statement of Expectations to confine the commercial role of the Export Finance and Insurance Corporation solely to providing export finance to 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.

The Australian Government should make amendments to the *Export Finance and Insurance Corporation Act 1991* (Cwlth) to this effect.

DRAFT 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, based on a clearly defined and rigorous objective under the *Export Finance and Insurance Corporation Act 1991* (Cwlth), directed at market failures affecting newly exporting small and medium-sized enterprises. The framework should be developed in consultation with other Australian Government agencies, 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

DRAFT 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.

INFORMATION REQUEST

The Commission seeks further information on the potential costs and benefits of trust law reform, in particular:

- what would be the potential effect of trust law reform on the domestic and export markets for traditional trustee services?*
- is a new Commonwealth trust act required, and if so should it replace or operate alongside the existing state and territory based trust acts? What lessons can be learned from trust law in other jurisdictions such as New Zealand?*

DRAFT 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.

DRAFT 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 having regard to:

- the effect of withholding taxes on domestic and international investment markets, and on the supply of financial 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.

DRAFT RECOMMENDATION 6.4

The Australian Government should not make changes to the dividend imputation system in order 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 markets, and the supply of financial 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
- the broader revenue raising requirements of the Australian Government
- the efficiency of international capital markets.

DRAFT RECOMMENDATION 6.5

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

- 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.

DRAFT RECOMMENDATION 6.6

The Australian Government should continue to facilitate the development of a range of collective investment vehicles as part of the Tax White Paper process. Options should be evaluated with an eye to their taxation implications and the possibility of inadvertently creating distortions in the domestic market.

Enhancing export capacity in education and health

DRAFT 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.

DRAFT 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 within three years of the platform being fully implemented (which is scheduled to occur by August 2015).

DRAFT 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 enabling more innovative and flexible approaches to delivering education services. This evaluation could include the use of policy trials that gradually relax restrictions on the use of online education by international students, with periodic evaluation by an independent body to assess any risk to immigration integrity, and any unintended consequences for course quality.

INFORMATION REQUEST

The Commission seeks further information on the scope for streamlining current medical treatment visa application processes, taking into account the need to manage immigration risks through the visa system.

Removing impediments to tourism exports

DRAFT RECOMMENDATION 8.1

The Australian, state and territory governments should:

- undertake an 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 program or major event and following the activity's completion. The complexity of this analysis should be commensurate with the value of government funding being provided to the activity
- publicly release the analyses of costs and benefits of funding or providing a destination marketing program or major event as soon as practicable
- not provide or fund a destination marketing program or major event unless an analysis of the costs and benefits of the activity demonstrates that government funding would provide net benefits to the Australian community.

DRAFT RECOMMENDATION 8.2

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 gateway cities. 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 community.

DRAFT RECOMMENDATION 8.3

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 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.

DRAFT RECOMMENDATION 8.4

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

Reducing international barriers to service exports

DRAFT RECOMMENDATION 9.1

The Australian Government should focus on plurilateral or multilateral negotiations when seeking to encourage enforcement of intellectual property rights in export markets. The Australian Government should not include intellectual property provisions in future trade agreements unless a published economic assessment shows that the effects of any provisions, including on Australian consumers, generate overall net benefits to the Australian community.

DRAFT RECOMMENDATION 9.2

The Australian Government should put in place a framework for developing and implementing mutual recognition arrangements as part of, or following, the inclusion of mutual recognition provisions in trade (or other) agreements. The framework should include clear actions and timeframes, involve relevant regulators and government bodies, and include a process for consulting with industry stakeholders.

DRAFT RECOMMENDATION 9.3

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 consistent
- measures restricting cross-border data flows are the least restrictive necessary 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) could not achieve the same objective at a lower net cost.

INFORMATION REQUEST

The Commission seeks further information on the effect of international barriers to service exports in the following areas:

- impediments to the flow of data across borders, such as requirements to store data locally*
- violations of service providers' intellectual property rights*
- licensing, registration or standards regulations that are more burdensome than is necessary to maintain standards of quality, consumer protection or safety*
- barriers to establishing a commercial presence in another country.*

The Commission is seeking specific examples of how international barriers in these areas, or other areas not covered in the Commission's draft report, have affected service providers' operations and costs.

INFORMATION REQUEST

The Commission seeks further information on whether there are effective policy approaches used overseas to address barriers to service exports that could be adopted in Australia, including:

- the barrier that the policy was designed to address, and the costs that the barrier was imposing on providers seeking to export services*
 - why the policy approach would be expected to generate net benefits in an Australian context*
 - the likely costs and benefits of using the policy approach to address barriers to Australian service exports.*
-

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 a foreign student, and the provision of a range of financial and professional services to consumers overseas, such as insurance, engineering and legal services. Exports from all service sectors accounted for about 17 per cent of total exports in 2013-14. The value of Australia's service exports is two times larger now than it was two decades ago — at \$57 billion in 2013-14. 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 Australia's 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

- 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 educational institutions. Education exports are provided to international students, either in Australia, or in other countries at foreign campuses or through 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.

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.

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 affecting services* and *margin services*.

Change affecting 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 affecting 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).

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

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 services trade. Quantification of this type of trade has been made possible by new value-added trade measures, discussed in chapter 3.

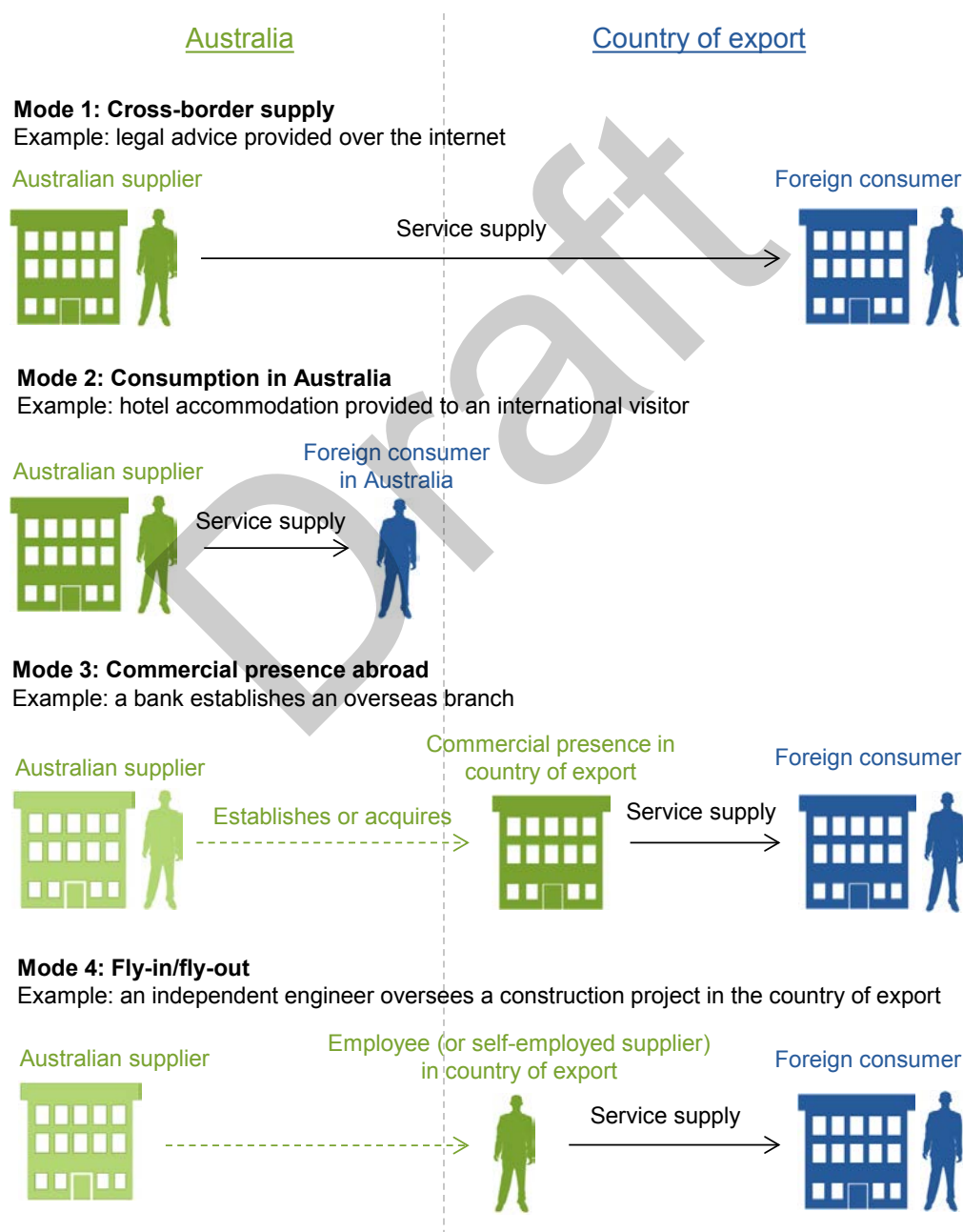
Measuring service exports

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 above, three are captured in Australia’s balance of payment statistics — 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 services 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.

Figure 1.1 **Modes of exporting services**



Source: Adapted from DESA (2010).

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 and regulation (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 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.

Barriers to service exports can be either:

- domestic barriers — those that can be addressed by changes in government regulation or policy within Australia
- international barriers — those that can only be addressed by overseas governments making changes to their regulations or 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 regulation, a barrier could arise where existing regulations are not the least burdensome required to achieve their objective. There may also be instances where regulations that are justified on policy grounds are designed in a way that protects local service providers. An important challenge for this study is distinguishing between measures that are unnecessarily restrictive and those that address a market failure or equity objective in the least burdensome way.

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

Regulatory and 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 and regulatory 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, 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 legislation and 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 draft 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 draft report.

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

The Commission would welcome submissions in response to this draft report by 18 September 2015, to enable full consideration of the submissions for the final study report. The Commission will produce a final report, which will be released in early December 2015.

2 The analytical approach

Key points

- 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 international competitiveness of Australian service providers will influence how well placed they are to capture these benefits.
 - 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 considers 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.

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.

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 cheaper and better 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 products) are lower than other countries' economic costs of producing the service. Differences in technology and factor endowments (land, labour and capital) at a point in time provide the basis for comparative advantage, and lead to countries specialising in areas of production.

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 — whereby 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 from the easier diffusion of information and technology.

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

In sectors where Australian service providers have a comparative advantage, can draw on economies of scale or hold some other advantage over their international competitors (such as assets protected by intellectual property), barriers to service exports reduce the benefits from Australia's involvement in international trade. By reducing the number and diversity of markets that Australian service providers can participate in, barriers to service exports decrease their 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 chains,¹ which in addition to providing opportunities to earn export income increase the competitiveness of Australian service providers by enabling them to access cheaper 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 Australian 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 thus 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 community.

The nature of barriers to service exports

For the purposes of this study, a 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 leading to underprovision of the service. Domestic policies that target a market failure or equity objective may, from the community's perspective, have costs that exceed the benefits. 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.

¹ 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.

Barriers to service exports can arise due to regulations or 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, measures 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.

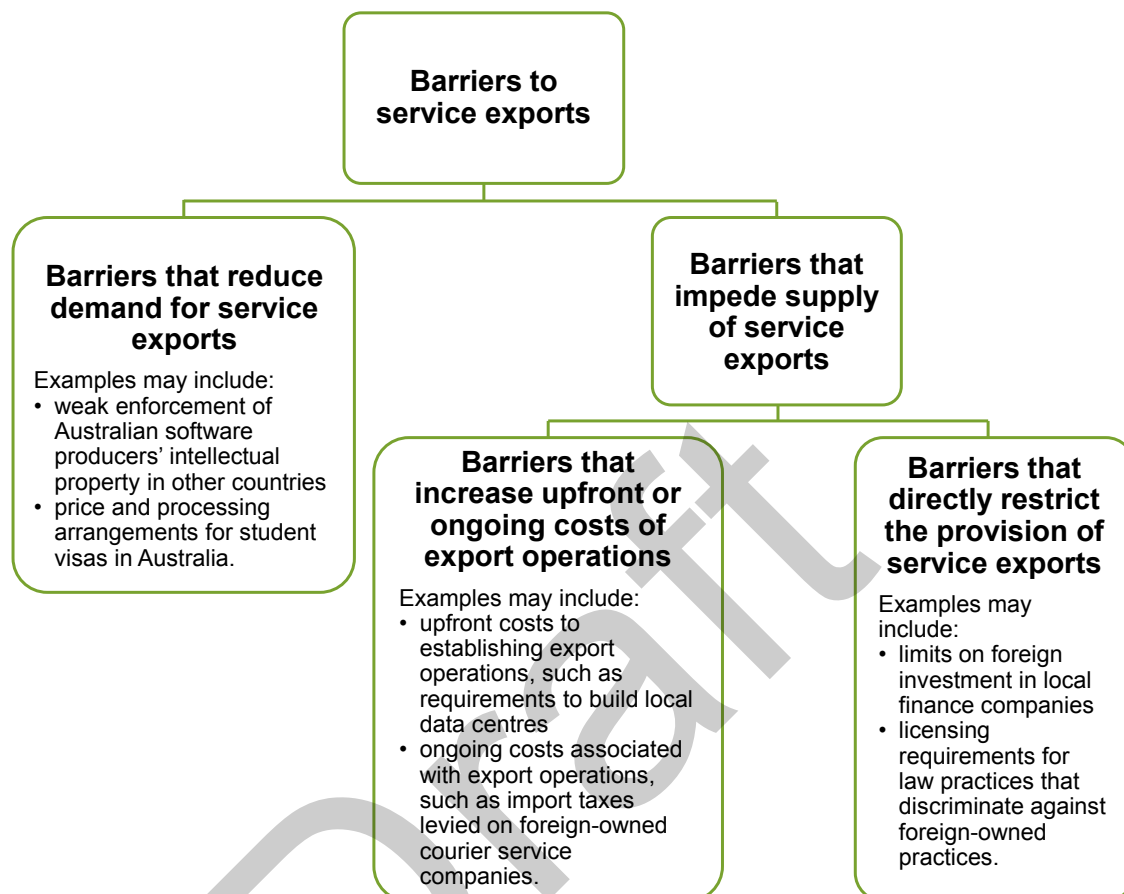
Barriers that impede the supply of service exports

In some cases, measures 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 to avoid 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

Regulatory and 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.²

² 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 any substitute services.

Figure 2.1 **Barriers to service exports^a**

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

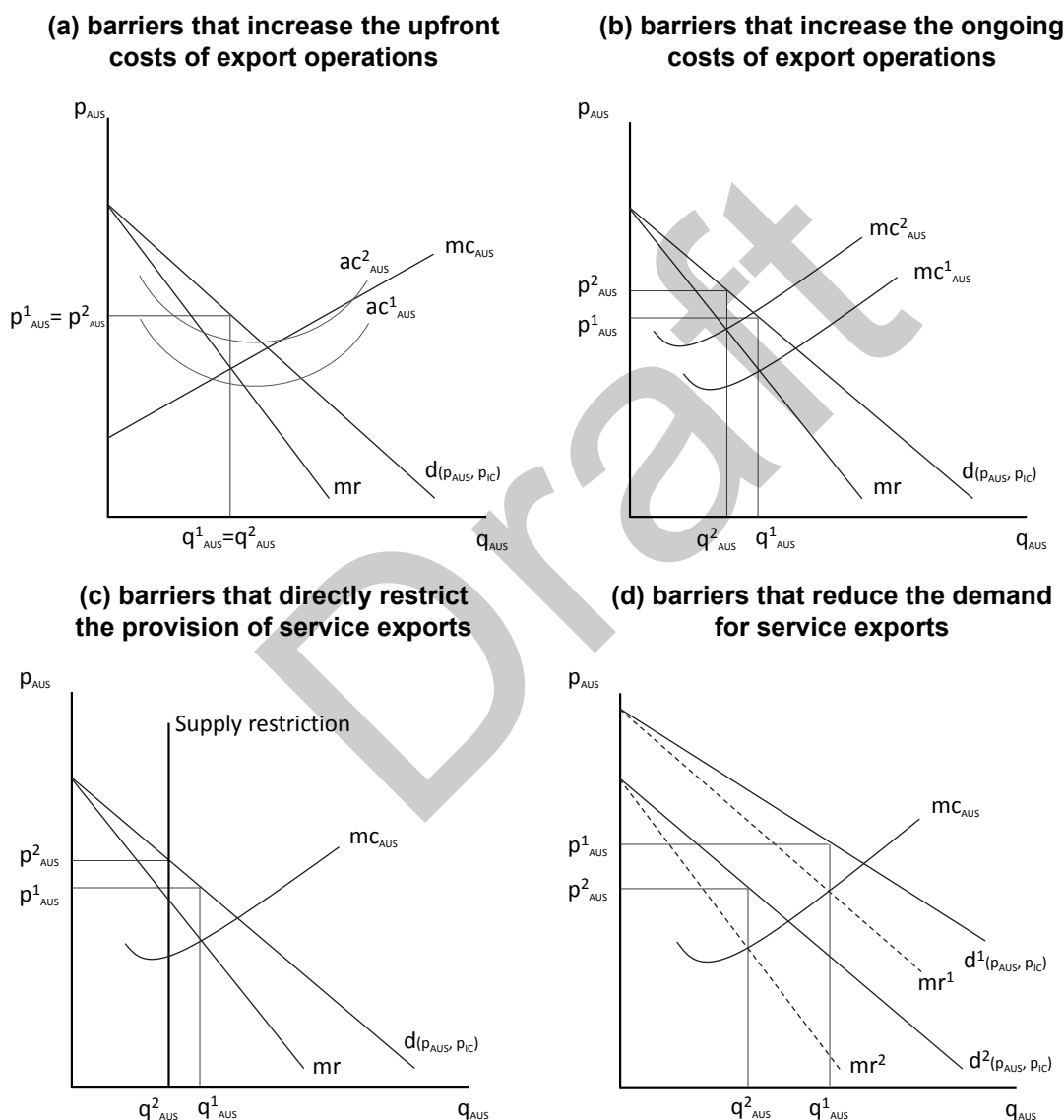
Measures that increase the upfront costs of establishing export operations increase the average costs of supplying service exports, and decrease the overall expected returns to the Australian service provider from supplying the export market. Measures that increase upfront costs could distort investment 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)). Where upfront costs are largely sunk, these measures will have little or no influence on the service provider's decisions about prices or supply if it does still decide to enter the export market. Examples of measures that increase upfront costs include rigorous screening of foreign investments and requirements to invest in infrastructure in the local market.

Measures 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 measures 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^{a,b}

Market for a differentiated service



^a **mc** marginal cost; **ac** average cost; p_{AUS} price of the service produced by Australian provider, p_{IC} 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. ^b 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 measures 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 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 and regulatory 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 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 therefore 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 can be useful for informing priorities for domestic policy reform and efforts to reduce barriers in other countries.

Empirical approaches to estimating the benefits

Much of the literature that empirically analyses barriers to service trade 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 service trade 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 measures.

Box 2.2 Quantitative measurements of barriers to trade in services

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

- 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 countries, 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

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 (chapter 3).

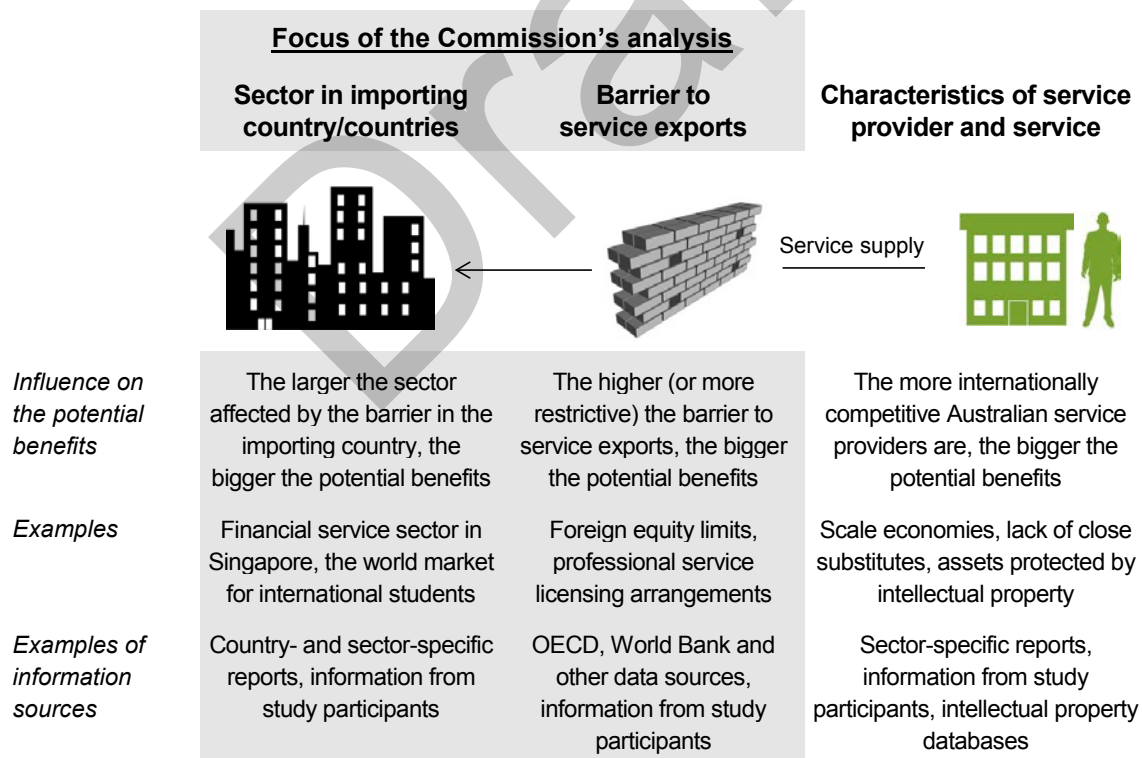
The Commission's approach to assessing the benefits to Australia from reduced barriers to service exports is qualitative in nature, drawing on consultations with study participants and other information sources such as case studies and quantitative evidence, including from other countries. While increasing service exports is not an end in itself, due to data and modelling constraints the Commission mainly focused on the potential benefits to Australian service providers when assessing the benefits to Australia from reduced barriers

to service exports. 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 much of the potential benefits as they can.

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



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 ongoing or upfront 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.

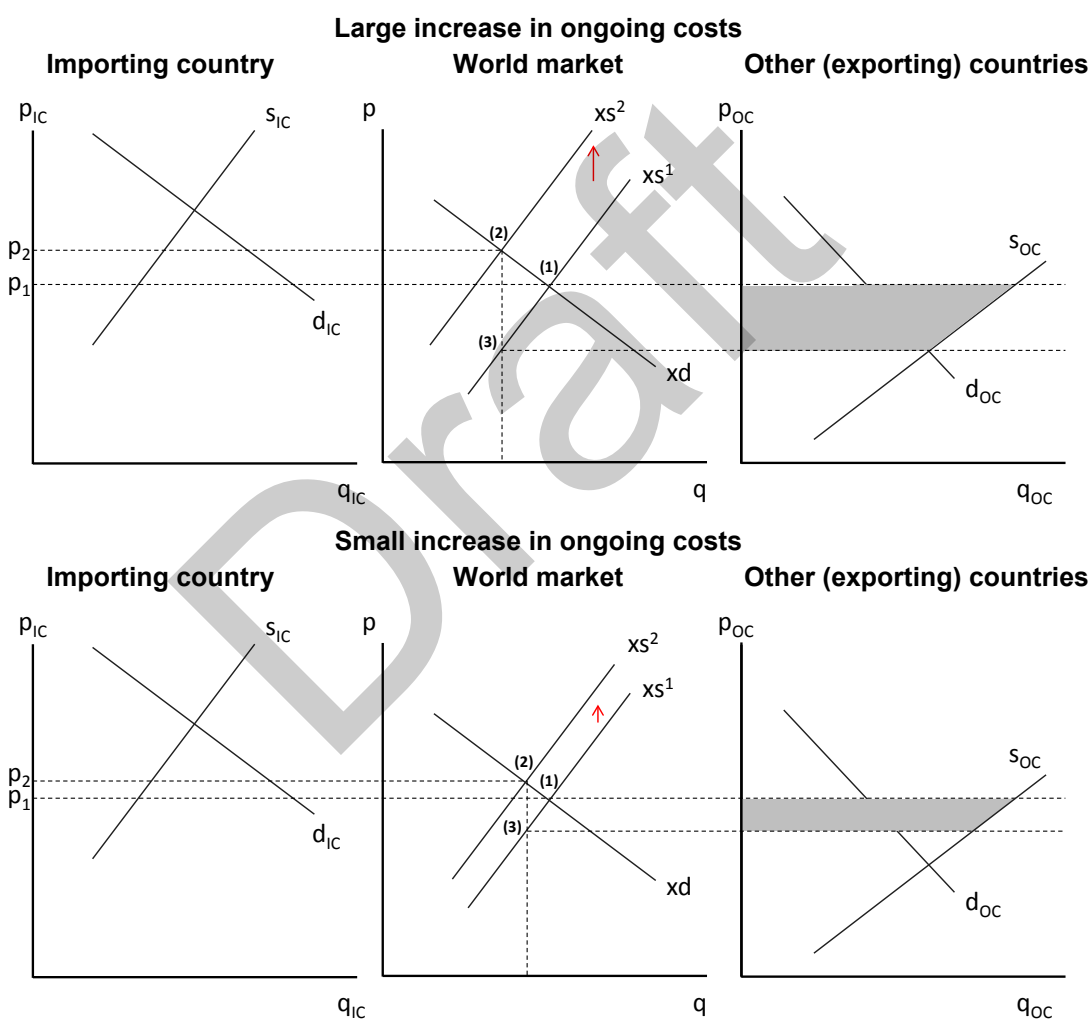
It is not possible to conclude that any one of the above types of barriers will in general be more distorting than another. For example, a barrier that fully restricts the provision of a service may have little effect on market outcomes because trade in the service would have been negligible even in 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^{a,b,c}

Barrier that increases the ongoing costs of export operations

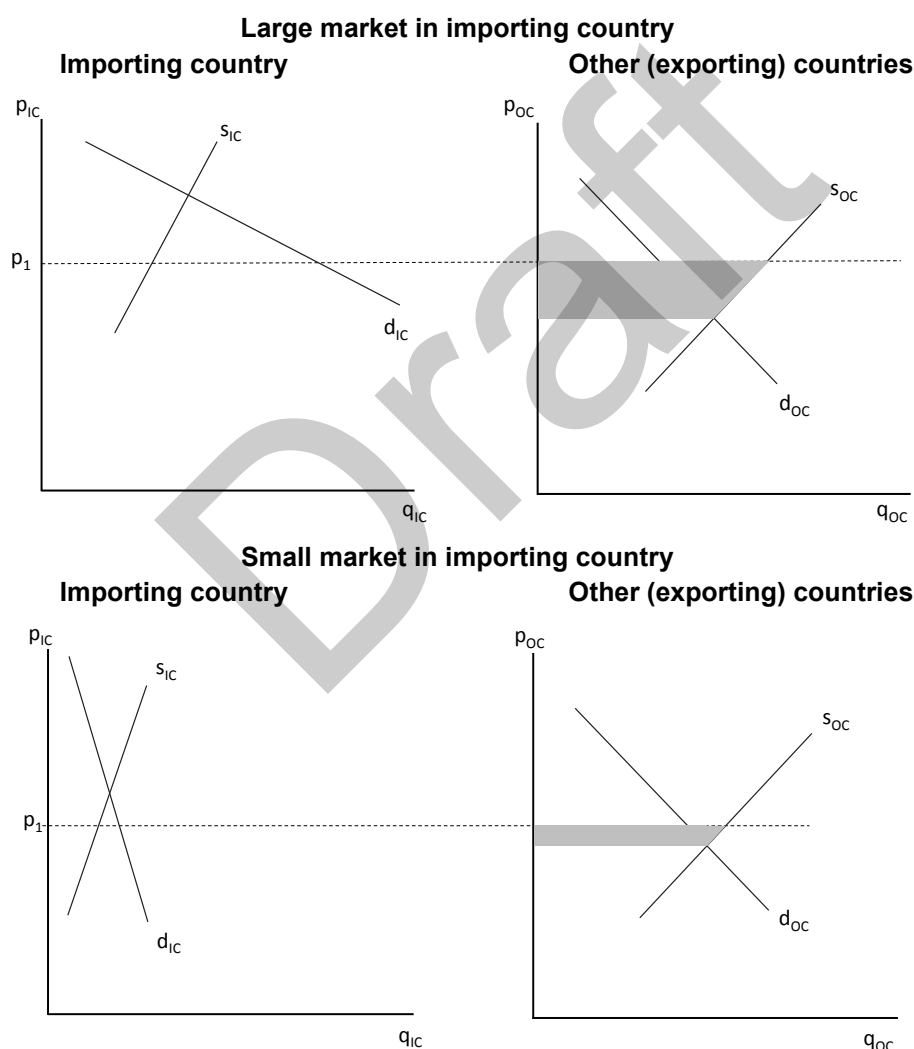


a p_{IC} price in importing country; s_{IC} supply from providers in importing country; d_{IC} demand in importing country; q_{IC} quantity in importing country; xs excess supply; xd excess demand; p_{OC} price in other countries; s_{OC} supply in other countries; d_{OC} demand in other countries; q_{OC} 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^{a,b,c}



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.

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 suppliers. The CIE 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 service at a lower cost than rival competitors in other countries (for example, due to scale economies), or because they offer a highly valued service 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.

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the research report.

Draft

3 Australian service exports: trends and drivers

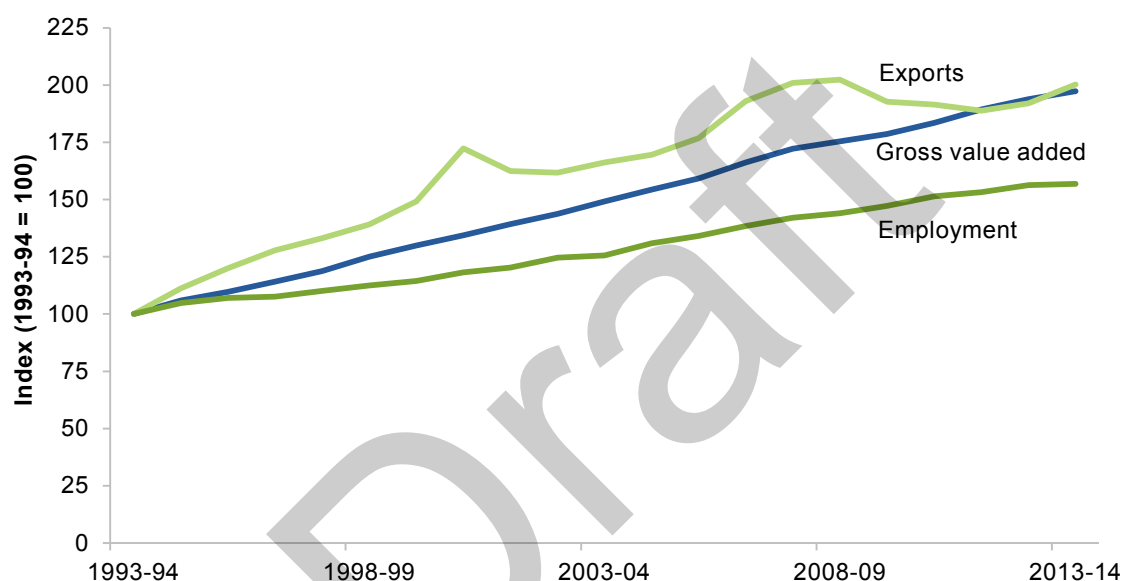
Key points

- The provision of services accounts for about 60 per cent of Australia's gross domestic product and about 80 per cent of employment.
- The total value of Australian service exports was \$57 billion in 2013-14 — about 17 per cent of the total value of exports (down from about one quarter of total exports in 2003-04). The value of service exports has doubled (in real terms) over the past two decades.
 - Service exports make up a greater share (41 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 the balance of payments. 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.
- Global demand for services has been increasing due to rising incomes, particularly in Asia. As incomes rise, consumers generally spend a greater share of that income on services, so consumption of services grows at a faster rate than income.
- The cost of exporting services has fallen due, in part, to lower airfares and the development of internet tools including email and online video calls, and electronic payment systems.
- Australia's largest services sectors in terms of 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 3.2 million to almost 6.7 million. Increasing income in many source countries has been a key driver of Australian tourism exports.
 - Australian exports of education services have increased significantly over the past two decades, growing at an average annual rate of 12 per cent (despite falling between 2009-10 and 2012-13). 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, as well as 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, which depend on services such as currency exchange and maritime insurance. Common language is also an important determinant of financial service exports.

3.1 Services make up the majority of the economy

In 2013-14 the gross value added of Australian services industries was about \$950 billion, or 60 per cent of GDP (ABS 2014b).¹ This percentage has remained fairly constant over the past two decades as the output from services industries has grown at about the same rate as GDP (ABS 2014b). The gross value added of Australian services industries has doubled (in real terms) over the past two decades (figure 3.1).

Figure 3.1 Real gross value added, real exports and employment
Australian services industries



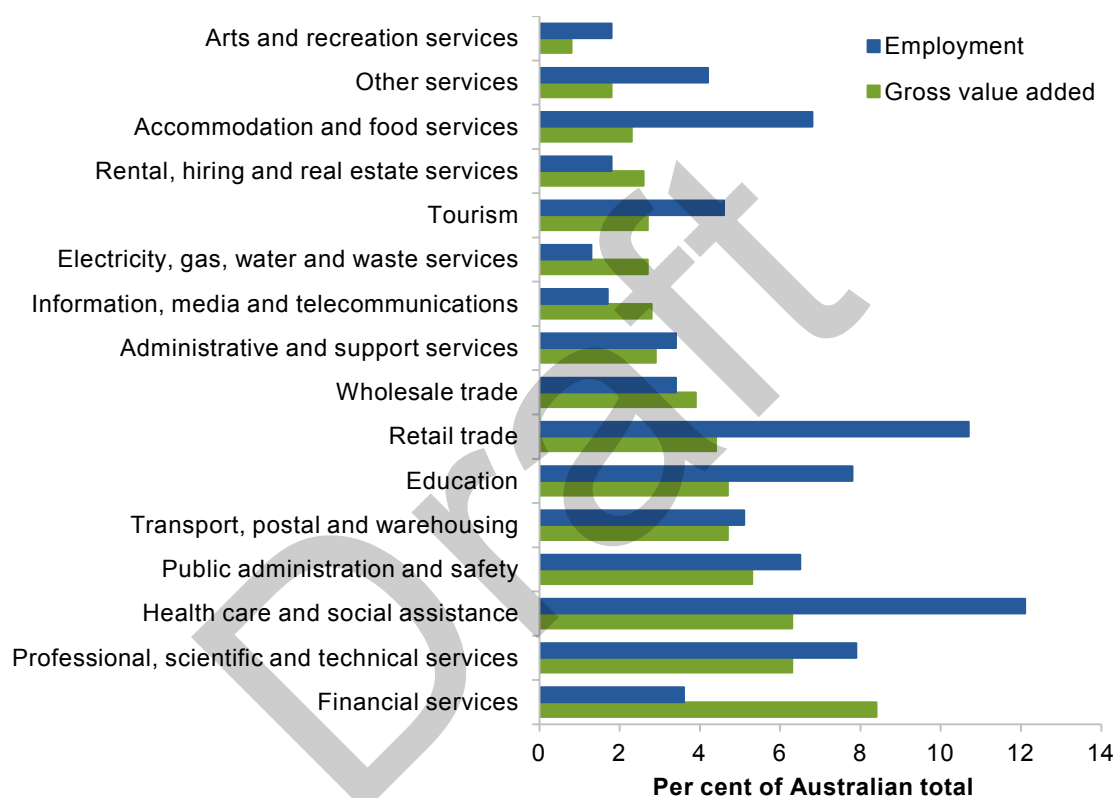
Sources: ABS (2014b, 2015b, 2015g).

Total employment in services industries has also risen over time, but at a slower rate than real gross value added (figure 3.1). There were 9 million people employed in services industries as of May 2015, up from about 6 million two decades prior (ABS 2015g). Combined, Australian services industries account for a much higher proportion of total employment (almost 80 per cent) than GDP (about 60 per cent) (ABS 2015g). This reflects the relative labour-intensity of most services industries (figure 3.2) in comparison to non-services industries such as agriculture, mining and manufacturing, which are more capital-intensive.

¹ There are different definitions of 'services industries'. Unless specified, 'services industries' is here taken to include the electricity, gas, water and waste services industry (which produces both goods and services), but not the construction industry or ownership of dwellings. Tourism is not included separately (as it is not defined as an industry by the ABS) although most tourism activity is counted as part of other services industries. Some stakeholders (such as DFAT, sub. 31) have suggested different figures for Australian service exports value added. These differences are likely due to different industries being included as services.

Employment in services industries increased by about 270 000 from May 2014 to May 2015. The industries that had the largest increases in employment were professional, scientific and technical services (100 000) and health care and social assistance (just under 70 000). Over the same period, employment in non-services industries fell by about 40 000 (including a fall of more than 30 000 in mining employment) (ABS 2015g).

Figure 3.2 Services industries' gross value added and employment
2013-14, ranked by gross value added^a



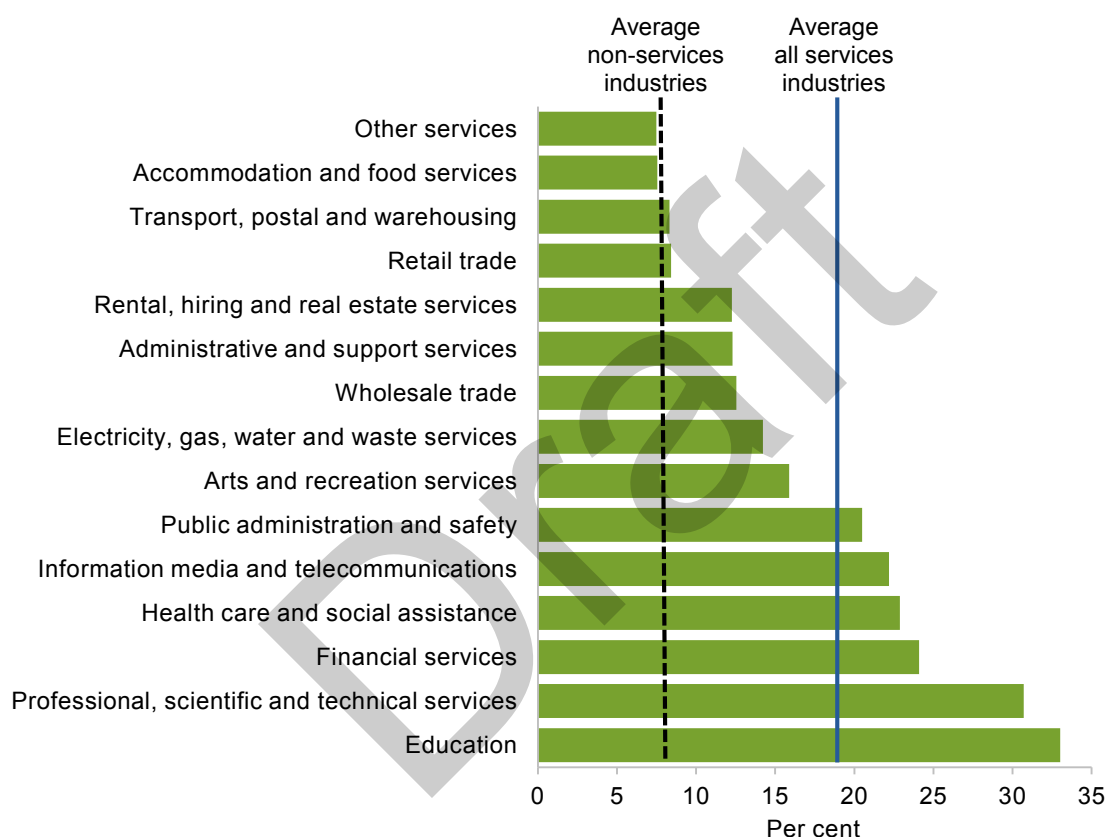
^a Tourism is 'direct tourism' as defined in the ABS's Tourism Satellite Account. Other services includes: a broad range of personal services; religious, civic, professional, and other interest group services; selected repair and maintenance activities; and private households employing staff. Financial services includes insurance. Education includes training. Ownership of dwellings is not included as part of rental, hiring and real estate services. In general, these industries — as defined in the Australian and New Zealand Standard Industrial Classification (2006) — do not align with the six sectors referred to in the terms of reference to this study (section 3.4).

Sources: ABS (2014a, 2014b, 2015g).

People employed in services industries are more likely to have a bachelor's degree or higher than those employed in other industries (figure 3.3). In 2011, almost 20 per cent of the services workforce had a bachelor's degree or higher, compared to less than 8 per cent of employees in other industries (although people working in services industries were less likely to have a certificate-level qualification) (Productivity Commission estimates based on ABS (2011)).

The education levels of people employed in the services workforce varies widely across industries. For example, while almost 20 per cent of the total services workforce had a bachelor's degree or higher (in 2011), the proportion of employed people with a bachelor's degree or higher ranges from less than 8 per cent in accommodation and food services to one third in education (figure 3.3).

Figure 3.3 Percentage of employed people with a degree^a
By services industry, 2011



^a A degree is defined as a bachelor's degree or higher. Non-services industries are mining, manufacturing, construction, and agriculture, forestry and fishing. Averages are weighted for the size of each industry. Financial services includes insurance. Education includes training.

Source: Productivity Commission estimates based on ABS (2011).

The differences between services industries suggest that there are different 'types' of services industries, such as those that are:

- relatively labour-intensive, and have a highly qualified workforce, such as education, health care and social assistance, and professional, scientific and technical services
- relatively labour-intensive, and have a less qualified workforce, such as accommodation and food services, and retail trade

- relatively capital-intensive, such as electricity, gas, water and waste services, and financial services.

These between-industry differences are also apparent in productivity estimates (box 3.1). For example, over the past two decades 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.

Box 3.1 Productivity growth has varied between services industries

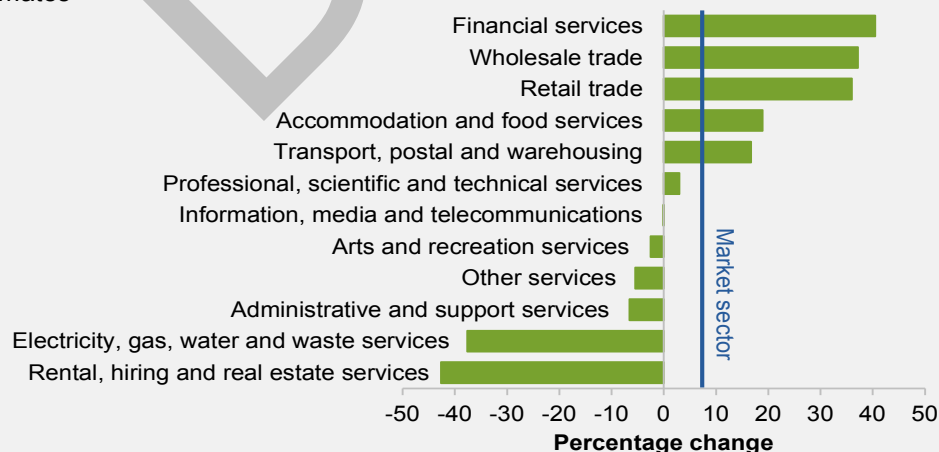
Productivity is the efficiency with which firms, organisations, industries, and the economy as a whole, convert labour, capital and raw materials into output. Multifactor productivity measures the growth in value added output per unit of labour and capital input used. According to ABS estimates, multifactor productivity growth has varied widely between Australian services 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 2015a). 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 services industries, 1994-95 to 2013-14

ABS estimates



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

Source: ABS (2014c).

3.2 The value of Australian service exports

On the basis of balance of payments data, the value of Australian service exports from all sectors was \$57 billion² in 2013-14 — about 17 per cent of the total value of exports (down from about 25 per cent of the total value of exports a decade prior) (ABS 2015b). The decline in the proportion of Australian exports that are services 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 doubled (in real terms) since 1993-94 — although the real value of exports has been relatively flat since about 2009 (figure 3.1).

Many of Australia's largest trading partners are also key destinations for Australian service exports (table 3.1). Markets in Asia have been the fastest growing for Australian service exports, particularly China, which recorded average annual growth in the value of service exports of 12 per cent over the past ten years. There has also been strong growth in the value of Australian service exports to India, Malaysia and Singapore (DFAT, sub. 31).

When measured in value-added terms (rather than gross-value terms), Australian service exports account for a greater proportion of total exports (box 3.2). Australian services sectors are estimated to have accounted for about 41 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).

Service exports through commercial presence abroad

Unlike exports through other modes, 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. The lack of periodic data on Australian exports through commercial presence abroad makes it difficult to assess trends in service exports through this mode. In a one-off survey, the ABS estimated that the value of Australian service exports through commercial presence abroad was about \$60 billion in 2002-03 (ABS 2004), at which time the value of service exports through other modes was about \$35 billion (ABS 2015b).³

² Unless specified, exports statistics presented in this chapter are in gross value terms, and refer to exports through cross border supply, consumption abroad and fly-in/fly-out. Exports through commercial presence abroad are presented separately, for reasons discussed below. Export modes are described in more detail in chapter 1.

³ For statistical purposes, a commercial presence abroad refers to an enterprise that is majority-owned by an Australian resident enterprise.

Table 3.1 **Australia's largest trading partners, 2014^a**Australia has trade agreements with the countries shaded green^b

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

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

Sources: Productivity Commission estimates based on ABS customised report and ABS (2015f); DFAT (2015i).

Some organisations have attempted to estimate commercial presence exports for years later than 2002-03 — these estimates are likely to be less reliable than ABS data. The 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 (figure 3.4).

Box 3.2 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 (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 2015f). 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 (US), and less in China, Korea and Taiwan, than suggested by gross measures (Kelly and La Cava 2013).

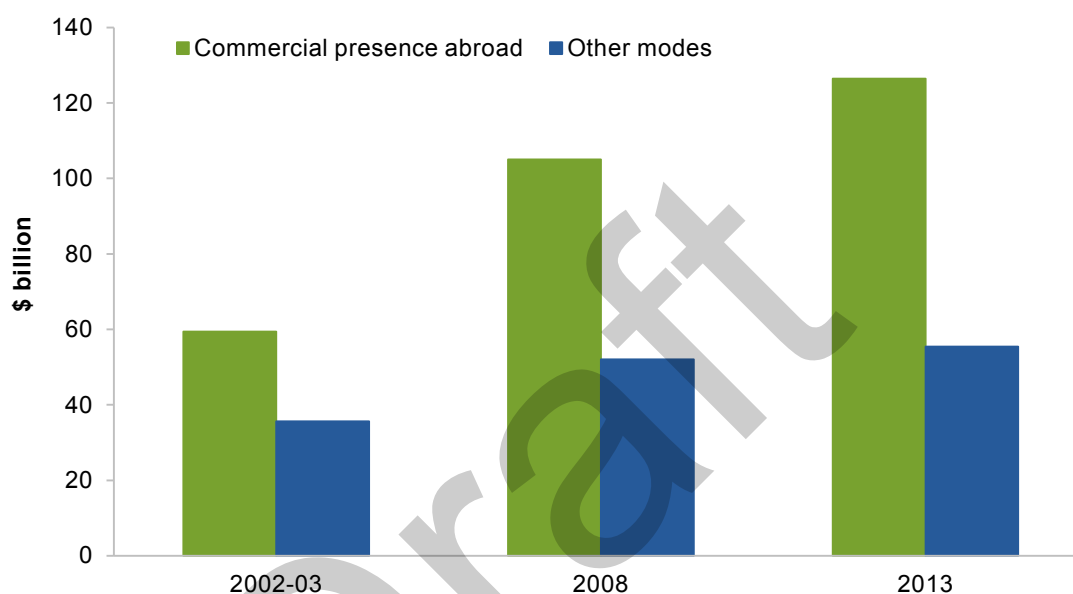
The ABS is currently reviewing its statistical output related to international accounts. The ABS is seeking input from users as part of the review, and expects to announce any decisions by September 2015 (ABS 2015d). Assessment of Australia's service exports would be much enhanced should more comprehensive statistics become available — particularly in relation to the commercial presence abroad of Australian service providers.

Australian service exports through commercial presence abroad are provided to customers in the country of the commercial presence, typically by employees that reside in the same country. They are counted as exports because the employing business is owned by an Australian enterprise. Australian exports through commercial presence abroad are different from Australian exports through other modes, which are provided to foreign customers (although they may be visiting Australia at the time) by Australian residents. The income earned on the investment in the commercial presence abroad will still flow to the Australian investor, but the overall economic effects from commercial presence exports will be different to the economic effects from exports through other modes.

There is limited evidence on the relationship between Australian exports through commercial presence abroad and economic outcomes in Australia. Research from other

countries suggests that a greater volume of exports through commercial presence abroad is likely to be associated with economic benefits in the exporting country, such as higher employment, research and development, and export (through other modes) (Hufbauer, Moran and Oldenski 2013) .

Figure 3.4 Service exports by mode of delivery^a
\$ billion (nominal)



^a 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.

Sources: ABS (2004, 2015b); Productivity Commission estimates based on CIE (2010) and PwC et al. (2015).

3.3 Key trends and drivers of Australian service exports

Demand for Australian service exports is in part driven by global trends. Over the past two decades, global service exports and Australian service exports have largely moved together (in US dollar terms) (figure 3.5). Since 2012, growth in global service exports has outpaced Australian service exports (in US dollar terms), although this may be partly due to a depreciation of the Australian dollar against the US dollar since 2013.

Factors that affect comparative advantage and economies of scale are also important drivers of Australian service exports (chapter 2). 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. 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 educational company that offers ‘massive open online courses’ (MOOCs), 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).

Policy reforms in other countries have facilitated growth in demand for service exports. 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 (General Office of the State Council 2013).

Movements in the value of the Australian dollar are one factor that affects Australia’s 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 value of the Australian dollar the most important factor adversely affecting their international competitiveness (ECA 2014). The appreciation of Australia’s exchange rate against the trade weighted index since the early 2000s has 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 beach holiday might choose to travel to Bali or Thailand instead of Queensland (PC 2015a). Since 2013, the value of the Australian dollar has fallen against the trade-weighted index, although in 2014 the dollar remained about 12 per cent above 2004 levels (RBA 2015).

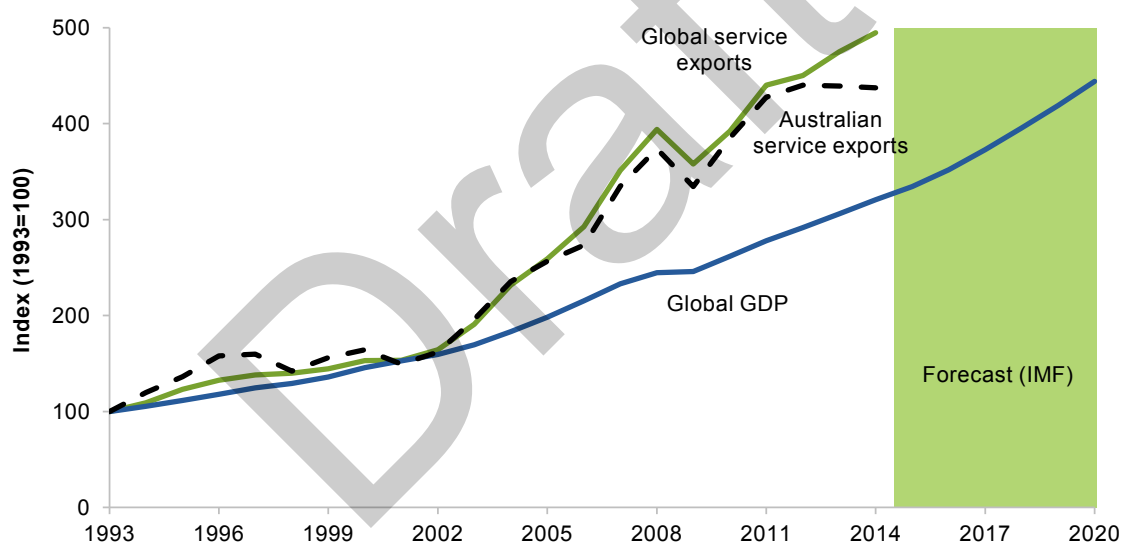
Global demand for services will continue to rise

Changes in demand for services over time can be explained by long-run trends (including rising incomes) and short-run fluctuations (including those caused by global recessions). Increases in global household incomes (as measured by global GDP), and particularly incomes in Asia, have been a key driver of global demand for service exports (ECA, sub. 32). Between 1993 and 2002, growth in the value of global service exports closely followed global GDP growth; since 2002, global service exports have grown more rapidly (figure 3.5). From 2004 to 2014, the average annual growth rate of global service exports was 8 per cent (WTO 2015). 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.

Higher incomes tend to lead to greater consumption of most products, known as ‘normal goods’. Services are generally ‘superior goods’ — as incomes rise, consumers spend a greater share of that income on services — so consumption of services tends to grow at a faster rate than income (Jaaskela and Windsor 2011). This may be one reason why average growth in Australian and global service exports has been more rapid than GDP growth since 2002. Other reasons, such as reductions in the costs of services trade, are discussed below.

Short-run demand fluctuations also affect global demand for service exports. For example, between 2008 and 2009, there was a sharp fall in both Australian and global service exports (figure 3.5). A slump in global demand as a result of the global financial crisis is likely to have been the chief cause of this fall. The status of most services as superior goods partly explains why the crisis caused a much larger percentage fall in global service exports than in global GDP (figure 3.5).

Figure 3.5 Australian and global service exports, and global GDP^a



^a Global GDP is in nominal purchasing power parity terms. Service exports measured in nominal US\$. 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).

The cost of exporting services has fallen

Technological advances in information technology (IT) and communications, have greatly reduced the costs of delivering a range of services through cross-border supply. Email means that documents and other files can be delivered instantaneously anywhere in the world. Websites and electronic payment systems allow businesses to advertise and sell their services in overseas markets at low cost — more international visitors, for example, are now researching and booking components of their trip on the internet, especially

airfares and accommodation (PC 2015a). These advances have been a key factor in the fast growth of global service exports, particularly as a result of the expansion of internet use since the late 1990s. For example, a growing proportion of Australian exports of legal services are through cross-border supply. Growth in exports through this mode has coincided with a fall in the proportion (and value) of exports through fly-in/fly-out (Law Council of Australia 2014), suggesting that some exporters of legal services have switched from exporting through fly-in/fly-out to cross-border supply.

The costs of trading services that are delivered face-to-face are also affected by the cost of international travel. For example, airfares account for a large part of the total cost of a short-term visit by a visitor to Australia (airfares account for a smaller, though still sizable, part of the total cost of longer-term visits). Over the past four decades, the real cost of providing air travel fell by about 60 per cent, and the real price of tickets for consumers fell by a similar amount. This decline in travel costs was enabled by the increased efficiency of new aircraft, higher utilisation of existing aircraft, better operational performance of airlines, and more efficient business models, including the development of low-cost carriers (IATA 2011). 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 2015a).

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 2013-14, more than a 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 2015g; 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.

3.4 Australian service export sectors

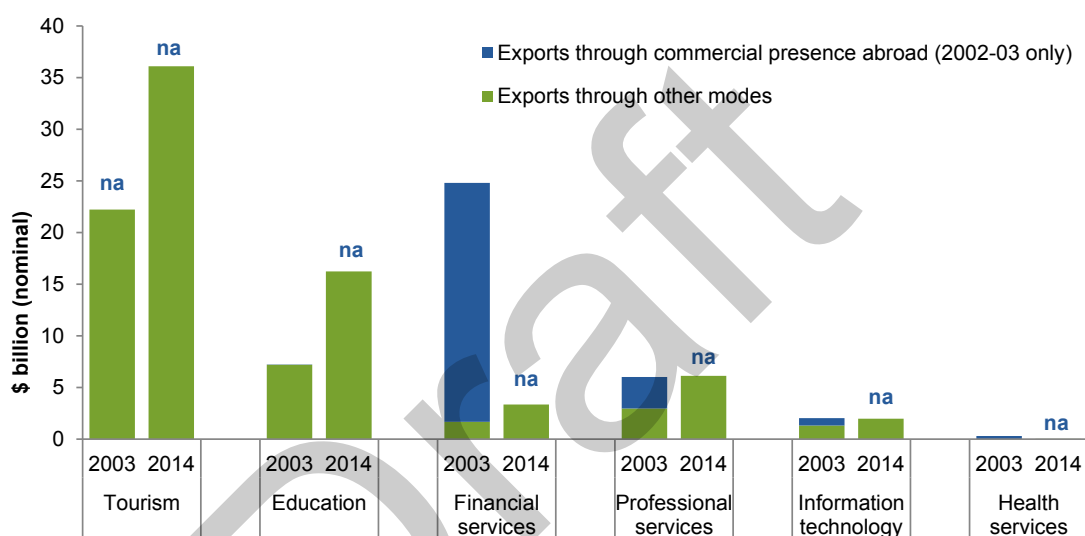
The terms of reference for this study request that the Commission focus on six services sectors: tourism, education, financial services, professional services, IT and health services. Combined, these six sectors accounted for:

- almost 85 per cent (about \$48 billion) of the value of Australian service exports in 2013-14 (ABS 2015b)
- a little under 50 per cent of the value of service exports through commercial presence abroad in 2002-03 (a large proportion of the value of service exports through commercial presence abroad is not assigned to a sector, in order to protect privacy) (ABS 2004)

- about 30 per cent of Australian gross value-added in 2013-14 (ABS 2014b)
- almost 40 per cent of employment in Australia in 2015 (ABS 2015g).

Figure 3.6 shows Australian service exports by sector in 2002-03 (through commercial presence abroad and other modes) and 2013-14 (through modes other than commercial presence abroad). As discussed above, there are limited data beyond 2002-03 for exports through commercial presence abroad, particularly for exports by sector.

Figure 3.6 Australian exports by services sector^a
2002-03 and 2013-14



^a 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 \$15.9 billion in 2013-14) 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 2013-14, is 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 (here refers only to exports through commercial presence abroad).

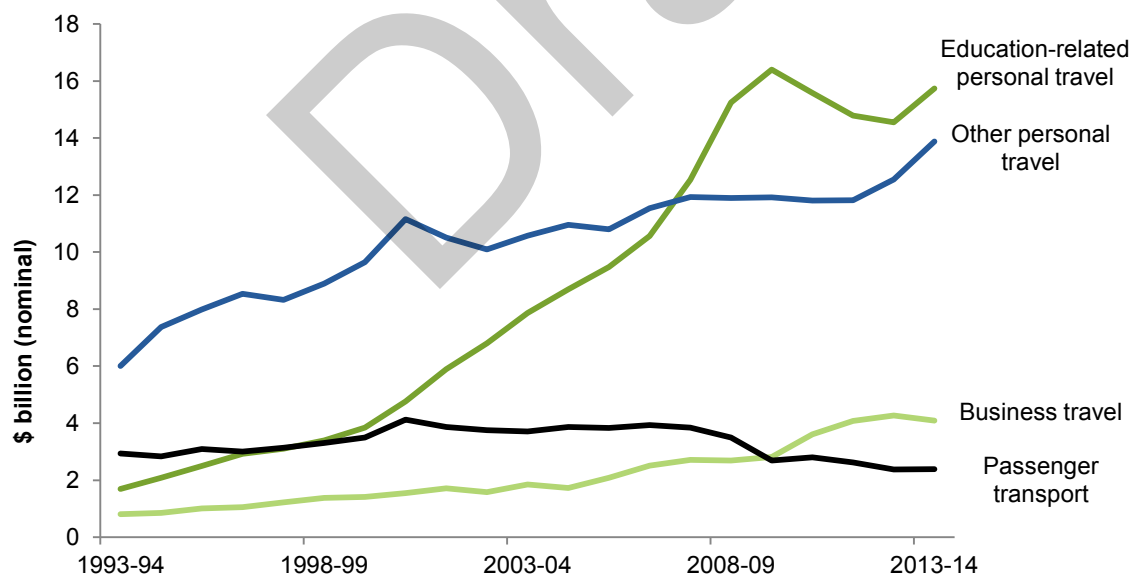
Source: Productivity Commission estimates based on ABS (2004, 2015d).

There has been strong growth in tourism exports

The value of Australian tourism exports was about \$36 billion in 2013-14 (ABS 2015c). This includes the value of expenditure by international students in Australia ('education-related personal travel'), which was \$15.9 billion in 2013-14 (ABS 2015c). (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.)

There has been strong growth in Australian international tourism over the past two decades. The number of international visitors travelling to Australia rose from 3.2 million in 1993-94 to almost 6.7 million in 2013-14 (ABS 2015h). The value of tourism exports has grown by an average of 6 per cent per year over this period (ABS 2015b). 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 family and friends, and for health-related reasons) (figure 3.7). 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 2015d).

Figure 3.7 Australian tourism exports by segment
1993-94 to 2013-14



Source: ABS (2015b).

New Zealand was the largest source market for international visitors to Australia in 2013-14, 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 3.8). China is likely to continue to be a significant source of growth in

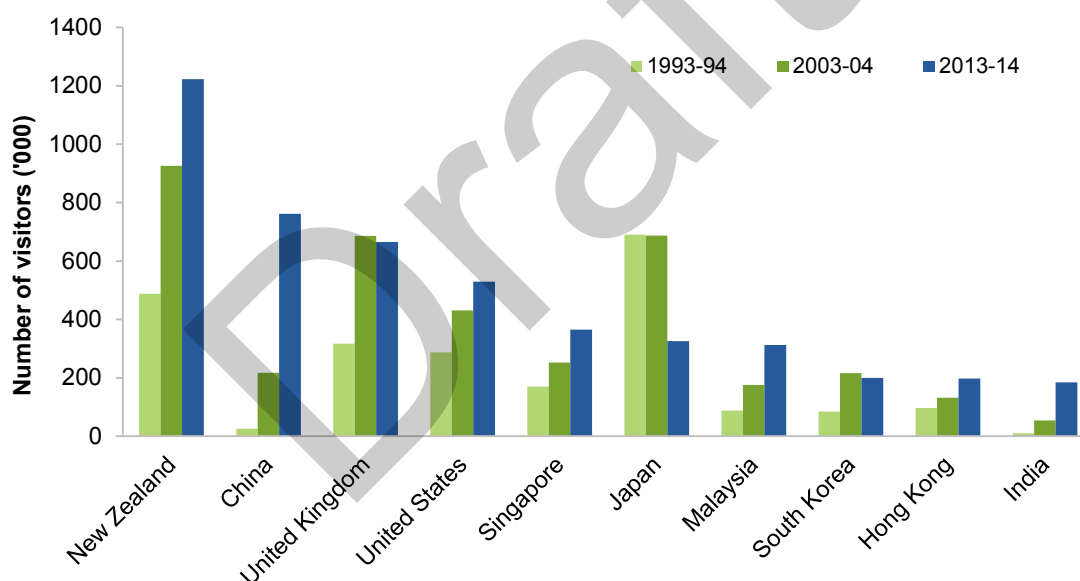
visitor numbers as real incomes in China continue to rise. The proportion of international visitors who travel to Australia to visit their friends and relatives has increased from 21 per cent to 28 per cent between 2005-06 and 2013-14 (PC 2015a). Increased migration to Australia could have contributed to this growth, as friends and relatives of migrants may visit them in Australia (Seetaram and Dwyer 2009; Seetaram 2012).

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. The Commission examined the drivers of Australian tourism exports in more detail in its 2015 research paper on international tourism (PC 2015d).

Figure 3.8 **Short-term visitors to Australia^a**

Top ten source countries in 2013-14



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

Source: ABS (2015h).

Increased demand as a result of rising incomes (section 3.3), particularly in some countries in Asia, is a key driver of international tourism. Studies have found that income in source countries is the primary driver of Australian tourism exports (Algeri and Kanellopoulou 2009; TRA 2011). One of the most important drivers of outbound travel from China — the world's fastest growing source of international tourism (UNWTO 2014) — has been the increase in real incomes, reaching an average of about US\$7600 per capita in 2014, up from about US\$190 per capita in 1980 (World Bank 2014).

Demand for Australian tourism exports is also affected by visitor preferences. 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 in the United States and United Kingdom) are running international destination marketing and other programs focused on attracting visitors from China (Brand USA 2014; British Tourist Authority 2014). Countries including Canada, the United States, the United Kingdom, Thailand and India 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 (TTF, sub. 25; PC 2015a). 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 (NTA, sub. 11; Advance Cairns, sub. 13).

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 to the Commission’s tourism research report argued that Australia was a relatively high cost destination and that this adversely affects Australia’s tourism sector (PC 2015a). 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.

The price of air travel has a significant effect on demand for Australian international tourism. Australia is a long-haul, island destination, and about 99 per cent of international short-term visitors come to Australia by air — a very small number of visitors arrive by other means, such as cruise ships. International airfares are a significant share of the total cost of travel to Australia, accounting for almost 25 per cent of total trip spend by international visitors in 2013-14 (PC 2015a). Airfares have fallen by more than half (in real terms) over the past four decades, which has lowered the cost of Australian tourism exports (section 3.3).

Education exports are mostly to Asia

In 2013-14 the total value of Australian education exports was just over \$16 billion, or about 30 per cent of total Australian service exports from all sectors (ABS 2015b). 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 an average annual rate of 12 per cent — despite falling between 2009-10 and 2012-13 (ABS 2015b).

About three quarters of international students enrolled with Australian education providers are studying in Australia. The remaining quarter are studying offshore, either at foreign campuses or through distance education, including online courses (table 3.2).

Table 3.2 International student enrolments with Australian education institutions^a
2013

<i>Sector</i>	<i>In Australia^b</i>	<i>In (onshore)</i>	<i>Foreign campus (offshore)</i>	<i>Distance education (offshore)</i>	<i>Total</i>
Higher education		230 000	85 000	25 000	340 000
Vocational education and training (VET)		134 000	50 000 ^c	na ^d	184 000
School education		18 000	18 000
English language		115 000	na	na	115 000
Other ^e		28 000	na	na	28 000
Total		525 000	135 000	25 000	685 000

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

Sources: AEI (2012, 2014b, 2015); DET (2013); DFAT (2015m).

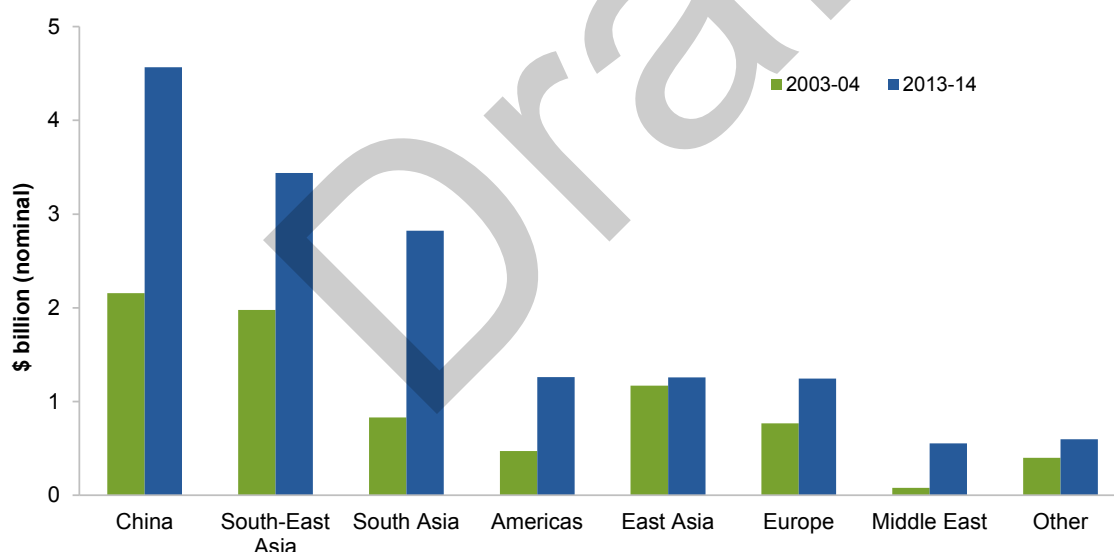
The value of Australian exports to onshore international students (‘education-related personal travel’) has grown rapidly over the past two decades (figure 3.7). This includes not just expenditure on course fees, but all expenditure by international students in Australia, including on accommodation, food and transport. In 2013-14, just over \$7 billion was fees paid to education providers by international students studying in Australia and about \$8 billion was spending on accommodation, food and transport by international students while studying in Australia.(DFAT 2015m).

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 largest countries for 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, Vietnam and South Korea (DFAT 2015m). Over the past decade, developing countries in Asia have accounted for most of the growth in Australian education-related travel exports (figure 3.9).

In 2013, 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, 2015). In 2013-14, the value of Australian education exports through cross-border supply and fly-in/fly-out was \$470 million (ABS 2015b). This includes only part of Australian offshore education exports — revenue from students enrolled at foreign campuses controlled by Australian education institutions is not included.

Figure 3.9 **Australia education-related travel exports, by region^a**



^a China includes Hong Kong and Macao.

Source: ABS (2014e).

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 key. 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 (PC 2015d).

For international students, the quality and reputation of Australian education providers 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 (PC 2015d). 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 heavily in onshore and offshore education services (Australian Government 2015c). Countries in Asia and in the Middle East are developing world-class capacity in higher education and research, and are investing heavily in higher education systems. China is also actively engaged in improving the range and quality of its domestic education services (PC 2015d).

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). The Australian Business Deans Council advocated domestic policies that ‘support a quality higher education system that is attractive to international business students and academics by investing in excellence in business learning and teaching and research’ (sub. 21, p. 1).

Although educational 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. 7, 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. However, 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. A study in 2011 stated that about one fifth of international students gained permanent residency upon graduation (Group of Eight Australia 2014). Blackmore

et al. (2014) and Tremblay (2005) found that the potential for obtaining permanent residency in the host country is a key factor in the choice of study destination for 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 2015k). There was a pattern of students choosing vocational education and training (VET) courses that provided the easiest path to a permanent visa, such as cookery and hairdressing courses (DIBP 2015k). 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 services sector. In 2009-10, the value of exports of financial services through this mode was over \$35 billion (Bingham 2011) — although it is problematic to extrapolate from this year as it was during the global financial crisis (PwC, ANZ and Asialink Business 2015). In 2013-14, the value of financial service exports (not including exports through commercial presence abroad) was \$3.4 billion (ABS 2015c).

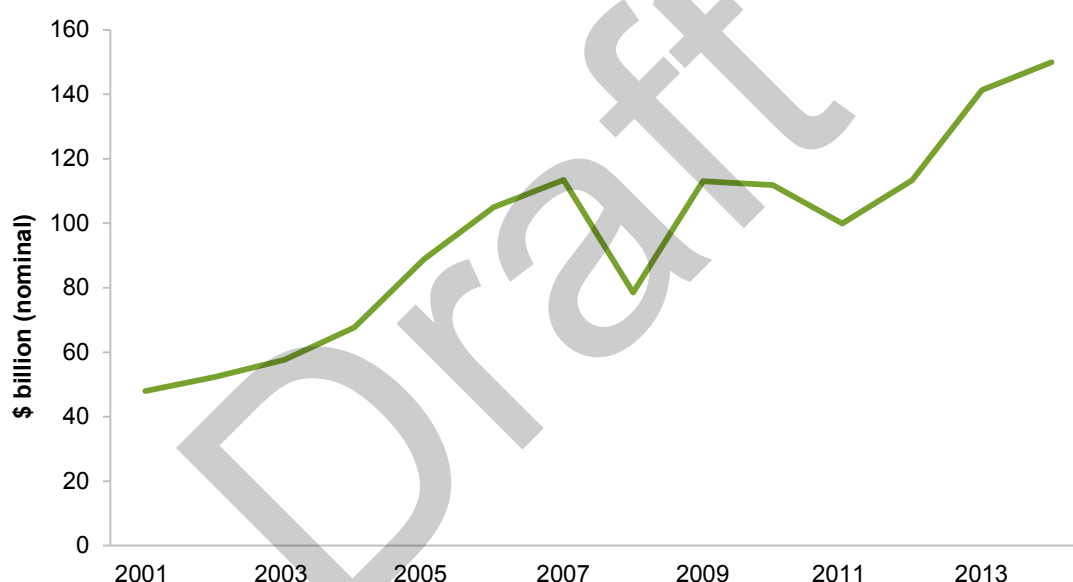
In 2009-10, exports through commercial presence abroad accounted for more than 95 per cent of financial service exports through all modes (ABS 2015b; Bingham 2011). There are several explanations for the relative importance of commercial presence abroad as a mode of export for Australian financial services. 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 (figure 3.10). Financial service exports through other modes increased by about 70 per cent over the same period (ABS 2015b).

In 2009-10, more than three quarters of Australian 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) (table 3.1; Bingham 2011; 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. Continuing reductions in the costs involved with trading services between parties that speak different languages (section 3.3) are likely to reduce the relative importance of English-speaking markets for Australian exports of financial services.

Figure 3.10 Stock of Australian outward FDI in financial services^a
2001–2014



^a FDI: foreign direct investment as of 31 December.

Sources: ABS (2010, 2014d, 2015e).

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 the United States, Europe and Asia. 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 that year (a little over

\$9 billion) (Bingham 2011). In 2009-10 no other type of financial service accounted for more than 10 per cent of exports through commercial presence abroad, although the value of exports of credit granting services (\$2.3 billion) and portfolio management services (\$1.3 billion) were 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 the 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 3.3).

Box 3.3 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 Vietnam and the Philippines
- 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).

Over the past few decades, rapid income growth in Asia (section 3.3) 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). Hence, 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 2008 to 2013, the wealth of ultra-high net worth individuals in the Asia Pacific grew at an

average annual rate of 17 per cent, compared to 8 per cent in other regions (Capgemini 2014).

Technological change has lowered the costs of trading many financial services that are now commonly traded online such as insurance, loans and brokerage (section 3.3). Technological change has also affected the funds management sector through, for example, the introduction of exchange-traded funds (ETFs), which give investors low-cost exposure to overseas markets. Auster and Foo (2015) argue that ETFs may reduce investors' appetite for higher-cost means of gaining exposure to overseas markets, such as offshore investment advisors or financial products.

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 Singapore and Ireland 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.

North America is the largest market for professional service exports

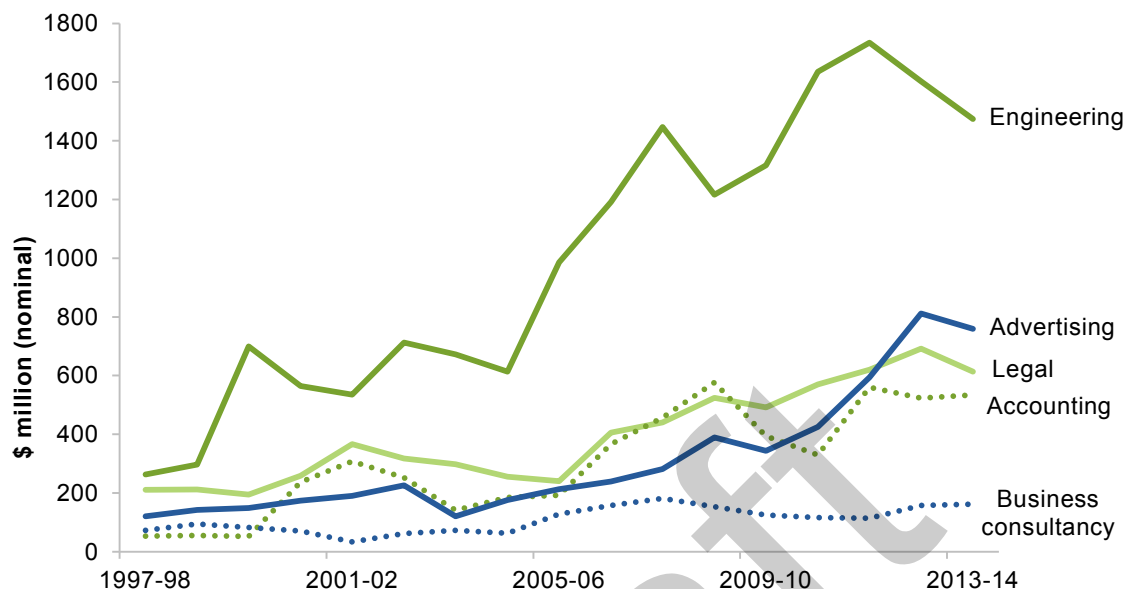
In 2013-14, the value of Australian exports of professional services was about \$6 billion (ABS 2015b). This includes services provided by engineers, architects, accountants, lawyers, management consultants, advertisers, market researchers and other professionals. The value of professional service exports has grown rapidly over the past two decades, averaging 10 per cent growth a year (ABS 2015b).

In 2013-14, engineers accounted for the greatest value of service exports of any professional group, despite a fall in value over the past couple of years (ABS 2015b). 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 3.11).

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 2015b).

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 3.11 Australian exports of selected professional services^a
1997-98 to 2013-14



^a Advertising includes market research and opinion polling services.

Source: ABS (2015b).

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)

Drivers of professional service exports

The costs of trading services (section 3.3) are an important driver of professional service exports. In a 2013 global survey of managers and business professionals, IT and communications infrastructure — which affect the costs of trading services, particularly for exports through cross-border supply — were considered among the most important drivers of competitiveness in all professional services sectors (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 services and legal services tend to follow investment flows (box 3.4). 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 3.4 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 Europe, Asia 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.

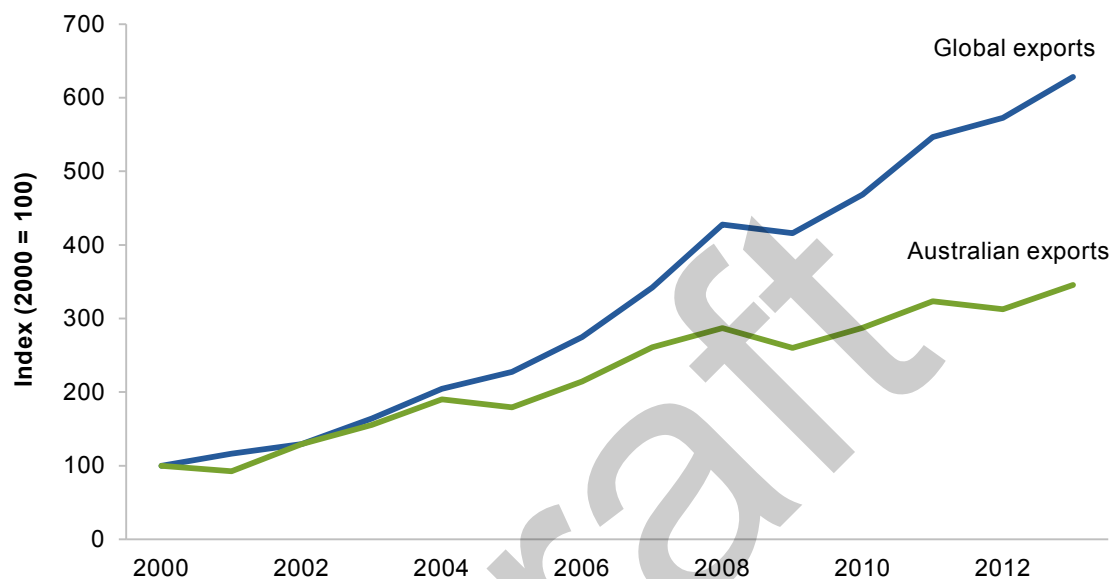
IT consultancy accounts for two thirds of IT service exports

In 2013-14, the value of Australian IT service exports was about \$2 billion (ABS 2015b). 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 3.12).

IT consultancy services (hardware and software) accounted for about two thirds of total Australian IT service exports in 2013-14 (\$1.3 billion). Exports of software licenses were significant in that year too, valued at a little over \$250 million (ABS 2015b).

Available data on the destination of Australian IT service exports is sparse. A 2015 survey by the Australian Export Council 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).

Figure 3.12 Australian and global exports of IT services^a



^a Measured in nominal US\$. IT defined as 'computer and information services'.

Source: WTO (2015).

Drivers of IT service exports

Global IT service exports are driven by falling costs of trade, by rising demand (particularly in Asia) (section 3.3), and by technological advances that have allowed the creation of new products. Australian IT service exports are also driven by factors affecting the export of IT consultancy services.

Advances in information technology have allowed the creation of new hardware and software. 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 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 services are a small contributor to service exports

Australian exporters are meeting the increasing demand for health services in three ways: 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, the United Kingdom, Indonesia and Malaysia (Ramsay Health Care 2015a).

There are limited data available on medical-related travel to Australia. Deloitte Access Economics (2011) estimated that in 2010, there were around 13 000 visitors to Australia for medical reasons, which was only about 0.25 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 \$50 million (Deloitte Access Economics 2011).

Most people visiting Australia for medical reasons come on regular visitor visas rather than medical visas. In 2009-10, Australia issued fewer than 2500 medical visas — equal to about 20 per cent of those people who visited Australia for medical-related reasons in 2010 (Deloitte Access Economics 2011).

The main source markets for medical-related travel to Australia between 2005 and 2010 were countries in Australia's immediate region — New Zealand, and Pacific nations such as Papua New Guinea, New Caledonia, Vanuatu and East Timor. 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 (Deloitte Access Economics 2011).

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 25 000 out of 340 000 international

enrolments) in Australian higher-education courses in 2013 (counting both onshore and offshore enrolments) (table 3.2; DET 2014b). 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).

In 2013-14, the value of Australian health service exports through cross-border supply and fly-in/fly-out was \$37 million (ABS 2015b). 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 2013-14, the gross value added of the domestic health care and social assistance industry was over \$100 billion (ABS 2014b).

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). These global factors affect demand for Australian health service exports, as do the availability and quality of Australian health services, and the prices of health services in Australia relative to other countries. Health services provided in Australia are typically more expensive than in key competitor destinations for medical-related travel such as India, Singapore, South Korea and Thailand — partly as a result of Australia's high labour costs relative to these countries (Deloitte Access Economics 2011). However, this is not the case for health services provided through commercial presence abroad where labour is employed under market conditions in lower-wage countries.

Globally, the number of people aged 60 years or over 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).

Demand for health services rises with income, as does demand for health service exports, including through the expansion of health insurance schemes. All developed countries (with the exception of the United States) have universal health coverage, and most developing countries without universal coverage are aiming to achieve it (CEPAR 2013b). For example, China enrolled 1.2 billion people into the health insurance system between 2003 and 2013, and increased coverage for rural citizens from near-zero to almost 100 per cent in just five years (CEPAR 2013b). According to the Centre of Excellence in Population Ageing Research (2013b), both Vietnam and the Philippines are en route to achieve universal coverage, although their current coverage levels are low.

In Asia, labour mobility and the growing proportion of older people are eroding traditional family support networks in which older people live with their families (CEPAR 2013a). Additionally, increases in life expectancy are occurring in developing Asian countries at much lower levels of income per capita than they did in developed Western countries. For example, life expectancy in China is just three and half years less than in the US (although income per capita in the US is ten times that of China) (CEPAR 2013a). These factors boost demand for health service exports to Asian countries, especially exports of aged care services through commercial presence abroad. Under the China-Australian Free Trade Agreement, signed in June 2015, Australian companies will be able to establish profit-making aged care institutions throughout China, and wholly-owned hospitals in some provinces (DFAT 2015h).

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 a more sophisticated market with countries specialising in types of care or procedures. For example, holidays and medical 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 of 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. A significant proportion of medical-related visitors to Australia come from smaller countries in the Pacific — such as Papua New Guinea and New Caledonia — in which there is insufficient demand to support the provision of some specialist or very high quality health services. Australia also compares well on other aspects of quality such as the prevalence of antibiotic resistance rates and state of the healthcare system (Deloitte Access Economics 2011).

Australian health professionals also deliver health services to residents of other countries on humanitarian grounds, either in Australia or offshore. For example, not-for-profit organisation Interplast sends qualified Australian and New Zealand volunteer plastic and reconstructive surgeons, anaesthetists, nurses and allied health professionals to the Asia-Pacific region to provide free surgical treatment for patients who would otherwise not be able to afford access to such services (Interplast 2015).

Draft

4 Domestic barriers to service exports

Key points

- The priority for the Australian Government should be policy reform that promotes competition and provides incentives for domestic firms, including in services sectors, to innovate and lift their productivity. Determining policy on the basis of matching policies in other countries — with the expectation that it would help Australian service providers to increase exports — could have broader consequences and impose substantial costs when considered from an economywide perspective.
- Consistent screening thresholds for Foreign Investment Review Board examination of investment proposals across investors from different countries would provide a clearer and more transparent 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 community-wide 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.
 - Whether governments are justified in undertaking international marketing and promotion activities can only be determined on a case-by-case basis. The case for government involvement should be supported by a rigorous economic analysis of the costs and benefits to the community, both prior to the activity being funded, and following the activity's completion.
 - The Export Finance and Insurance Corporation (EFIC) should be confined solely to providing export finance to newly exporting small and medium-sized enterprises. Steps should be taken to improve the transparency of EFIC's operations.

Service exports, and trade more generally, are intrinsically linked to domestic regulatory and policy settings. In many instances the service sector can be heavily regulated and protected, 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 and regulatory 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 equally (Dee 2005b).

This chapter examines the domestic barriers to service exports that are cross-cutting in nature — that is, barriers that apply to more than one service sector. It also examines the ways in which governments provides export assistance. Barriers that are specific to the financial services; education and health services; and tourism, professional and information technology service sectors are considered in chapters 6 to 8.

Maximising community wellbeing should be the objective

Domestic policy and regulation 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 — this will invariably lead to exports of some goods and services and imports of others. Reforms can be undertaken in Australia's best interest, using regulation that addresses efficiency or equity objectives in a way that is no more burdensome than necessary.

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).

The Commission agrees, but would go further and note that domestic policy settings have a far broader role than just facilitating trade. The overriding priority should be sound policy settings that facilitate competition and enhance productivity. For example, the Independent Schools Council of Australia (sub. 24) submitted that there would be significant benefits from addressing overlaps between the general domestic regulations and the education services for overseas students (ESOS) framework. (This issue is being considered as part of the Department of Education's current review of the ESOS framework.)

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 the Australian Information Industry Association and the Department of Foreign Affairs and Trade (DFAT):

... 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)

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, equity objective or regulatory barrier. For example, regulatory concerns have been raised in relation to new forms of service provision such as Uber and Airbnb (concerns include safety and local noise respectively) (PC 2015a). Regulations to address any 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 and regulatory 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 compete against, and use, those services. More generally, increased competition from foreign service providers could put downward pressure on domestic prices, providing benefits to businesses and individuals consuming those services.

The broader purpose of domestic regulatory and 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 that go beyond the services sector are important, such assessment should be undertaken in the context of broader policy reviews.

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

Some participants submitted that Australia should have ‘competitive’ policy settings in order 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)

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 outlined above. 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 competing with other countries. For instance, if another government provides industry subsidies, attempting to compete by providing a matching subsidy in Australia would divert resources from their most efficient uses and make the Australian community worse off overall.

Broader community welfare considerations should be the basis for domestic policy settings, regardless of how other governments proceed. For example, setting prudential regulation on the basis of maintaining competitiveness with other countries could undermine financial system stability in Australia, with ramifications that are broader than those specific to service exports (chapter 6). It may be possible to draw on the experiences of other nations, 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.

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 exporters by inhibiting supply. First, it might reduce the sources of capital available to firms in the service sector 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 (for example, some investment proposals might not be submitted, on the expectation that they would be rejected).

Table 4.1 Foreign investment review thresholds

	Threshold — partner countries subject to higher threshold ^a	Threshold — other countries
	\$ million	\$ million
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 ^b	252	252
Rural land	1 094 ^c	252 ^d
Foreign government investors: all direct investments, new business proposals and interests in land	0	0

^a 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. ^b Sensitive sectors are media, telecommunications, transport, defence and military related industries, and the extraction of uranium or plutonium or the operation of nuclear facilities. ^c A proposed change to \$15 million (cumulative value of rural land owned by the foreign investor) for China, Japan and South Korea is currently under consultation. ^d Proposed change to \$15 million (cumulative value of rural land owned by the foreign investor) is currently under consultation (subject to some exceptions associated with trade agreements).

Source: Australian Government (2015h).

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 act as a barrier to exports by restricting productivity spillovers:

A more liberal approach to inward FDI [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 services firms if other countries respond with reciprocal restrictions on investment:

Australia's own stance on foreign direct investment also has negative implications for Australian services companies seeking to operate overseas. Media coverage of Australian Government decisions to reflect 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 must run their business,¹ which could act as a barrier by increasing costs for service providers seeking to export.

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

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 2015b). 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 wide range of businesses, including those that export services. Through 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. This is not to say the foreign investment framework has no effect. AFMA (sub. 14) highlighted that data from the United Nations Conference on Trade and Agriculture showed that US\$87.8 billion in cross-border mergers and acquisitions into Australia were withdrawn for political or regulatory reasons between 2008 and 2012, a greater value than in any other country. This is a substantial figure in the context of just over US\$140 billion in cross-border mergers and acquisitions into Australia over that period (UNCTAD 2015). Of relevance to service exports, the mergers and acquisitions withdrawn include the proposed acquisition of ASX Limited by Singapore Exchange Limited, blocked in 2011 by the Australian Treasurer.

Notwithstanding the issues noted above, wide-reaching reforms to the foreign investment framework are not canvassed in this study. More directly relevant in the context of this study are the foreign investment screening thresholds applied across investors from different countries. 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 exporters 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.

DRAFT 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 can be 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. For example, 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 2015a). In a submission to this study, the National Tourism Alliance stressed that 'tourism requires urgent and extensive investment in its infrastructure', identifying aviation and port infrastructure, accommodation, and tourist attractions as areas where increased capacity is needed (sub. 11, p. 21).

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 and regulatory settings are a barrier to infrastructure investment. Government involvement in infrastructure investment (for example, support for investment in tourist 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

Policy options to improve the adequacy and quality of infrastructure depend on whether the infrastructure is provided and/or funded by government. Governments have a role in providing some infrastructure on public land, to meet an equity objective or where market failures mean the infrastructure is unlikely to be provided by the private sector (or would be underprovided). Examples include network infrastructure such as telecommunications networks, public school facilities and some infrastructure in national parks.

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.

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 2015a). 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 (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 principle 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).

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. For example, the National Tourism Alliance (sub. 11) argued that reforms should be made to the Building Code of Australia where tourist developments are disadvantaged, in particular relating to accessible room standards. The Commission has previously concluded that accessible room standards may impose an unnecessary burden on the tourism sector and that it would be appropriate to examine the issue as part of the five yearly review of the Premises Standards in 2015 (PC 2015a).

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, 2015a). 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 2015a). 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.

DRAFT 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 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 project 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.

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 (HRSCEFA 2007).

Employment in the mining industry peaked in mid-2012 and as of February 2015 had fallen by almost 20 per cent from that peak (ABS 2015g), releasing labour back into 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 also can significantly influence innovation, skill formation and growth in different industries (PC 2015g).

The effect of the workplace relations framework on service exports

Workplace relations policy settings can have substantial implications for all parts of the economy, including service exports. Costly bargaining arrangements, for example, could act as a barrier that inhibits the supply of service exports by increasing the cost of export operations through higher labour costs. Adagent Pty Lty cited rigid and restrictive employment laws as a key barrier to service exports (questionnaire 1).

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 (sub. 11) and the Tourism and Transport Forum Australia (sub. 25) argued that there is a need to reform workplace regulation (including the penalty rates system) to recognise the 24/7 economy.

Workplace relations changes should be assessed in a broader context

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 appropriate consideration to communitywide effects. The Commission has not made any recommendations or findings regarding the workplace relations framework in this study because it is currently being reviewed in the Productivity Commission's concurrent inquiry into the workplace relations framework. The draft report

for that inquiry was released on 4 August 2015 and included draft 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 employee skills required to provide services for export. Where policy and regulatory settings do not facilitate training of employees with the skills that services firms require, this can be a barrier that inhibits the supply of service exports. For example, Service Skills Australia (sub. 27) raised the need for a strengthened vocational education and training system that delivers the skills that industry needs.

The Export Council of Australia (sub. 32) and Australian Information Industry Association (sub. 7) recommended additional support for training and skills development specifically 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 National Tourism Alliance (sub. 11) and Service Skills Australia (sub. 27) highlighted issues with the 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.

Education and training programs should have broad-based eligibility

The need to match workforce capability to employer needs is far broader than service exports — it 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 really need (as opposed to what they say they 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 payments² and greater managerial independence for public training providers.

The rationale for additional government support for training specifically 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 (relating to broader community benefits of education) 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 that accrue beyond the firm that provides the training or the employee that receives it. It is not clear that those spillover benefits are, or will be, larger for the five sectors that the Fund currently targets.

As noted in the Commission's 2013-14 Trade and Assistance Review, 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 2015f). 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 activities, including those in the tourism and hospitality sector.

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

DRAFT 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.

² 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).

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

^a Planning levels are set by the Australian Government each year and monthly monitoring ensures visa grants are consistent with planning levels. ^b A number of other temporary resident visas are also available, the majority of which are granted for short stay or entertainment purposes (DIBP 2014b). Also, under the Trans-Tasman Travel Arrangement, New Zealand citizens are able to enter Australia freely and live in Australia on an indefinite basis. ^c Includes 51 939 visas granted to primary applicants, with the remainder granted to their dependents (DIBP 2014b, 2014c). ^d Annual limits apply to the number of 462 visas that can be issued to applicants from all current countries with which Australia has reciprocal arrangements, with the exception of 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. There is 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. A Joint Review of Border Fees, Charges and Taxes was undertaken by The 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 in specific areas 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.

Costs and benefits of changes to eligibility for temporary work visas

Reducing constraints to filling short-term 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. Restrictions on eligibility for temporary work visas are unlikely to be a substantial barrier to service exports, given the need for some visa restrictions to maintain immigration integrity.

Temporary skilled migration

The objective of the temporary skilled migration visa 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 shortages 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. This would allow assessment of any effects on student enrolments and breaches of visa conditions.

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:

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

There could be greater merit in further consideration of relaxing eligibility conditions for extensions to working holiday (subclass 417) visas.³ Three months of work must be completed in agriculture, mining or construction in a regional area in order 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 a number of workers into regional areas (where they might be willing to work for less than market rates) in order 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 working 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)

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) 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.

³ Work and holiday (subclass 462) visa holders are not eligible to extend their visa for a second year.

These issues are relevant to substantial export markets — in particular, education exports to a wide range of recipient 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).⁴ 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 and subsidised education

There are not strong equity grounds for extending access to public services to temporary immigrants. On average, temporary skilled migrants earned \$95 500 in total remuneration in 2014-15 (to March 2015) (DIBP 2015j), compared with the average full time adult wage in Australia (in November 2014) of \$80 480 (ABS 2015a). 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).

Nor is there 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.

There is also 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

⁴ 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).

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).

For these reasons, the Commission does not see a strong case for extending temporary immigrants' access to national public health cover or subsidised education. Similar arguments apply to extending access to public healthcare to international students. (Access to healthcare through Reciprocal Healthcare 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.)

DRAFT RECOMMENDATION 4.4

Australian, state and territory governments should not extend temporary immigrants' 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).

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 international 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.

DRAFT 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.

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 potentially reduce the barriers to exporting faced by firms. These government programs 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, general brand and image marketing undertaken under the Australia Unlimited program, and destination marketing such as that conducted by Tourism Australia.
- information, advice, and market research, including services provided by the Australian Government, through Austrade, and the various trade organisations of the state and territory governments
- finance and insurance — loans and other finance products principally provided by the Export Finance and Insurance Corporation (EFIC).

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-to-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 the USA, Japan, South Korea, the Middle East, China, Hong Kong, India and South East Asia (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 firms 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 enterprises 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).

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)

As noted in chapter 2, domestic policies designed to facilitate service exports should address a market failure or meet an equity objective, and should be expected to provide net benefits to the community. 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. Net benefits will not be present where assistance fails to create additional economic activity (that is, where the recipients of export assistance would have undertaken the export activity even in the absence of assistance). To enhance accountability and to help inform future expenditure decisions, government programs should be evaluated at their completion to assess their effectiveness against their policy objective.

Even where the above criteria are satisfied, it does not necessarily mean there is a case for government *funding* of export assistance programs. As the benefit of export assistance accrues primarily to businesses, funding it from general revenue constitutes an implicit subsidy to these businesses 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 must be weighed against the administrative and compliance costs of identifying and charging those benefiting from government provision.

Is there a rationale for the current export assistance schemes?

The provision of cash 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 firms and industry representatives were supportive of grants schemes, particularly the EMDG scheme. For example, the Export Council of Australia 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)

Others called for expansion of the EMDG (ATEC, sub. 16; AIPE, sub. 22).

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 up to eight grants with a maximum value of \$150 000 to each eligible applicant.

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 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 95 applicants. 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 industry under two separate programs.

- The Tourism Quality Projects Grants Program offered matched funding of between \$15 000 and \$100 000 to support tourism industry 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 (TDDI) Program. Under the TDDI 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).

The EMDG scheme is currently being reviewed to assess its effectiveness 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 (Austrade 2015a).

The Commission notes the current review of the EMDG would be improved by conducting an assessment of the rationale for the provision of government grants to businesses seeking to export. Grants programs aimed at increasing the overall level of exports, including service exports will not necessarily result in a net benefit to the community (chapter 2). Governments should only provide grants to businesses where they address a market failure, or where they meet an equity objective, and the communitywide benefits of providing the grants outweigh the costs.

DRAFT 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.

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 4.4)
- 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 4.5)
- tourism promotion through destination marketing, such as the work of Tourism Australia and its state and territory equivalents (chapter 8).

The benefits arising from international marketing and promotion programs such as these can have ‘public good’ characteristics. Public good characteristics are present where the benefits of such promotion can be captured by a variety of businesses, and it is not feasible to exclude those businesses that benefit from the campaign but do not contribute to the costs. 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.

The presence of free riding is not sufficient to justify government provision of marketing. The test for government involvement is whether it would generate net benefits to the community, relative to no government involvement. 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.

Box 4.4 **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, 2015b).

Box 4.5 **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 (2015c).

The need for economic assessments for international marketing and promotion programs

Whether governments are justified in undertaking international marketing and promotion activities can only be determined on a case-by-case basis. The case for government involvement should be supported by a rigorous economic analysis of the costs and benefits to the community, prior to the activity being funded. 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 in recouping the costs from them. 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 be more effective 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 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). For example, in the higher education sector larger providers 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 programs being assessed prior to funding, programs should also be assessed following the activity's completion. Ex-post evaluation should be publicly available to enhance government accountability and to create information on which to base future policy settings. This principle is consistent with that outlined for destination marketing and is covered in draft recommendation 8.1.

Government provision of information

The Australian Government through Austrade (box 4.6) and some state and territory governments (box 4.4) provide information, advice and market research to firms seeking to export, including service providers. Participants 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).

Box 4.6 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 domestic 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 in order 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 (2014b, pers. comm., 21 July 2015); DFAT (sub. 31).

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 in overseas markets and badge-of-government assistance to firms in-market. For example, the Royal District Nursing Service noted that Austrade helped them 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 in-principle case for government provision of information

There is an in-principle case for government bodies to provide information to businesses where the information is collected anyway in order to improve the effectiveness of government activities (PC 2015a). For example, Austrade provides 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). There is a case for providing the information collected during the course of performing these functions to service providers.

Care should be taken by governments to ensure that their provision of information to businesses does not crowd out private provision. Where government provision crowds out an activity that would otherwise have been undertaken privately it imposes unnecessary costs on the Australian community, such as the opportunity cost of government funds, or the cost of raising additional taxation revenue. Private sources of export information and advice include consulting firms, and industry bodies, such as the Export Council of Australia and the Australian Institute of Export.

Cost recovery is appropriate where there is a private benefit that can be captured by users

Where there is a private benefit that can be captured by the business receiving the information, government charges will encourage efficiency by giving users important price signals and will also assist government agencies to use their resources efficiently (PC 2001). Where the beneficiaries of information provided by government can be easily identified, this facilitates cost recovery.

The Commission notes that at present some costs of providing information to businesses seeking to export are recovered by government agencies, while others are not. For example:

- 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. However, 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. Cost recovery should be pursued where the administrative and compliance costs of identifying and charging the beneficiaries do not outweigh the benefits arising from improvements in resource allocation.

DRAFT RECOMMENDATION 4.7

Where the administrative and compliance costs of identifying and charging the beneficiaries do not outweigh the benefits arising from improvements in resource allocation, 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.

The provision of export finance and insurance products to exporters

The Export Finance and Insurance Corporation (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. This would require EFIC to charge prices that cover the expected full economic costs of provision — a standard not met for many of EFIC's activities.

The Australian Government has taken steps to address the Commission's 2012 recommendations. The recent passing of the *Export Finance and Insurance Corporation Amendment (Direct Lending and Other Measures) Act 2015* (Cwlth) removes EFIC's exemption from competitive neutrality to ensure that EFIC's fees cover the full economic costs of provision. The Australian Government also introduced the *Export Finance and Insurance Corporation Amendment (New Mandate and Other Measures) Bill 2013* (the Bill), which included a number of changes to the EFIC Act intended to (among other things):

- restrict EFIC's operations to areas where there was a clear market failure
- ensure it focused its activities on SMEs.

The Bill lapsed at the end of the 43rd Parliament on 5 August 2013. 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 Expectation 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, or that such support is at the expense of SME transactions (Robb 2014).

While the Statement of Expectations is an improvement over the status quo, further reform is required as the Statement stopped short of ruling out the provision of financial support for large firms — and of ensuring export assistance is directed to the areas of greatest benefit to the community as a whole.

The Commission reaffirms its position that there is no evidence that market failures impede large firms from accessing financial services. EFIC's involvement where there is no case for government assistance will impose a net cost to the Australian community. Where there is no market failure, EFIC's involvement will not create additional economic or export activity *unless* the price of its financial services fails to cover the full economic cost of provision, in which case recipient firms are being unjustifiably subsidised by taxpayers.

Assistance to large firms continues to represent the bulk of EFIC's transactions. In 2013-14, the value of EFIC's support for large businesses and overseas projects accounted for 81 per cent of the face value of facilities signed in that year (EFIC 2014).

The Export Finance and Insurance Corporation should be refocused to a market failure objective — that is, EFIC’s commercial role should be *solely* focused on reducing barriers for newly exporting SMEs in accessing financial services.

DRAFT RECOMMENDATION 4.8

The Minister should amend the Statement of Expectations to confine the commercial role of the Export Finance and Insurance Corporation solely to providing export finance to 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.

The Australian Government should make amendments to the *Export Finance and Insurance Corporation Act 1991* (Cwlth) to this effect.

Changes to enhance transparency are also required to ensure that EFIC’s activities are consistent with the objective set out above. In particular, EFIC’s reporting does not provide information on how effectively or efficiently EFIC is fulfilling its mandate or meeting the objectives of the EFIC Act and the Statement of Expectations. Consistent with the Commission’s 2012 review of EFIC, a new performance management framework should be developed by EFIC with indicators based on the objective of addressing the market failures affecting newly exporting SMEs.

DRAFT 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, based on a clearly defined and rigorous objective under the *Export Finance and Insurance Corporation Act 1991* (Cwlth), directed at market failures affecting newly exporting small and medium-sized enterprises. The framework should be developed in consultation with other Australian Government agencies, 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.

5 International barriers to service exports

Key points

- International barriers to service exports are pervasive. International barriers affect all Australian service export sectors and can impede the provision of services through all modes of supply.
- Two cross-cutting barriers that have been an increasing focus for researchers, governments and the private sector are restrictions on cross-border data flows and violation of intellectual property rights.
 - 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. Removing restrictions would reduce the upfront and ongoing costs for Australian service providers from supplying some export markets. 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. Other methods are available to address data security and privacy concerns, including contracts and laws.
 - Australian service providers, including providers of architectural, engineering and software services, would benefit from other countries better meeting their commitments to enforce intellectual property rights.
- There are also restrictions on the movement of people, such as burdensome licensing regulations and visa processes, and restrictions on Australian service firms establishing a foreign commercial presence.
 - 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 highlighted the market for legal services in India as an area where large gains from reducing barriers could be achieved.
 - Reducing barriers to Australian firms establishing a commercial presence in another country could have large benefits for firms seeking to export their services in this way, particularly in the financial services sector, which currently provides the majority of its exports through foreign commercial establishments.

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 Australia's largest service export destinations, including China (the largest), India (the 5th largest) and Indonesia (the 8th largest) (table 3.1, chapter 3). The data also suggest that Australia imposes a low level of restrictions to service trade for these sectors relative to other countries in the database.

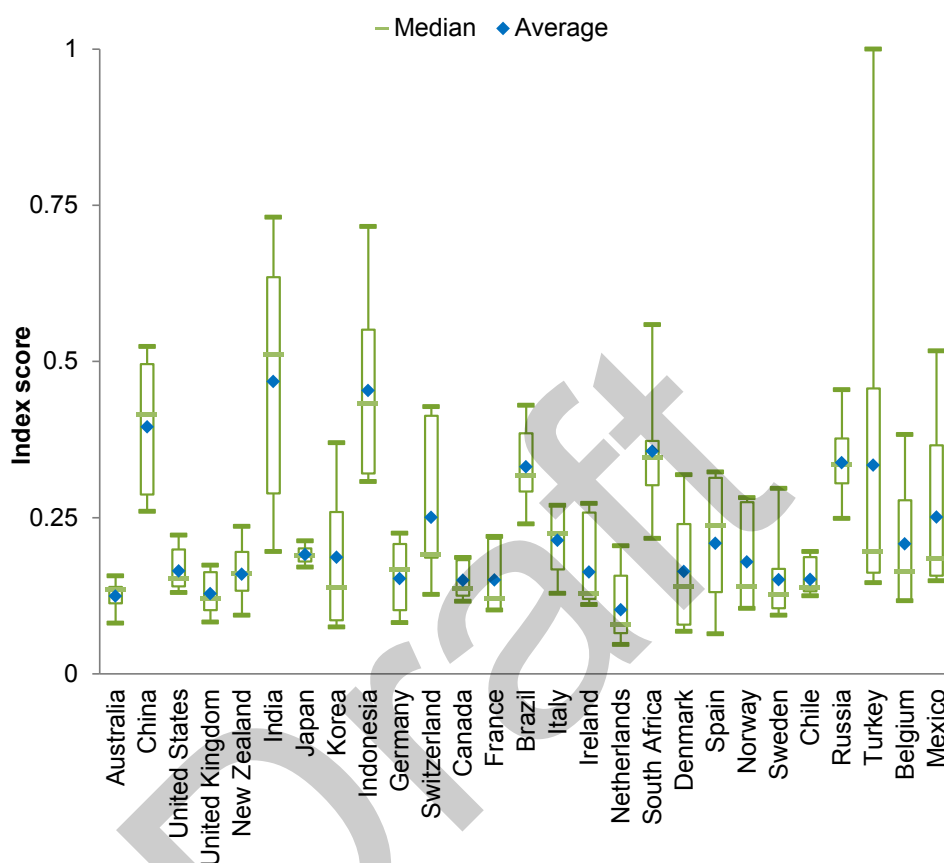
The highest index scores are in subsectors that have traditionally been subject to a high level of regulation — the legal, accounting, insurance and banking subsectors (figure 5.2). In these subsectors there are some outlier countries with much higher index scores than average. India and Indonesia have 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 licensing regulations, and foreign ownership 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 service trade. Two cross-cutting barriers not included in the database, but that have been an increasing focus for researchers, governments and the private sector, are restrictions on cross-border data flows and violation of intellectual property rights. These barriers have also 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^{a,b,c}**

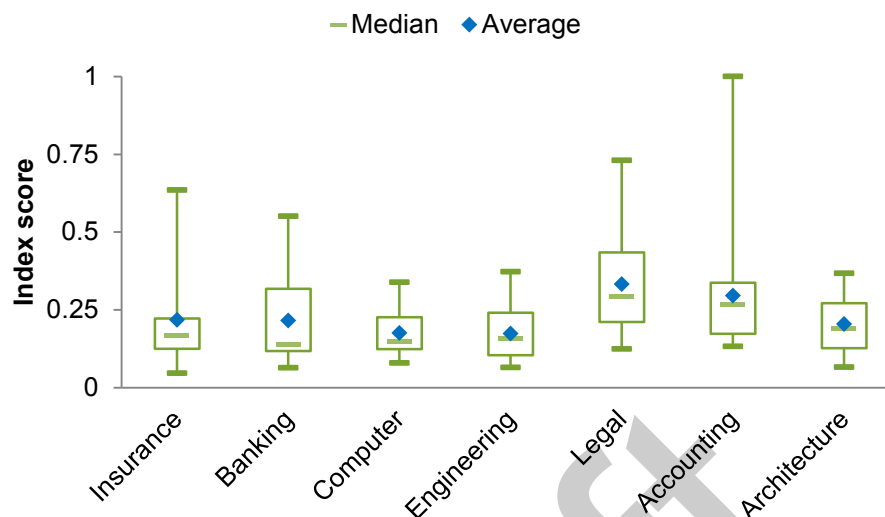
Countries in the OECD database that are in Australia's top 40 trading partners, and Australia



^a 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. ^b 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. ^c 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).

Cross-cutting barriers to trade affect more than one service sector. 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; licensing and standards regulations; and investment barriers in overseas jurisdictions.

Figure 5.2 Services trade restrictiveness by subsector^{a,b,c}

^a 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. ^b 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. ^c 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 (2004, 2015b); 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 services sectors rely on the internet and the movement of data across borders to export their service. 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 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.¹ 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 its IT expenditure on 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.² 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 (see below, Business Roundtable 2015). 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 forms of data localisation measures (box 5.1). Some measures apply to any personal or business data, and so can potentially 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 allow data to flow into other countries provided they meet certain standards of data protection.

¹ 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).

² 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.

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 due to come into force in September 2015 will require all personal data of Russian individuals to be stored and processed in local data centres (DLA Piper 2015).
- In Canada the Federal Government's request for proposals to consolidate its IT services stipulates that the government's data cannot 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 2015). (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 and other arrangements inhibit, or may inhibit, 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, or to help meet other objectives such as industry protection, regional development or local employment objectives. The Explanatory Memorandum for the *Personally Controlled Electronic Health Records Act* said 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). The French Government declared its support for efforts to keep data storage and processing local to support domestic employment (Chander and Le 2014). In New Zealand, the Inland Revenue

Service provides permission to store business records offshore if doing so does not hinder its tax compliance activities (IRS 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 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 (TPP) and Trade in Services Agreement are expected to include provisions that address cross-border data flow issues, although details are not yet public. The TPP provisions are expected to prohibit both restrictions on legitimate cross-border data flows and requirements to store data in the originating country (APEC 2014c).

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. For example, ongoing

costs can be increased where data localisation prevents service providers from benefiting from the scale economies available from processing data in regional data hubs. Australian financial service providers such as ANZ and Westpac operate regional data hubs in Asia. ANZ (2013, p. 4) said that restrictions on cross-border data flows ‘inhibit organisations’ ability to gain the full benefits of new technologies’. 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). 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 can increase the upfront costs of establishing export operations for Australian service providers. Data localisation measures will increase upfront costs 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)

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. 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 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 also benefits 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 measures that promote data security and privacy, it is not clear that data localisation measures are the best method of promoting data security and privacy.

- 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 it is stored, only on the measures used to store it. In consultations study participants noted that security protocols are more important than where data are stored.
- Castro (2013) 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 many 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.

Regardless of whether data localisation measures increase data security and privacy, if concerns about security and privacy are not adequately addressed then removing such 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. These outcomes could reduce service exports.

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 for IP rights is to increase incentives to create new products by enabling innovators to capture a sufficient amount of the benefits to support the initial investment. 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.

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 — for example, because 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, 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 Western Australian Government argued that unreliable IP and copyright guidelines in Indonesia restrict trade (Government of Western Australia 2011).

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 has also not sought to win business in China or India, where it considers it would not be able to receive legal remedies if its intellectual property is 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).

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). Chapter 9 includes a discussion on the role of IP rights provisions in Australia's trade agreements and a draft recommendation for addressing IP issues relating to service exports.

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 would 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.
- 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).

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). On the basis of evidence

available to the Commission, better enforcement of IP rights in other countries could help to reduce 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 by reducing demand for their services and increasing 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 strengthen IP rights agreed through TRIPS. Analysis indicates that extensions in the duration of copyright protection under the Australia-United States agreement (which extended the term of copyright to the life of the author plus 70 years and compares 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 some benefits to Australian service providers, this should not be considered justification for extending the coverage of IP in negotiations. Any IP provisions in trade agreements should take account of the net effect on Australian consumers and the Australian community (see chapter 9).

5.4 Licensing and standards regulations

The role of licensing and standards

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 who can supply services.³ 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.

³ This report generally uses the term 'licensing' to refer to all of the different forms of authorisation for providing a service. Terms such as registration, certification and licensing are often used interchangeably to denote occupational regulation (PC 2015e). Licensing 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.

Governments, professional bodies and regulators can 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 may go beyond what is required to address asymmetric information between service providers and consumers. Where licensing and standards regulations are overly burdensome they can 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. More generally, the process for gaining a license to practice in another country can be slow and administratively difficult. Service exports may also be inhibited where a country has decided not to adopt internationally recognised standards. Service providers supplying through commercial presence or fly-in/fly-out are most likely to be affected by licensing and standards regulations in other countries.

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 be admitted as a local lawyer only 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 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 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).

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 in government 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, particularly where they are tailored to the laws or standards of a particular country.

Study participants in the law, engineering and architectural professions consider that licensing arrangements for professional services in Australia are relatively open, enabling foreign service professionals to provide their services in Australia (chapter 8).

Determining whether licensing and standards regulations are overly burdensome and 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) to 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, Singapore and New Zealand; and Australia, New Zealand and Canada (AACA 2015).
- CPA Australia (a professional accountancy body) has mutual recognition agreements with professional accountancy bodies in a number of jurisdictions, including India, Singapore, Canada, Europe and Hong Kong (CPA Australia 2015).
- The Mutual Recognition Agreement and the Trans-Tasman Mutual Recognition Arrangement between Australia and New Zealand cover some legal occupations, including barristers and solicitors.

Governments have used trade agreements and international forums to help facilitate mutual recognition. Australia has included provisions related to mutual recognition in trade agreements, including with New Zealand, the United States, Japan, South Korea and China. 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 (PASC), a regional grouping of national standards bodies, is identifying and prioritising actions that PASC 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.

The effects of licensing and standards on service exports

Licensing regulations that are more burdensome than necessary to achieve a minimum level of safety and quality can restrict the supply of Australian service exports and increase the upfront costs of establishing export operations. Licensing regulations restrict service exports where service providers cannot meet the requirements for a license to provide the service in the country, such as 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 residence. The extra costs of meeting licensing regulations could result in a service provider not supplying the export market at all. Slow procedures for obtaining a license can also impose costs, including in the form of foregone sales.

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 financial service providers to tailor their client software to operate in the importing country of supply, increasing upfront (and potentially ongoing) costs.

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 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.

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 are also 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 competitiveness 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.

Reducing barriers associated with licensing and standards is not without costs. As discussed in chapter 9, negotiating and establishing MRAs can be time consuming and costly, and could impose costs on Australia if regulatory approaches and standards in the partner country reduce the quality or safety of the service provided in Australia.

5.5 International investment barriers

Barriers to foreign investment can take many forms. Barriers to international investment can be separated into:

- foreign equity limits
- screening and approval (approval required for new foreign direct investment 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 compulsory 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).

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. For example, foreign education institutions have historically not been allowed to establish a commercial presence in Indonesia, 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 more 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 2015). 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 permitted to establish branches in several countries, including Indonesia, India and Russia (Rouzet et al. 2014).

ANZ stated that foreign equity limits are the primary barrier to accessing Asian banking markets (ANZ, sub. 23). Foreign equity limits and related regulation restricts ANZ from acquiring 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. 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 impose 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.

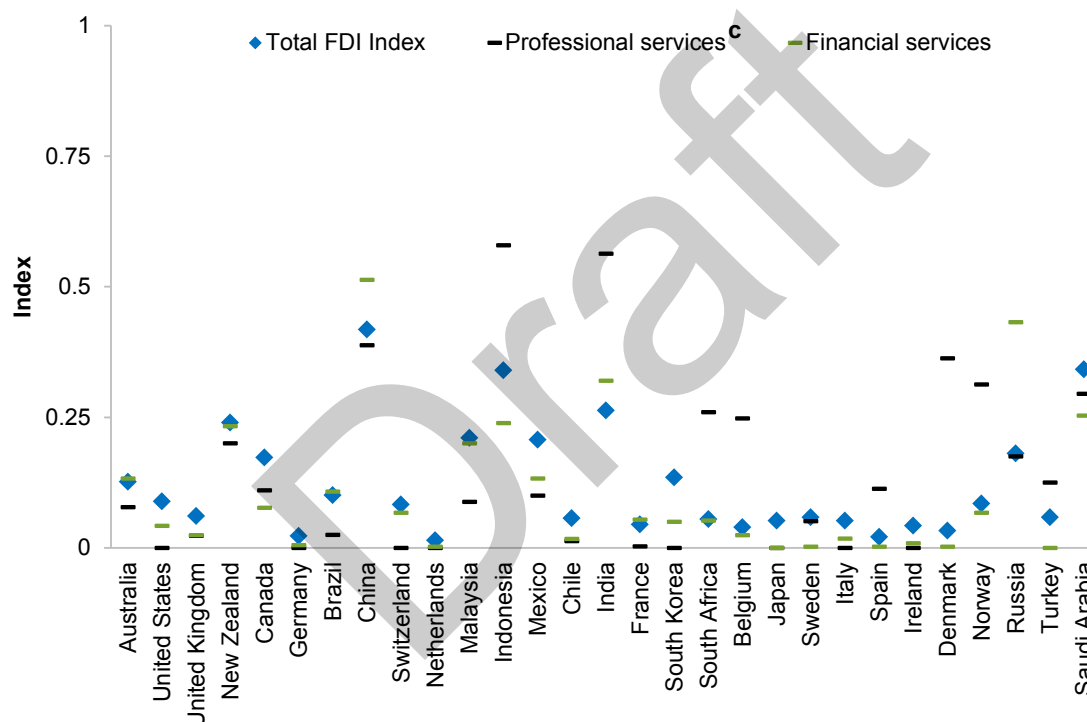
In other cases, requirements to establish a joint venture or to have local representation on the board of directors might not have a substantial effect on costs if a business would have done something similar anyway. There can be good commercial reasons for entering into joint ventures with foreign partners 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 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 2015) 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.

Figure 5.3 OECD index of restrictions on foreign direct investment^{a,b}
Countries in the OECD database that are in Australia's top 40 trading partners, and Australia



^a 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). ^b The index does not account for specific concessions such as bilateral and regional trade agreements or MRAs. ^c Includes legal, accounting, architectural and engineering services.

Sources: ABS (*International Investment Position, Australia: Supplementary Statistics, 2014*, Cat. no. 5352.0); OECD (2015a).

Barriers to investment are particularly high for financial services in several large Asian developing countries, most notably in India and China. Barriers to investment in financial services in Indonesia are also among the highest applying in Australia's major trading partners.

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 trade agreements — on a multilateral basis through the GATS and on a preferential basis through bilateral and regional agreements (chapter 9). 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).

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). For example, the ASEAN-Australia-New Zealand Free Trade Agreement requires national treatment of investments and prohibits performance requirements. 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 5.6).

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 financial services are often supplied 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).

Box 5.6 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 free 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. While Indonesia has recently implemented a 40 per cent cap unless a 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).

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 2015)
- 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).

5.6 Further evidence on international barriers

The Commission has identified a number of broad areas where regulations or policies in other countries are impeding Australian service exports. Further evidence would strengthen the Commission's assessment of the costs and benefits of reform and inform its views in the final report. The Commission is seeking further feedback and evidence on the effects of international barriers to service exports in the areas discussed in this chapter or other areas not covered in this draft report.

INFORMATION REQUEST

The Commission seeks further information on the effect of international barriers to service exports in the following areas:

- impediments to the flow of data across borders, such as requirements to store data locally*
- violations of service providers' intellectual property rights*
- licensing, registration or standards regulations that are more burdensome than is necessary to maintain standards of quality, consumer protection or safety*
- barriers to establishing a commercial presence in another country.*

The Commission is seeking specific examples of how international barriers in these areas, or other areas not covered in the Commission's draft report, have affected service providers' operations and costs.

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the research report.

Draft

6 Financial services

Key points

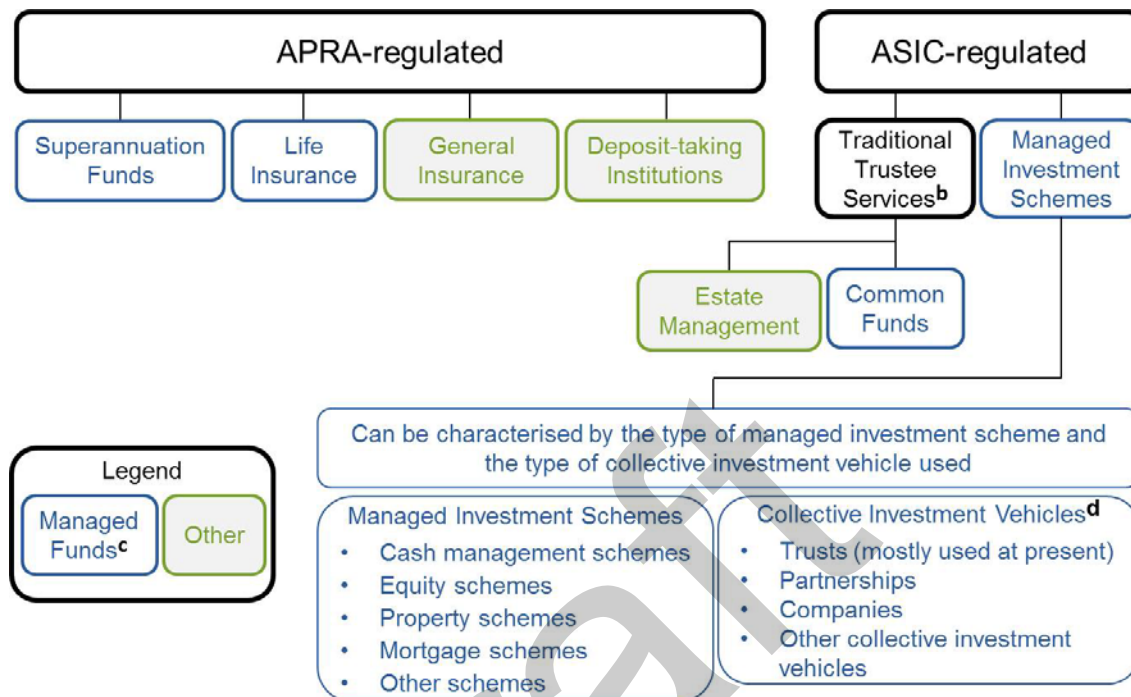
- There are likely to be opportunities to grow Australia's financial service exports. Due to its geographic location and time zone, Australian service providers may be well placed to take advantage of increased demand for financial services resulting from rising incomes in Asia.
- Policy changes, including some already underway, could facilitate growth in financial exports.
 - The Asia Region Funds Passport — a regional scheme that would allow managed investment schemes to be marketed across borders — will reduce regulatory restrictions on marketing managed investment schemes (at the retail level) in participating countries. The introduction of the Asia Region Funds Passport is likely to benefit Australian (and other) investors. Australian financial service providers will need to continue to examine ways to improve their productivity and performance to compete with managed funds domiciled in other countries, including those with lower rates of withholding tax.
 - A broader and more flexible range of collective investment vehicles would reduce barriers to exporting faced by Australian based fund managers.
 - 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.
 - There may be scope to improve prudential regulation in ways that could reduce the regulatory burden on Australian firms, while maintaining the stability of the financial system. The 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. Implementing this recommendation would help to identify any barriers to financial service exporters 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. Substantive 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 2013-14 — contributing \$135 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). This chapter examines domestic barriers to export, including in relation to managed investment schemes (section 6.1), traditional trustee services (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 and regulation 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 financial services. In assessing potential policy changes, the Commission is mindful that the regulation of financial services will 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 2014; ASIC 2015a). 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.

Figure 6.1 **Simplified overview of the financial services sector**Parts of the financial services sector considered in this chapter^a

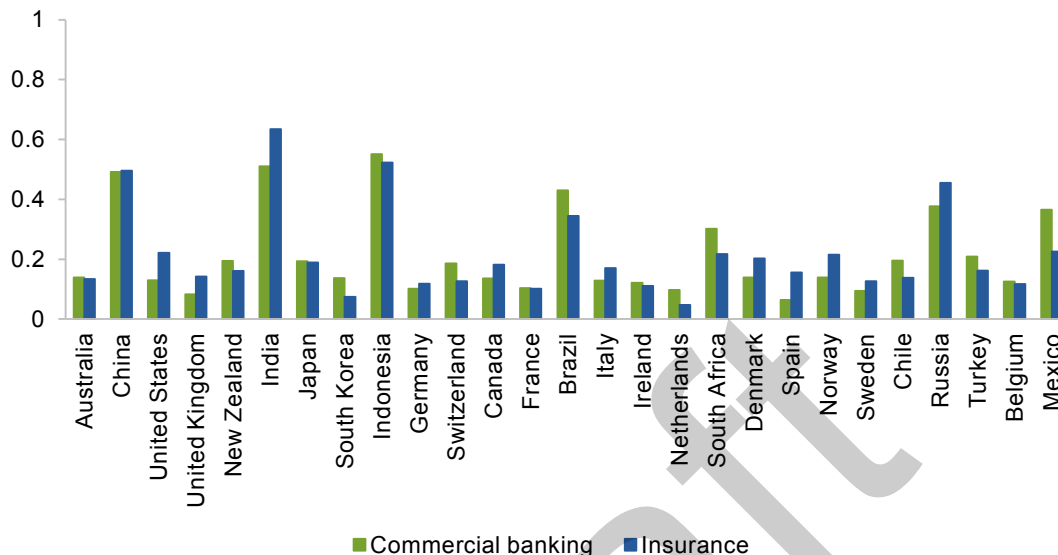
^a This diagram does not include all types of financial services, as sector-specific barriers were not identified in some parts of the sector. Other types of financial services include friendly societies, brokerage services and merchant banks. ^b Traditional trustee services are also regulated by state and territory governments. ^c Managed funds are as defined in ABS, *Managed Funds, Australia, Mar 2015* (Cat. no. 5655.0). ^d 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.

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 establishing a commercial presence abroad (chapter 5), which is the predominant mode of export for financial services (chapter 3).

Figure 6.2 Barriers in the commercial banking and insurance subsectors^a

Countries in the OECD database that are in Australia's top 40 trading partners, and Australia



^a 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).

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), that have three broad features:

- investors contribute money to get an 'interest' (a type of financial product) in the scheme
- money is pooled by sometimes hundreds or even thousands of investors, or used in a common enterprise
- investors do not have day to day control over the operation of the scheme; it is managed by a fund manager known as a 'responsible entity' (ASIC 2015b).

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. The ABS does not provide separate data on foreign funds under management in Australian managed investment schemes (discussed below) — rather, the data include all managed funds, including those entities regulated by APRA.

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 Australian managed funds, 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). The majority of foreign funds under management in Australia are from wholesale investors, such as pension funds. About 14 per cent of foreign funds under management were from retail investors as at 31 December 2013 (Perpetual and Financial Services Council 2014).

Participants in this study, and previous studies, 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 (FSC, sub. 20; AFCF 2009; Deloitte Access Economics 2014).

- 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 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

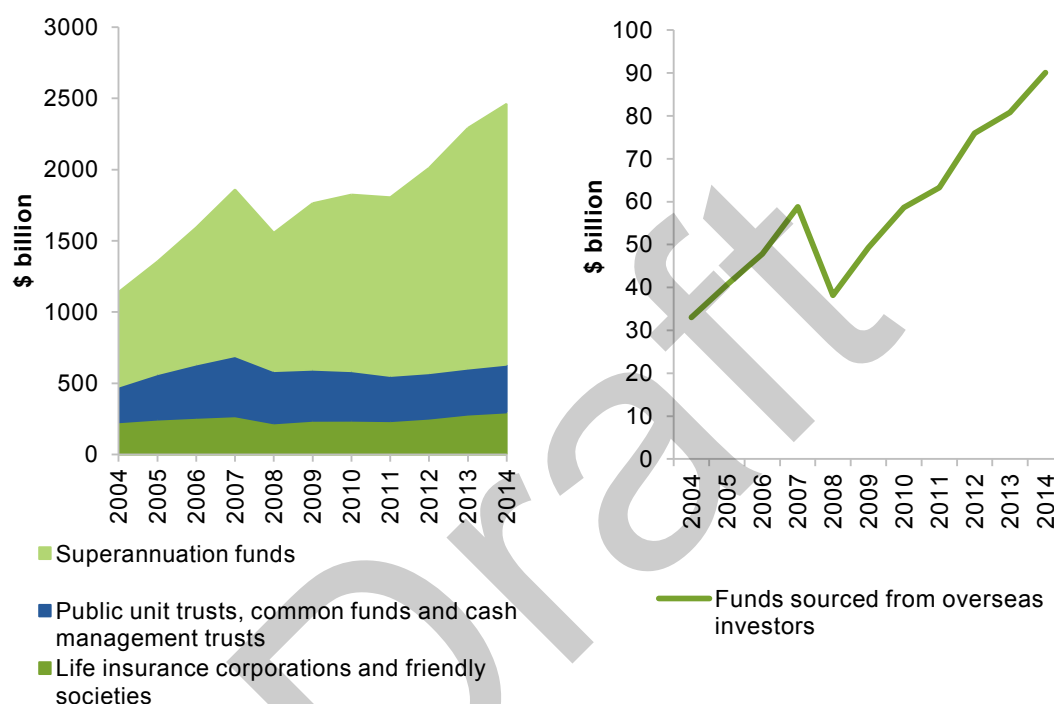
Increases in foreign funds under management provide opportunities for Australian fund managers to export their services. Deloitte Access Economics (2014) estimated that, for every \$100 of foreign funds under management in Australia, fund managers receive about \$0.60 in annual revenue from the services they provide. Based on the level of foreign funds under management in June 2013 (\$74 billion), fund management service exports are estimated to be about \$442 million for that year.

The 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). Given Australia's close proximity and similar time zone to Asia, Australian fund managers may be well placed to take advantage of growing demand for fund management services from Asia.

Figure 6.3 The size of Australia's managed fund sector and funds sourced from foreign investors

Funds under management



Sources: ABS (*Managed Funds, Australia, Mar 2015*, Cat. no. 5655.0).

There is strong competition to provide financial services to Asian investors, particularly from providers of Undertakings for Collective Investments in Transferable Securities (UCITS) schemes domiciled in the European Union (box 6.1). UCITS schemes are heavily used in Asia — in 2011 there was about \$490 billion of funds from investors in Hong Kong, Singapore and Taiwan in UCITS schemes. This is in contrast to an estimate of about \$44 billion in Australian managed funds sourced from the Asia-Pacific region in 2013.¹

Australian managed funds also face strong competition from the use of exchange-traded funds (ETFs) in Asia — funds that are traded on a stock exchange. The value of assets in ETFs in Asia is growing by about 20–30 per cent per year, and there is a strong preference for ETFs listed in the United States (EY 2014; PwC 2015b).

¹ 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.

Box 6.1 UCITS schemes are widely used in Europe and Asia

The UCITS scheme was established in 1985 and has been reformed several times since. The UCITS scheme established 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 was assessed as meeting the UCITS rules by the regulatory authority in its home member state.

Following the initial EU directive in 1985, takeup 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 of their funds in UCITS funds in 2011 (APEC Policy Support Unit 2014).

In light of this competition and the growing levels of wealth in Asia, barriers to financial service exports from Australia will be particularly costly. There are some 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. There are also taxation issues that 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 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 fund 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 operate in Australia, a retail managed investment scheme (schemes that are not exclusively targeted at wholesale investors such as pension funds) must first be registered with ASIC. A registered managed investment scheme must have a constitution and compliance plan, among other things, and the operator of the scheme must have a financial services license. Schemes that are solely targeted at wholesale investors do not need to be registered with ASIC.

A retail managed investment scheme may meet the requirements to be able to offer interests in the scheme in Australia, but this does not mean that fund managers are able to offer interests in that scheme internationally. Rather, to offer interests in a scheme in a particular country, schemes must first meet the requirements to be registered in that country (AFCF 2009; FSC 2014). For example, to be able 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
- be registered in a jurisdiction that offers investors protection at least equivalent to that in Singapore
- have a representative that is a Singapore resident or a company registered in Singapore
- comply with the Singapore Code on Collective Investment Schemes (Securities and Futures Act (Sing), s. 287).

Registration requirements for managed investment schemes are in place to meet consumer protection objectives. If a country's registration requirements are not the least cost way of meeting its consumer protection objectives, they can increase the costs of exporting services associated with managed investment schemes or prevent Australian fund managers from offering their product internationally. The Australian Financial Centre Forum has noted that:

Differences and duplication in regulatory requirements across countries can add significantly to the difficulties faced by financial services companies selling their products across borders. In some countries, regulatory requirements are so stringent as to make it almost impossible for an Australian fund manager to market a retail managed investment scheme. (2009, p. 84)

Similar registration requirements exist in Australia for the operation of foreign 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 also be useful for Australian service providers with overseas businesses. For example, 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 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 mutual recognition arrangements.

Box 6.2 Registration requirements for foreign managed investment schemes in Australia

Foreign managed investment schemes that operate in Australia are subject to the same regulatory requirements as Australian schemes — including complying with ASIC's registration, licensing and disclosure requirements.

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. ASIC will only do this 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 Jersey, Hong Kong, New Zealand, Singapore and the United States.

ASIC has similar arrangements for granting Australian financial services licences to international businesses. ASIC can grant relief from the requirement to hold a licence for foreign providers (such as managed investment schemes), on the condition that the business provides services to wholesale clients only.

Source: ASIC (2012).

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 — including two mutual recognition agreements (MRAs) and the Asia Region Funds Passport (ARFP). These agreements seek to reduce regulatory duplication between jurisdictions and remove any unnecessary restrictions on the operation of foreign managed investment schemes.

Mutual recognition agreements

In 2008, a MRA was signed between ASIC and the Hong Kong Securities and Futures Commission to facilitate cross-border marketing of managed investment schemes between Australia and Hong Kong. Under this MRA, ASIC-regulated managed investment schemes are recognised as meeting Hong Kong's regulatory requirements, on the condition that:

- the managed investment scheme is not principally targeted at persons in Hong Kong
- an ASIC-regulated custodian is appointed
- the scheme complies with certain Hong Kong regulations
- a Hong Kong representative is appointed (ASIC 2008).

Australia's MRA with New Zealand covers managed investment schemes. To offer financial products in New Zealand the Australian issuer must have made an offer of products in Australia, and comply with Australian laws (ASIC 2014).

The Asia Region Funds Passport

The Australian Government is negotiating the ARFP with a group of jurisdictions — Australia, New Zealand, Singapore and South Korea have signed a statement of intent to implement the ARFP, and the Philippines and Thailand are part of the ARFP working group. Once commenced in early 2016, the ARFP will allow fund managers to market retail managed investment schemes that meet the passport rules (as regulated by their home regulator) in the other passport countries (APEC 2015b).

Under the proposed rules, to be registered as an ARFP fund a managed investment scheme must meet:

- the rules and regulations required to be registered as a scheme in its home economy
- the ARFP rules. In some cases, the rules may go beyond the rules required in the home economy, while in others the home economy rules will go beyond the ARFP rules. ARFP rules cover areas such as experience requirements for the employees of the fund manager, capital adequacy, independent oversight, permitted investments and the valuation of the fund for pricing purposes
- any additional regulations imposed by the host economy in relation to dealing with investors, such as annual reporting requirements (APEC 2015c).

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 Australia's. For example, the MRA required managed investment schemes to appoint an ASIC-regulated custodian that is separate from the responsible entity to hold scheme assets, which is not a requirement of Australian regulation. In the FSC's view, tax arrangements, particularly where there is no double tax agreement in place, have undermined the ability for Hong Kong managed funds to access the Australian market (FSC, sub. 20).

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, in addition to interests in managed investment schemes) (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 a MRA should be based on an economywide assessment of the benefits and costs of the agreement. Principles for MRAs are discussed further in chapter 9.

The Asia Region Funds Passport is likely to have net benefits to 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). 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 and ‘a significant challenge to the success of an [ARFP], and also increased financial integration generally’ (sub. 20, p. 15).

The ARFP may have dual benefits to Australia.

- First, to the extent that there is demand for Australian managed investment schemes overseas, the ARFP would 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 associated with 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.
- Second, by opening up the Australian market to greater competition, the ARFP will benefit Australian (and other) investors. Based on a reduction in the average costs of managed investment schemes (due to increases in scale), the APEC Policy Support Unit has estimated that the benefits from the ARFP could be US\$20 billion annually across the Asian region (APEC Policy Support Unit 2014). Competition is also likely to lead to increased pressures for innovation and efficiency in the sector, leading to higher quality services being offered in Australia. There is likely to be an increase in choice and diversity in managed investment schemes offered in Australia, leading to lower fees and greater portfolio diversification opportunities for investors (APEC Policy Support Unit 2014). The value of this diversification should not be overstated as diversification opportunities already exist for investors, such as through ETFs. There are close to 100 ETFs listed on the Australian Stock Exchange that are based on stock indexes in the United States, Europe and Asia (ASX 2015).

The ARFP may offer several benefits over MRAs. By creating a new set of regulatory standards, passport schemes can provide benefits in terms of consumer protection and market integrity. In addition, as the passport rules are applied across all participating jurisdictions, passport schemes can reduce the risk of regulatory arbitrage and create a level playing field for market participants (IOSCO 2014).

The benefits resulting from the ARFP will not be spread evenly across countries. For example, in the case of the UCITS, 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 — and 14 of the 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.

The ability for managers of Australian managed investment schemes to take advantage of opportunities to increase scale will be an important determinant of the benefits of the ARFP to Australia. Taking advantage of economies of scale has been an issue in Australia's superannuation sector — the Financial System Inquiry found that improvements in scale in the superannuation sector have not delivered the benefits to the system that would be expected (including lower fees), as the benefits have been offset by higher costs elsewhere in the system (FSI 2014a). Scheme managers will need to continue to examine ways to improve their productivity and competitiveness to compete with UCITS schemes, global ETFs and managed funds domiciled in the Asian region.

Regulatory factors can influence the costs of providing services relating to managed investment schemes, such as the taxation arrangements that act as a barrier to the export of managed investment schemes (section 6.4). For example, Australian financial service providers will be competing with providers in ARFP jurisdictions that have more favourable tax arrangements, particularly lower rates of withholding tax for international investors.

The introduction of the ARFP is likely to benefit Australian (and other) investors through lower fees, increased opportunities for portfolio diversification and increased competition in the market for managed investment schemes. 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.

DRAFT 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 investments 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.

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 other 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 is an issue for international investors, including the inability for Australian funds to adopt UCITS structures, this may reduce the demand for exports of financial services associated with managed investment schemes domiciled in Australia.

There is some 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 appoint an external asset manager and operate in some respects as a separate trustee and asset manager would.

The costs and benefits of greater structural flexibility for managed investment schemes

The Commission considers that there is already sufficient flexibility for responsible entities to delegate tasks such as asset management if they see fit — the barrier to exports imposed by the single responsible entity structure is not particularly restrictive. There may also be costs associated with allowing managers of managed investment schemes to move away from the single responsible entity model. For example, concerns regarding confusion over responsibilities between the asset manager and the trustee arose prior to the 1998 amendments to the Corporations Law and drove the decision to create a single responsible entity regime (Costello 1997).

It is not clear that the benefits arising from a change in regulatory structure would outweigh the costs of the change. Other factors, such as taxation arrangements and the expertise, scale 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. The above issues do not preclude alternative regulatory structures, such as a separate trustee and asset manager, being considered for use in alternative collective investment vehicles where feasible (section 6.4).

6.2 Traditional trustee services

Traditional trustee services refer to a suite of services provided by trustee corporations including estate management, preparing wills and operating common funds (which are funds used by trustees to pool together money held on behalf of estates). Trustee services in Australia are regulated using a combination of Commonwealth legislation (a licencing regime in chapter 5D of the Act), state and territory-based acts and common law established through the courts.

The traditional trustee industry in Australia is concentrated. There are 28 entities licenced as a trustee corporation under chapter 5D of the Act — and many of these are subsidiaries of the same corporation (Corporations Regulations 2001, schedule 8AA). Additionally, each state and territory has a public trustee that provides traditional trustee services on a not for profit basis.

The value of assets managed by trustee corporations in Australia is substantial — in 2010, licenced trustee corporations held about \$500 billion in assets² (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.

² 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.

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 in 2010 (it is unclear how much of the assets were for foreign investors) (FSC 2012). The market in Asia is expected to continue to grow — there has been strong growth in the number of ultra-high net worth individuals (chapter 3) and these individuals are most likely to be consumers of private wealth management and succession planning services offered by trustee corporations. Nisha Singh, quoted in Hubbis, notes that ‘Asia is on the cusp of an inter-generational transfer of wealth, for the first time among many creators and owners of wealth’ (2015, p. 4). KPMG noted that there has been ‘... a surge in the demand for wealth and estate planning services’ in Asia (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 outdated nature of Hong Kong’s trust law contributed to a preference for offshore private trusts by Hong Kong settlers. While New Zealand has not updated its trust law following the 2013 review, 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).

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 stated that Australia's trust law is antiquated

The FSC (sub. 20) raised concerns about the application of trust law to trustee services. The concerns of the FSC predominantly arise from the fact that Australia's trust law has not been reviewed for many years (except in Queensland), and the use of trusts has changed over time. The FSC (sub. 20) stated that Australia's trust law is outdated, and results in undesirable outcomes for settlors and investors.

There are several differences between Australia's trust law and that applying in jurisdictions where trust law has been reviewed and updated. Much of Australia's trust law relies on common law and is not codified, including in relation to the powers and duties of trustees. Chakin and Brown (2014b) note that this makes Australia's trust law inaccessible to non-experts. There have been moves to codify the powers and duties of trustees in other jurisdictions including Hong Kong and the United Kingdom (FSTB 2012; Law Commission 2013). The variations in Australia's trust law across jurisdictions may be confusing to international investors and, 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 (PC 2015b).

To the extent that the above issues are concerns for international consumers of trustee services, Australia's current trust law could result in Australia's trustee sector not being able to offer products that consumers prefer, reducing the demand for Australian trustee services.

Trust law is only a barrier for certain types of trusts. For example, Chakin 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. Chakin 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' (2014a, p. 14). In addition, assets held by trustee corporations in relation to managed investment schemes and superannuation funds are covered by separate Commonwealth legislation, and are unlikely to be adversely affected by Australia's state and territory-based trust law.

Should Australia's trust law be updated?

The FSC (sub. 20) proposed an alternative trust act to provide a fit for purpose legal infrastructure for Australian trusts. According to the FSC, 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.

The effects of Australia's system of trust law on service exports is unclear. There is limited evidence on the potential size of the export market for Australian 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 which jurisdiction to domicile a trust. These other factors include taxation arrangements and the competitiveness of the domestic financial providers offering trust management services. The relative importance of each of these factors is unclear.

Establishing the magnitude of benefits resulting from reforming trust law is critical, as reform would not be costless. Given the complexity of the current trust law provisions, implementing reform in this area would likely be a lengthy process, require agreement between numerous stakeholders and would potentially require cooperation between Australian jurisdictions. The Commission is seeking further evidence on the costs and benefits of reform in this area to inform its position in the final report.

INFORMATION REQUEST

The Commission seeks further information on the potential costs and benefits of trust law reform, in particular:

- *what would be the potential effect of trust law reform on the domestic and export markets for traditional trustee services?*
 - *is a new Commonwealth trust act required, and if so should it replace or operate alongside the existing state and territory based trust acts? What lessons can be learned from trust law in other jurisdictions such as New Zealand?*
-

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. Many of Australia’s largest banking and insurance groups operate across several international jurisdictions. The ANZ (sub. 23) operates in 15 markets in Asia including India, China and Indonesia. Similarly, Westpac operates throughout the Asia–Pacific, and has operations in markets including the United Kingdom and the United States (Westpac 2015). Insurance Australia Group (sub. 10) has operations in China, India, Malaysia, Thailand, Vietnam and New Zealand, and QBE insurance has about 70 per cent of its premium income sourced from outside Australia (FSI 2014b).

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.

Stringency of Australia's prudential standards

The FSC (sub. 20), 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. Both the FSC and the Insurance Council of Australia raised concerns with capital adequacy requirements for insurers in Australia, noting that APRA has set capital adequacy requirements that are higher than those for Australia's competitors.

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 was 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 more financially difficult for Australian insurance companies relative to EU and US companies.

The costs and benefits of modifying prudential regulation

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. Changes to prudential regulation to address the FSC's and IAG's 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.

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).

The Commission considers that prudential regulation should not be set *solely* on the basis of maintaining or increasing international competitiveness of Australian providers. The costs of complying with regulation should be a consideration for APRA when setting prudential regulation, alongside other factors such as 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 2014, p. 6)

The Reserve Bank of Australia (2014) has also noted that the prudential framework in Australia played an important role in ensuring that the Australian financial system coped successfully with the global financial crisis. Similarly, the International Monetary Fund (2012a) has 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 maintaining 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). Implementing this recommendation would help to identify any barriers to financial service exporters 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 the European Union (Basel Committee on Banking Supervision 2014a, 2014b).

Many countries have implemented stringent financial regulation as a response to the global financial crisis, some aspects of which have been identified by participants as imposing barriers to financial service exports. For example the United States implemented the Dodd–Frank reforms as a response to the financial crisis (box 6.5). The *Banking Reform Act 2013* in the United Kingdom included reforms to ‘ring fence’ banks whose interruption would have a significant effect on the local economy.

Similarly, differing regulations across jurisdictions has been an issue raised in the insurance sector. The FSC (2015) noted that India uses a different method to Australia to calculate capital reserves. In addition the FSC (2015) 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 market for life insurance products.

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, corporate governance reforms 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:

- a requirement to employ a US risk officer and risk committee
- entities must 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
- US requirements in relation to capital adequacy, risk management and liquidity, and 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.

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. For example:

- 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 Asian 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 as adding to compliance costs — in particular, it highlighted the ‘Volcker rule’ (box 6.5) 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
- the Financial System Inquiry stated that divergent international regulatory requirements ‘increase compliance costs, create legal risk and limit the costs efficiencies of scale businesses’ (FSI 2014b, p. 4-93).

Costs and benefits of greater consistency in prudential regulation across countries

The key benefit of addressing regulatory inconsistencies in prudential regulation across countries would be a reduction in costs (both upfront and ongoing) for financial service providers that are currently required to comply with both foreign and Australian regulatory requirements. 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 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 policy can act as a barrier to service exports either by directly taxing the exporting activity or differentially taxing domestic provision to export provision. 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.

Taxes that participants have identified as creating distortions that directly affect finance exports are analysed in this section. 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 the communities' concerns about fairness.

Withholding taxes on foreign investment

Like most other governments, the Australian Government imposes taxes on the income earned domestically by foreign investors — withholding taxes 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 6.4).

International comparison of the headline rates of withholding tax charged (in the absence of tax treaties) reveals that 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, including tax policy, should be based on the goal of maximising community wellbeing, rather than matching policies in other countries (chapter 4).

The rate of withholding tax applied in Australia varies depending on:

- the type of investment or income (table 6.1)
- the conditions of tax treaties (box 6.6)
- a range of legislated exemptions set out in section 128 of the *Income Tax Assessment Act 1936* (Cwlth). For example the following payments are exempt from interest withholding tax:
 - interest derived on a nostro account (an account maintained for the sole purpose of settling international transactions) by a non-resident bank

- interest on certain publicly offered company and unit trust, debentures or debt interests
- interest payments on offshore borrowings by offshore banking units.

Table 6.1 Withholding taxes for foreign investors using Australian financial services^a

<i>Type of income</i>	<i>Withholding tax applied</i>
Dividends	Franked dividends exempt ^b 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 ^c	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

^a Table is a summary only. A range of additional exemptions are applicable to many of the income sources listed. For example, a range of exemptions to withholding taxes are set out in section 128 of the *Income Tax Assessment Act 1936* (Cwlth). ^b Franked dividends drawn from earnings subject to Australia's 30 per cent corporate tax rate. ^c 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 (2015g).

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 service exports by increasing the cost of capital for Australian investment, including in services.³

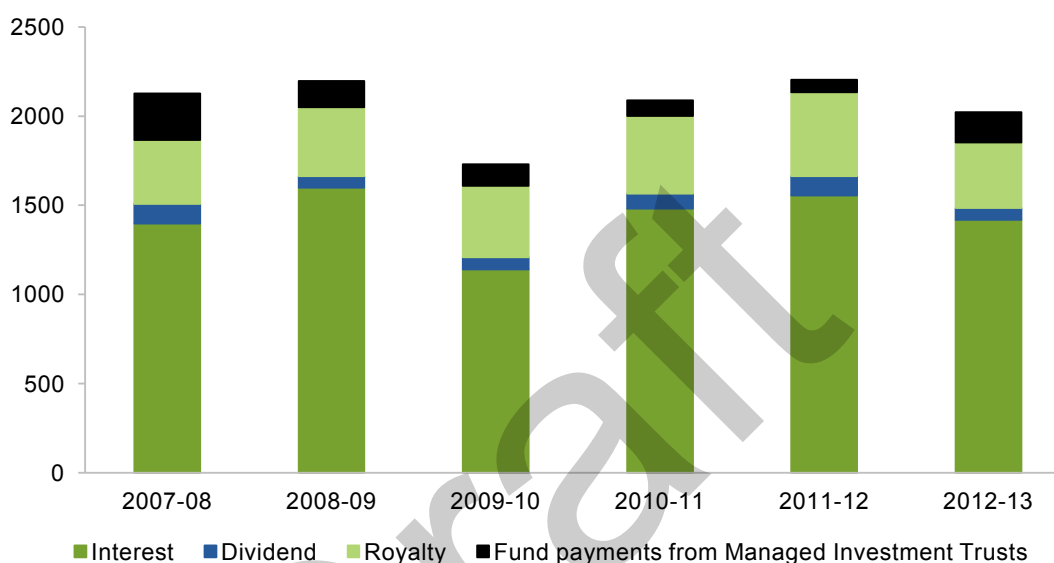
The effect of withholding taxes on service exports will depend on the tax treatment applied in the investor's country of residence and the extent to which there is double taxation of an investment (in the source and resident countries). This in turn will depend on the existence

³ 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 6.9).

of any exemptions or credits, and any relevant taxation treaties (box 6.6). An uneven incidence of tax between the source and resident countries can affect the efficiency of international investment markets (it violates the neutrality principle).

Figure 6.4 Withholding taxes collected by the Australian Tax Office, 2008-09 to 2013-14^{a,b}

\$ million



^a 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. ^b 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).

Study participants noted that double taxation can be a significant barrier to exporting activity. For example, Cox Architecture (sub. 2) noted that withholding taxes levied in international jurisdictions discouraged the provision of services offshore, as it was often difficult to avoid double taxation even where exemption arrangements and treaties are in place. Similarly, 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.

AFMA (sub. 14) 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 so that they are contemporaneous with other jurisdictions.

Table 6.2 International comparison of withholding tax rates^a
 Australia and major exporting countries of financial services, 2013^b

<i>Country</i>	<i>Interest</i>	<i>Dividend</i>	<i>Royalty</i>
OECD Model Tax Convention ^c	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 ^d	20.42	20.42	20.42
South Korea	20	20	20
Luxemburg	0	15	0
Singapore	15	0	10
Switzerland	35	35	0
United Kingdom	20	0	20
United States	30	30	30

^a Rates reported are the headline rates that apply to non-residents in the absence of exemptions and tax treaties. ^b Countries represented are a selection of the largest exporting countries of financial services reported by the WTO (2014). ^c Recommended maximum rates for parties negotiating a tax treaty under the OECD's Model Tax Convention on Income and Capital. ^d Rate includes a 2.1 per cent surtax.

Source: PWC (2015a).

Submissions to this study from the financial sector (AFMA, sub. 14; FSC, sub. 20) have called for simpler and lower rates of withholding taxes. The FSC also called for a 5 per cent concessionary rate to be applied to Managed Investment Trusts (MITs) participating in the ARFP, for the purpose of making Australian financial service providers more competitive with providers from other ARFP countries that have more favourable tax arrangements such as 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, 2014).

Costs and benefits of reducing the barriers associated with withholding taxes

Weighing the costs and benefits of changes to Australia's withholding tax regime on a communitywide basis is important as 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 a secondary effect.

Box 6.6 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 establishing 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.

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 any 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 6.7). 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 2015g; box 6.8).

Box 6.7 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, 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).

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 instance, 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 Dreyfus 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.

Box 6.8 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 taxation 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 (2015e).

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 investments differently for tax purposes. Further, where complexity results in uncertainty about the tax rate applying to investments it can reduce demand for the associated financial services. This aligns with the efficiency principle outlined above 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 would only create further distortions in an already complex system. 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, extending lower withholding tax rates to MITs that are participating in the ARFP is not justified on the basis that the current rate is uncompetitive with other jurisdictions participating in the passport (FSC, sub.20). Further, it is unclear why

investment from countries that are participating in the ARFP should receive preferential tax treatment to investment from other countries. In any case, some trusts already qualify for concessional rates of withholding tax under the MIT Withholding Tax Regime (box 6.8), and applying lower withholding tax rates to MITs participating in the ARFP would add concessions on top of these. This would create a situation where some trusts are charged the standard 30 per cent rate, some are charged 15 per cent as MITs, and others still are charged 5 per cent. Some forms of trusts may be excluded from the lowest tax rates. For example, property trusts do not qualify for the ARFP and so could not access the lowest withholding tax rate.

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 6.6 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, the Commission considers that future negotiations should seek uniformity between jurisdictions. There may also be scope to update taxation treaties, as some 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).

DRAFT 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 6.9). Despite this general conclusion there are a number of reasons for governments to retain such taxes.

Box 6.9 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 6.10), 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 in order to supply capital to that economy. The required return to capital would increase by the full amount of the tax in order 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.

First, where an investment generates location-specific rents, the rents can be taxed without distorting investment decisions (box 6.10). In theory, and in line with the efficiency principle, location-specific rents should be targeted and taxed separately from the normal returns to capital, but there are a number of problems associated with this in practice, including:

- 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, profits may be re-characterised as other forms of income that are taxed at lower rates as the rate of tax on location-specific rents increases. For example, if the tax rate on location-specific rents exceeds the tax rate on wage income, recorded economic profits will 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).

For these reasons governments have found it more practical to maintain taxes that also fall on the normal returns to investment, despite their inefficiency.

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 6.8) may not be as severe as if capital was perfectly mobile. As the globalisation and integration of capital markets proceed, however, this is likely to become less relevant.

Third, many jurisdictions provide tax relief for the foreign source income of their residents in order 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.

DRAFT 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 having regard to:

- the effect of withholding taxes on domestic and international investment markets, and on the supply of financial 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.

Box 6.10 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 (NPV) of investment decisions, inclusive of taxes.

Taxing economic rents does not generally create a distortion. An economic rent arises when a resource generates a high return relative to its next-best use. When an economic rent arises, taxing it should not alter behaviour, since these taxes leave the normal return to capital untaxed, and levy a tax only on economic rent — profit over and above the normal required return to capital. In a simple setting, a tax that only targets economic rent is neutral in the sense that an investment project that has a positive NPV before tax will also have a positive NPV 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).

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).⁴ 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 2015g).

Dividend imputation also produces a bias against investment abroad by Australian companies (and individuals), which increases the cost of service exports supplied via a commercial presence in another country. As the ANZ (sub. 23) noted, domestic shareholders of Australian companies that invest overseas must pay tax at the full marginal rate on 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 Australia⁵ and violates the principle of capital export neutrality.

Options to address the negative effects of dividend imputation on service exports

There are three main ways in which biases against foreign investment in the dividend imputation system could be addressed.

- Providing tax credits for dividends paid out of foreign source income, which would address the bias against investment abroad by Australian companies.

⁴ 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.

⁵ The disincentive would be diminished if the Australian business pays comparatively lower corporate taxes on the overseas investment.

- Dividend streaming, which would address both the bias against non-resident shareholders and the bias against investment abroad by Australian companies.
- Removing dividend imputation.

Providing tax credits for dividends paid out of foreign source income

The bias against investment abroad by Australian companies could be addressed by providing tax credits to Australian resident shareholders for dividends paid out of foreign source income. Credits for foreign taxes could take the form of either an imputation credit for actual foreign company tax paid or a uniform credit that is not linked to actual foreign tax payments (Australian Government 2010).

Providing imputation credits for foreign tax paid 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. Efficiency benefits would be greatest if imputation credits were attached to actual foreign tax paid. A downside of this approach is the administration and compliance costs associated with tracking foreign taxes paid by foreign subsidiaries. As such, advocates have typically proposed a uniform credit for dividends paid out of foreign source income, without any linkage to actual foreign tax paid (for example, Board of Taxation 2003).

Providing tax credits for dividends paid out of foreign source earnings would reduce the integrity benefits of the imputation system by reducing the incentive for Australian companies to pay Australian corporate tax (Australian Government 2010). Where uniform credits can be paid to resident shareholders for dividends paid out of foreign income that is subject to little or no foreign tax, this would increase incentives for Australian companies to shift profits to foreign countries with lower company tax rates than in Australia, placing additional pressure on rules to prevent international profit shifting. Even without any changes in behaviour, taxation revenue would decrease, as the additional tax credits would mean that Australian shareholders would pay less tax on income from investments abroad (Board of Taxation 2003).

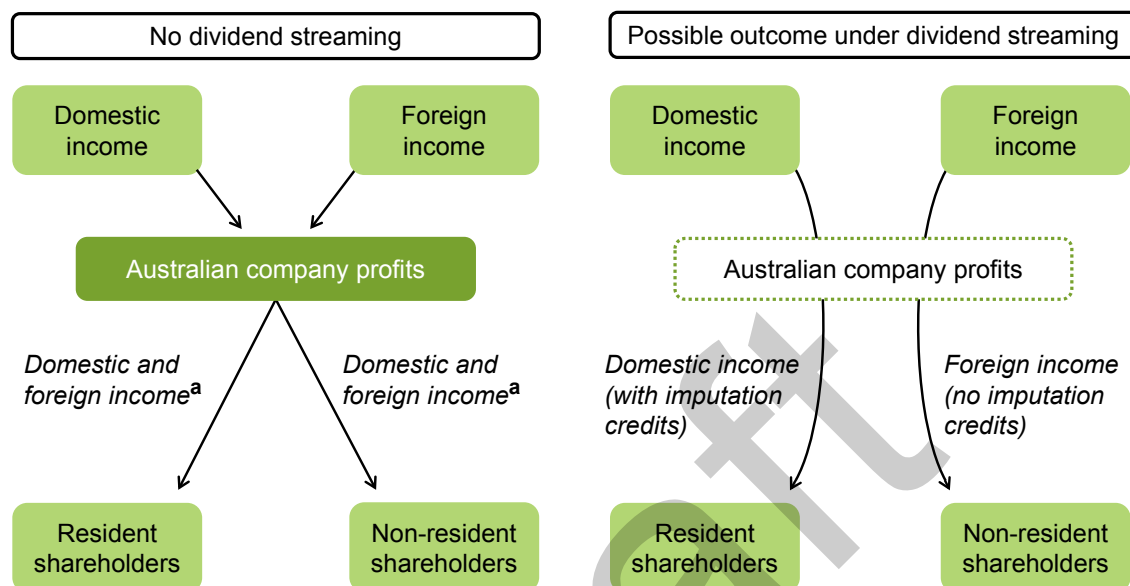
On balance, it is not clear that there would be net benefits to the Australian community from providing credit for foreign tax paid, particularly at a time where more fundamental changes to the dividend imputation system are being considered (discussed below).

Dividend streaming

Dividend streaming would allow companies with foreign and domestic income to ‘stream’ domestic income (with imputation credits) to resident shareholders and foreign income (with no imputation credits) to non-resident shareholders, potentially reducing the overall tax burden on both resident and non-resident investors (figure 6.5). Dividend streaming is

prevented under current rules, with the exception of companies that are dual-listed on stock markets in Australia and internationally.

Figure 6.5 **Distribution of profits under dividend streaming**



^a With imputation credits on domestic share of income only.

Source: Australian Government (2010).

Dividend streaming could increase service exports by allowing Australian firms that expand overseas to conserve imputation credits for their domestic shareholders. It would also encourage foreign investment in Australian companies, thereby increasing the export of associated financial services.

As for providing credits for foreign tax paid, dividend streaming would reduce the integrity benefits of the dividend imputation system and decrease taxation revenue. Other costs include the creation of an inconsistency between shareholders' tax interest in company profits and their legal interest, as well as potential distortions to the mix of resident and non-resident investment in order to maximise benefits from streaming (Australian Government 2010). It is not clear that there would be net benefits to the Australian community from introducing dividend streaming at a time where more fundamental changes to the dividend imputation system are being considered.

Removing dividend imputation

There have been calls to consider scrapping imputation and lowering the corporate tax rate. The Financial System Inquiry referred the matter to the Tax White Paper, but noted that:

The case for retaining dividend imputation is less clear than in the past. To the extent that dividend imputation distorts the allocation of funding, a lower company tax rate would likely reduce such distortions. (Australian Government 2014, p. 278)

The discussion paper for the Tax White Paper flagged dividend imputation as an issue for consideration (Australian Government 2015g). The implications of removing dividend imputation go well beyond service exports and would involve a number of complex trade-offs. 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 Commission is therefore supportive of further consideration of dividend imputation being undertaken as part of the comprehensive, and broader ranging, review process of the Tax White Paper. In conducting this assessment the effect of any changes to the following should be examined:

- domestic and international investment markets, and the supply of financial 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
- the broader revenue raising requirements of the Australian Government
- the efficiency of international capital markets.

DRAFT RECOMMENDATION 6.4

The Australian Government should not make changes to the dividend imputation system in order 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 markets, and the supply of financial 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
- the broader revenue raising requirements of the Australian Government
- the efficiency of international capital markets.

Taxation arrangements for managed funds

The Johnson Report identified two main taxation-related barriers to the export of the services related to managed funds:

- uncertainty surrounding the taxation of offshore funds that invest in Australia
- the limited range of available collective investment vehicles (CIVs).

In addition, the FSC (sub. 20) submitted that under Australian law each managed investment fund must be treated as a single entity for tax purposes. This effectively means that funds are unable to offer units with different currency classes under the same fund. This limits the flexibility of funds, as some unit holders would prefer not to bear the currency risk associated with transactions being undertaken across multiple currencies.

Each of these barriers has the potential to reduce demand for exports of financial services — further detail on how this might occur is discussed below.

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 Government has sought to address these uncertainties through the introduction of the Investment Manager Regime (IMR) (box 6.11).

The limited range of collective investment vehicles

The FSC (sub. 20) and previous reviews (AFCF 2009; Board of Taxation 2011) raised concerns that the limited range of CIVs available in Australia are 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 other investors may simply have preferences for other vehicles. This would be expected to reduce the demand for exports of financial services from Australia.

Box 6.11 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. Two 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 legislation for the third and final element was assented on 25 June 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.⁶ 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).

Similarly, limitations that prevent funds holding multi-currency classes could also reduce demand for Australian exports of these services where investors have particular preferences related to currency risk. Such arrangements are available from financial service providers in foreign jurisdictions. For example, UCITS funds allow for some level of customisation between subsets of investors in a fund under different 'share classes'. All investors in the UCITS own a portion of the same pool of assets but can be treated differently, including the currency in which their share of the fund is denominated (ESMA 2014).

The FSC (sub. 20) considered that a CIV regime comprising a broader range of tax flow-through CIVs, and allowing funds to hold multi-currency classes, would allow Australian based fund managers to compete more effectively internationally. The Australian Government is giving consideration to 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

⁶ 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 there are not 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.

months with a view to developing proposals for inclusion in the Options Paper. (Australian Government 2015g, p. 91)

The Australian Government has also developed draft legislation that contains provisions that are designed to allow funds to hold multi-currency classes — the exposure draft for the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015 (Cwlth) has undergone industry consultation, but is yet to be finalised.

The costs and benefits of changes to 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 fund 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. There are few costs associated with providing greater clarity beyond relatively minor administrative costs from introducing the Regime.

However the IMR does more than just provide 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 the introduction of such an exemption could be inappropriately accessed by domestic investors and intermediaries.

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 legislation has just been implemented (1 July 2015), it is too soon to assess its effectiveness.

The Commission considers that the effects of the Regime should be reviewed by the Board of Taxation no later than 2020. This 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 easily accessible, understandable, and that minimises the administrative and compliance costs imposed on the sector.

DRAFT RECOMMENDATION 6.5

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

- 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

Detail on the alternative CIVs under consideration by the Australian Government is yet to be released and the Commission is mindful not to prejudge the outcome of the work currently underway. In principle the Commission is supportive of moves to increase the flexibility of Australian financial service providers to offer a broader range of CIVs. Options should be evaluated with an eye to their taxation implications and the possibility of inadvertently creating distortions in the domestic market, such as where otherwise efficient investments are altered to use alternative vehicles (solely to minimise tax obligations).

As a matter of principle, decisions about the type of investment vehicle to use should not be distorted by different tax treatments. This would better align tax policy as it applies to CIVs with the efficiency principle outlined above. A model, such as that proposed by the Board of Taxation, which treats all CIVs as fully transparent and allocates all the different items of income and losses to the investor, would be desirable, provided the costs of doing so are not prohibitive (Board of Taxation 2011). Under this model investors would be treated as if they earned the income directly, and would be taxed accordingly, regardless of the vehicle used.

Consideration should also be given to extending the arrangements for multiple currency share classes to each CIV, as this would further increase the flexibility of fund managers to meet investor demands. The draft legislation that contains provisions designed to allow funds to hold multi-currency classes presently only applies to MITs.

DRAFT RECOMMENDATION 6.6

The Australian Government should continue to facilitate the development of a range of collective investment vehicles as part of the Tax White Paper process. Options should be evaluated with an eye to their taxation implications and the possibility of inadvertently creating distortions in the domestic market.

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the research report.

Draft

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 Quality Indicators for Learning and Teaching (QILT) online platform is scheduled to be fully implemented by August 2015, with the objective of ensuring adequate information is available for international and domestic students to make informed decisions about their study options. The Australian Government should review the effectiveness of the platform in meeting this objective within three years of implementation.
 - The Australian Government and education providers are scoping the potential for an industry-led national quality framework for Australia's international education agents, which could help address concerns about the poor 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 accreditation 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.
 - There may be scope to streamline the application process for an Australian medical treatment visa. However, the cost of providing health services in Australia relative to nearby competitors limits Australia's potential as a major destination for medical tourism.
 - 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.

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. The chapter builds on chapters 4 and 5, which consider domestic and international barriers to service exports that are common to multiple sectors.

7.1 Australia's international education sector

Australian education providers offer a range of services to international students including school education, vocational training, higher education and English language tuition. Many students who come to Australia follow an extended study pathway through a series of education institutions, which can involve years of study in Australia (Australian Government 2015c).

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).

In addition to generating export revenue, Australia's international education sector plays an important role in establishing closer social and economic ties with other countries.

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. Students who, after studying in Australia, go on to develop the skills required by the Australian labour market can apply to obtain permanent residency. Students who graduate with skills and qualifications that relate to an occupation on the Skilled Occupation List are afforded priority under specific temporary and permanent visa programs.

Over the past decade, numerous reviews have examined aspects of Australia's international education sector (box 7.1).

The Australian Government has created a Coordinating Council for International Education, including ministers responsible for policies and programs that support international education, which will be 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), visas for professionals coming to and from Australia (Curtin University, questionnaire 4; Universities Australia, sub. 17; University of Tasmania, sub. 18), visa application charges and fees (DEC International, questionnaire 5; English Australia, sub. 19), 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). (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).) Meeting this objective requires that the visa application process to achieve immigration integrity is no more burdensome than required and does not create unnecessary costs or adverse effects.

Box 7.1 International education — a thoroughly reviewed sector

Future Directions for Streamlined Visa Processing (SVP) (Department of Immigration and Border Protection (DIBP), June 2015) — a strategic evaluation of current SVP arrangements to inform the future direction of the student visa program following the expiry of the current policy guidelines that underpin SVP in mid-2016. On 16 June 2015, the Australian Government released the *Future Directions for Streamlined Visa Processing* report and announced the introduction of a simplified international student visa framework (SSVF) 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 and release the strategy in consultation with the sector in the second half of 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 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. Feedback on the paper will be considered prior to finalisation of any proposed changes to the ESOS Act or the National Code. Any amendments to the ESOS Act will need to be considered by Parliament as part of usual legislative processes. The Department expects to release an exposure draft of a revised National Code later in 2015, following further discussions with government agencies and regulatory impact assessment (as advised by the Department of Education and Training, 29 July 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 at the same time 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 for the review. The review included 41 recommendations.

Sources: Australian Government (2015c); Department of Education (2014); DET (2014a); DIBP (2015g, 2015i); ICAC (2015); IEAC (2013); Knight (2011); PC (2015d); Pyne (2015b).

Currently, student visa applications are processed either under the Assessment Level (AL) framework or streamlined visa processing (SVP) arrangements. The AL framework is 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,¹ is assigned an AL based on the calculated immigration risk posed by students from that country studying in a particular education sector. There are currently 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).

¹ 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.

Prospective international students who have a confirmation of enrolment from a participating SVP provider at bachelor, masters or doctoral degree level, or for a 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).

Irrespective of whether student visa applicants are assessed under the AL framework or SVP:

- both the course and the provider must be registered on the Commonwealth Register of Institutions and Courses for Overseas Students (CRICOS)
- applicants must meet the Genuine Temporary Entrant requirement, under which DIBP assesses whether the applicant's individual circumstances indicate they intend to stay in Australia temporarily
- the same health, character and health insurance requirements apply (DIBP 2015g)
- DIBP is responsible for issuing student visas to applicants.

Table 7.1 summarises current evidentiary requirements under the AL framework and SVP.

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 (figure 7.1). 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 7.2). 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).

Table 7.1 Current evidentiary requirements for student visas

Assessment Level Framework and Streamlined Visa Processing^a

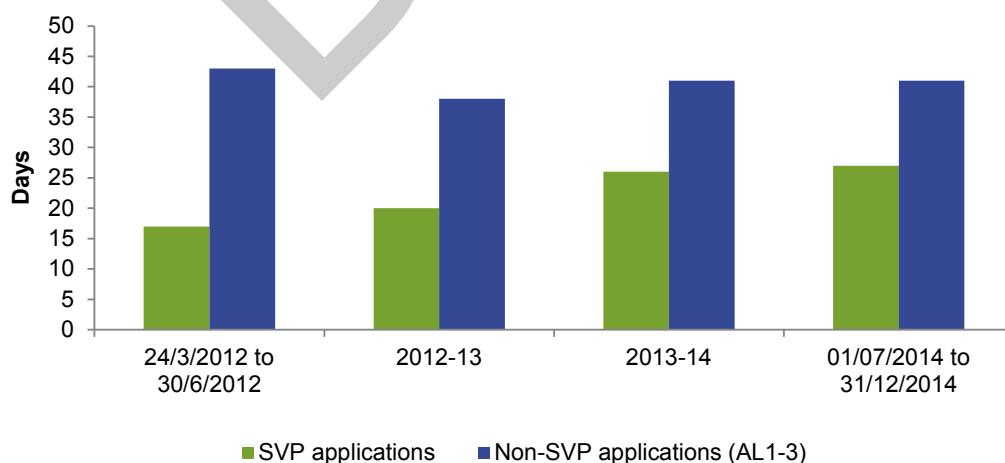
Requirements	Assessment Level 1	Assessment Level 2	Assessment Level 3	SVP
Financial	By declaration	<u>12 Months</u> (approximately \$40 000) and declaration for remainder of stay	<u>12 months</u> (approximately \$40 000) which must be in the name of the applicant or a close relative of the applicant 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				

^a 'Provider' is the education institution for which the student holds confirmation of enrolment.

Source: DIBP (2015g).

Figure 7.1 Processing times for visa applications^a

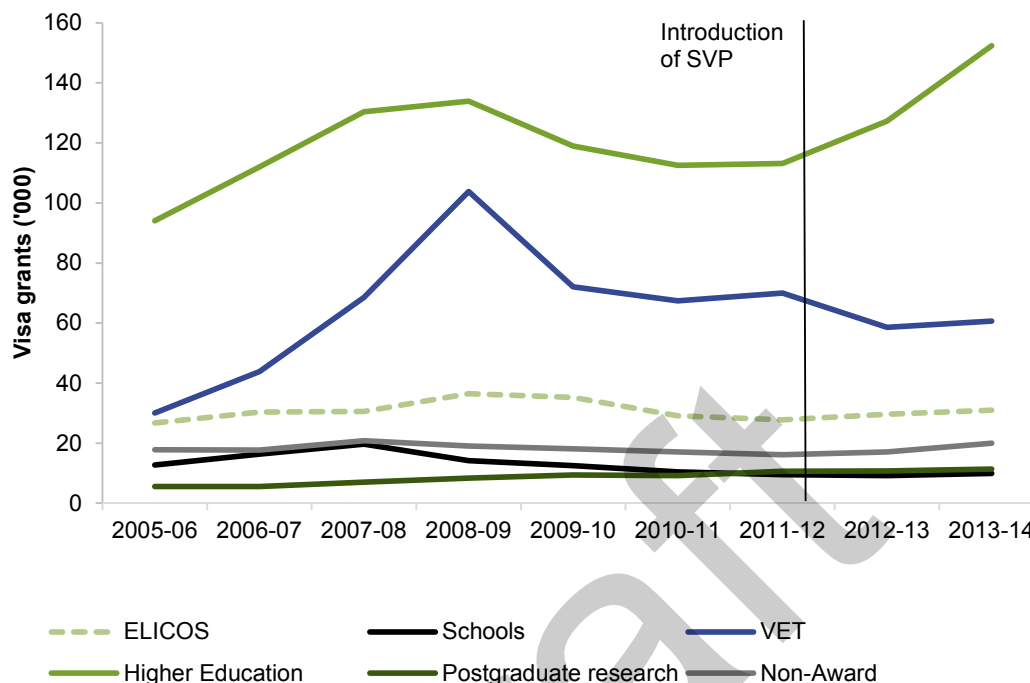
SVP and non-SVP applications



^a Estimates relate to the 75th percentile of visa applications.

Source: DIBP (2015g).

Figure 7.2 Total student visa grants by sector
2005-06 to 2013-14



Source: DIBP (2015g).

Econometric analysis undertaken by the Centre for International Economics (CIE) 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 CIE report, which included data on higher education visa applications up to and 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).

Universities Australia (2014) noted that despite the additional resources required for ongoing participation in SVP, the benefits to universities of this investment outweigh the costs.

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 2015i; 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 international 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 2015d).

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
- 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 observed that ‘course hopping’ has been of particular concern to stakeholders in the international education sector (DIBP 2015g). 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 may be legitimate reasons why a student would choose to 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).

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 CRICOS registered providers, across all courses and all education sectors (including schools, vocational education and training 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).

Box 7.2 The immigration department's proposed provider and country immigration risk model

DIBP's 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 CRICOS 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.

The 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.

At the time of writing, requirements relating to evidence of academic qualifications were subject to consultation. There are already requirements for education providers to ensure students have the necessary academic background under the *Education Services for Overseas Students Act 2000* (Cwth) 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>Possible evidentiary requirements</i>
Lower evidentiary requirements	1	1,2 or 3	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)
	2	1 or 2	
	3	1	
Higher evidentiary requirements	2	3	Generally these students would be required to provide evidence of their English language and financial capacity to DIBP.
	3	2 or 3	
Genuine Temporary Entrant requirement – continues to apply to all applicants			

Sources: DIBP (2015g; pers. comm., 24 July 2015).

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. Education providers could *choose* to put in place strategies to manage risks associated with the enrolment of international students to help obtain or maintain a low provider immigration risk rating (for example, by interviewing prospective students). The decision to implement risk management strategies would involve the education provider weighing the costs of the strategies against the potential benefits from an increased likelihood that students of that provider would have access to streamlined evidentiary 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 2015d).

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)

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 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 2015b).

The immigration department's proposed approach is an 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. DIBP's key measure of success would be the achievement of high levels of immigration integrity, rather than being concerned with the number of international students entering Australia.

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*. Both frameworks were premised on making student visas faster and easier to obtain, without compromising immigration risk. 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. The fact 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).

Changing student visa processing arrangements would involve transitional costs and have distributional consequences

Changes to current student visa processing arrangements would involve transitional costs and have distributional consequences for different types of providers and DIBP.

- 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

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 and would address the perverse incentives outlined above that arise from providers having differential access to streamlined visa processing. The net benefits of the SSVF will ultimately depend on how it is implemented. To ensure that the SSVF achieves the highest net benefits possible, the Australian Government should ensure that the principles of good regulatory practice outlined above guide the further development and implementation of the SSVF.

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 implementation of the proposed student visa processing framework, including through the Education Visa Consultative Committee working group.

DRAFT 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.

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 quality data on more than 9500 Australian schools (ACARA 2015).

Education counsellors representing the Department of Education and Training and other portfolios in Australian missions overseas liaise with a range of stakeholders, including education agents, in country to facilitate the dissemination of information on Australian education providers to students and their families (as advised by the Department of Education and Training, 29 July 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 an Australian course that falls well 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 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 is scheduled to finalise the implementation of the Quality Indicators for Learning and Teaching online platform by August 2015. 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 2015d). 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, 29 July 2015).

The 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 providers and government departments responsible for providing 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 announced initiatives (particularly the Quality Indicators for Learning and Teaching online platform) have been implemented and had time to take effect. There is a need to first understand the significance and nature of existing impediments to accessing and using information on provider quality (the restrictiveness of the barrier to service exports) before making future investments to enhance information provision.

DRAFT 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 within three years of the platform being fully implemented (which is scheduled to occur by August 2015).

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 some agents have behaved poorly

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 poor behaviour of some education agents (ICAC 2015; Knight 2011). Complaints about agents reported to the Overseas Students Ombudsman 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 (Overseas Students Ombudsman 2013).

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). 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 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 were sending non-genuine students to Australia — although the practice was becoming more widespread (Loussikian 2015). Evidence reported by 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 problems described above can arise because the incentives facing agents are poorly aligned with the interests of the students, education providers or the community more broadly. Reports examining the governance of education agents have identified a number of ways to reduce the risks of unscrupulous behaviour relating to the use of agents. For example, ICAC (2015) noted that institutions could consider increasing due diligence on and monitoring of agents and partners, focusing on the use of fine-grained data analysis of student issues that can be linked back to specific agents and partners. Other options could include changing agent payment structures to encourage the provision of quality students (ICAC 2015).

Peak bodies representing education providers are taking steps to improve how Australian education providers engage with education agents. English Australia (sub. 19) highlighted the English Australia Partner Agency Program, which supports and promotes those education agents who successfully recruit students for quality English language programs in Australia. In 2015, ACPET (2015) released a Code of Practice for the Engagement of Education Agents for its members.

The Department of Education and Training commissioned the International Education Association of Australia (IEAA) to deliver a project scoping the potential for an industry-led national quality framework for Australia's international education agents. The initial project involved consultation with agents, education providers, government and industry groups. The Department is currently considering a report that was received from IEAA in late June 2015 (as advised by the Department of Education and Training, 29 July 2015).

Given the work currently being undertaken to develop an industry-led national quality framework 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).

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).

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. 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. A 2014 survey of international students found that three quarters of students who enquired to an Australian higher education institution ranked 'use of technology in teaching' as an important

determinant of teaching quality. About 45 per cent of those students also ranked availability of mass online courses, which provide open access to courses via the internet, as an important determinant of teaching quality (Hobsons EMEA 2014).

The Australian Government has indicated that it will, as part of the review of the ESOS framework, consider increasing the flexibility for some types of courses on the CRICOS as appropriate for distance and online learning (Australian Government 2015c) (potentially including increased flexibility for providers to use online learning in courses offered to international students who are studying in Australia). The Department conducted face-to-face workshops in February 2015 and canvassed various options and suggestions for changing the current provisions. The outcomes of these consultations are being considered in preparation of a revision of the National Code (as advised by the Department of Education and Training, 29 July 2015).

Policy trials could help mitigate the risk of reducing restrictions on online education

Relaxing or removing limits on the use 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. For example, relaxing the restriction might make it more difficult to monitor whether the student is progressing with their course work if they are not attending classes on campus or meeting with their teacher less frequently
- 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 online learning.

Risk of non-compliance with student visa requirements could be evaluated through policy trials. One option for addressing 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.

DRAFT 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 enabling more innovative and flexible approaches to delivering education services. This evaluation could include the use of policy trials that gradually relax restrictions on the use of online education by international students, with periodic evaluation by an independent body to assess any risk to immigration integrity, and any unintended consequences for course quality.

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).

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 are associated with 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 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, primarily for international sponsors.

The footprint of Australian health-related exports goes beyond direct provision of health services. Several Australian businesses (such as the Royal District Nursing Service) export services relating to health management and training and the design of hospitals and aged care facilities (box 7.4).

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).

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 2015c). Governments also support health-related exports, such as by undertaking trade missions to other countries and providing funding to assist businesses to increase access to global supply chains. For example, in 2013 the Industry Capability Network (an Australian business network that acts as a matchmaker 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).

One consequence of heavy government involvement in Australia's health system is that market prices play a less central 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 core activities and compromising the delivery of health services to Australians (Deloitte Access Economics 2011; TIAC 2004; West 2014).

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).

7.4 Barriers to health service exports

Several government and industry reports have highlighted the significant opportunities to export Australian health expertise arising from:

- increased demand for high quality health and aged care services associated with rising incomes in many Asian countries (Australian Government 2012)

- forecast increases in the number of patients from developed countries, such as the United States, seeking health care abroad due to rising health care costs in their home country (Deloitte Access Economics 2011)
- technological advances in information communication systems that allow patients to access health service providers in other countries, without needing to travel (ACIL Tasman and ASR 2010).

Despite these apparent opportunities, Australian exports of health services are relatively modest compared to other service sectors (chapter 3).

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

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 (box 7.5).

There are 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. In 2013-14, DIBP granted 2860 medical treatment visas. 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. Required medical documents for patients seeking medical treatment include:

- a letter from the treating doctor in Australia outlining the patient's medical condition and the treatment that will be required
- evidence that the patient has sufficient funds to support themselves and anyone who comes with them while they are in Australia

- a letter from the treating doctor or hospital saying they are satisfied with arrangements for payment
- if the patient is going to be treated in a public hospital, the letter about payment arrangements must come from the financial officer or the administration department of the public hospital and confirm that no Australian will be disadvantaged in accessing medical services as a result of the patient's treatment (DIBP 2015h).

Box 7.5 Developing medical tourism in northern Australia

Several submissions to the Joint Select Committee on Northern Australia highlighted the opportunity to develop international health services in Cairns and Darwin. Australians for Northern Development and Economic Vision argued that Cairns and Darwin had many advantages as destinations for health tourism.

Cairns is:

- the closest major Australian city to the major expatriate populations living in the Pacific, particularly in Papua New Guinea and New Caledonia
- home to advanced medical facilities, including a world class fertility clinic with adjoining private hospital
- surrounded by high demand tourism destinations, including the Great Barrier Reef and Port Douglas.

Darwin is:

- the closest major Australian city to South-East Asia
- a city with an established reputation for high quality medical treatment in South-East Asia, partly because its hospital has been used after major regional emergencies
- a popular tourist destination, particularly known for its wildlife and scenery.

Source: ANDEV (2014).

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). These concerns have led these studies to recommend that the Australian Government consider streamlining the application process for medical treatment visas.² Professor John Catford, medical director at private hospital group Epworth, raised the possibility of streamlined visa arrangements to encourage international health care in Victoria.

We need a supportive government framework that actually encourages [medical tourism] and actually sorts out particular barriers or obstacles. A typical one would be visas so people can come in easily, with their families support, to receive medical care (quoted in West 2014).

² 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).

Further evidence is required to understand whether 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 what 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). Deloitte Access Economics (2011) found that many patients entering Australia for minor medical treatments, such as some cosmetic surgery and IVF, have 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), but Voigt et al (2010) suggested that some international patients use a short term visitor visa to avoid the delays associated with applying for a medical treatment visa. (In such cases, the incentive created by Australia's visa system may pose risks to the patient or public health system, to the extent the patient is subject to a less rigorous health evaluation when applying for a visitor visa.)³
- 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.⁴ Actual processing times for applications may be shorter or longer than the standard times due to local factors affecting processing of applications (DIBP 2015l).

INFORMATION REQUEST

The Commission seeks further information on the scope for streamlining current medical treatment visa application processes, taking into account the need to manage immigration risks through the visa system.

³ 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).

⁴ 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).

Australia's lack of cost-competitiveness in health services currently limits its potential to become a major destination for medical tourism

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 Malaysia, 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 are not 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^a

	<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 ^b	146 070	48 310	44 940	22 470
India ^b	10 450	10 110	9 550	3 370
Thailand ^b	12 360	13 480	11 240	5 060
Singapore ^c	14 920	9 680	10 480	4 840
Malaysia ^b	10 110	11 240	8 990	3 370
South Korea ^b	38 370	12 810	27 080	14 270

^a Cost data were compiled from various sources and should be treated as indicative only. ^b 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) and rounded to the nearest ten dollars. ^c Converted into Australian dollars at a rate of A\$1.00=SGR\$1.24 based on the average monthly exchange rate over the period for which data were compiled (2006 to 2012) (RBA 2015) and rounded to the nearest ten dollars.

Source: Medhekar (2014).

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 Commission (PC 2015c) 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.

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the research report.

Draft

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.
 - The case hinges on whether the marketing or major event would generate net benefits to the community relative to no government involvement.
 - 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 complexity of this analysis should be commensurate with the value of government funding being provided to the activity. The analysis should be publicly released as soon as practicable.
- The Commission has not been presented with, nor found, any evidence that demonstrates that restricting access to any airport in Australia's major gateway cities (Brisbane, Melbourne, Perth and Sydney) delivers net benefits to the Australian community, with perhaps the exception of Sydney Kingsford Smith Airport.
 - 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 gateway cities.
 - Following this, unrestricted access to Sydney Kingsford Smith Airport should be provided unless a published assessment shows that the costs would outweigh the benefits.
- The tourism sector, and other sectors that rely on visitors travelling to Australia, would benefit from the provision of differentiated border processing arrangements, such as premium services and off-terminal clearances. Such 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 a range of 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 (further discussion can be found in chapters 4 and 5).
 - There is insufficient evidence to conclude that a mandatory registration scheme for engineers would have net benefits for the Australian community, or would increase the level of engineering exports. The Commission has not identified any barriers to service exports that are specific to the professional service sector.
 - In addition to the general barriers faced by the IT sector the Commission has not been presented with, or identified, any barriers specific to the export of IT services.

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 providers in these sectors. Barriers that are more general in nature and affect multiple service export sectors are covered 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 by 2020 (box 8.1). The Australian Government, and all state and territory governments, support the tourism sector, primarily through the provision of destination marketing to promote Australia (or its regions), and through the funding 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 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
- build industry resilience, productivity and capability.

A draft implementation plan (2015–2020) for achieving the Tourism 2020 objectives has been released. Reform priorities included in the implementation plan are to: limit regulatory burden on tourism businesses (including visa arrangements, aviation capacity and planning and zoning requirements); work with industry to support the development of tourism infrastructure; and undertake coordinated and effective marketing campaigns.

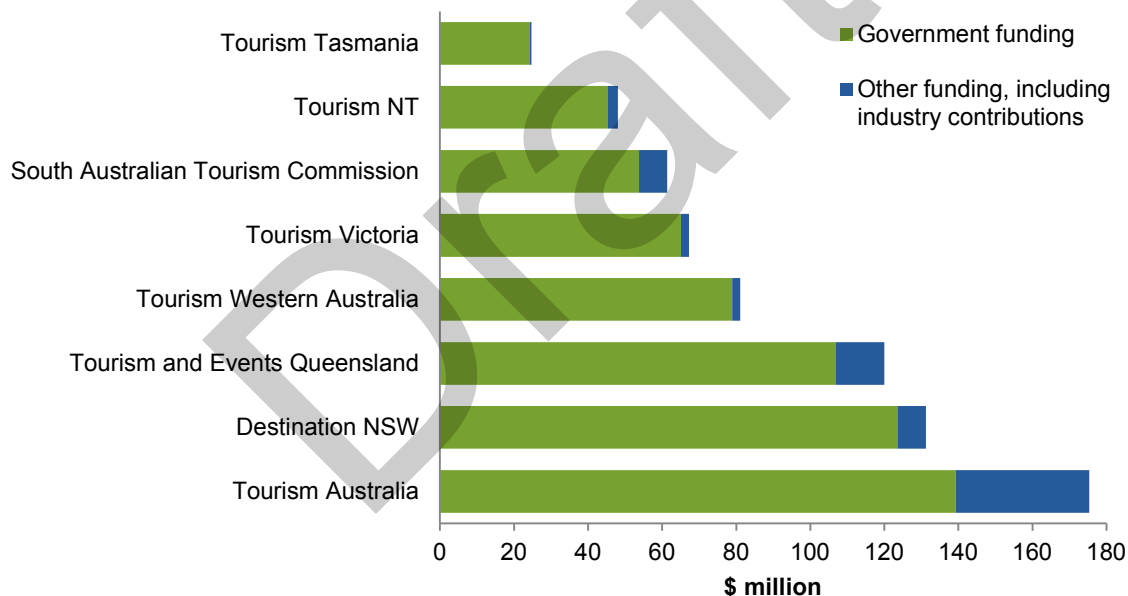
Sources: Austrade (2014a); DRET (2010).

Policy and regulatory 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 risks diverting resources from more worthy policy outcomes as it is not the same as maximising the net benefits to the

Australian community. Rather than target a particular level of economic activity from a sector, governments should focus on removing policy and regulatory impediments to tourism exports where they are identified. Removing impediments would allow the sector to take advantage of export opportunities. This section identifies areas where there may be scope for government reform. It makes draft recommendations for reform, drawing on a research paper on Australia's international tourism industry released by the Commission in February 2015, and additional evidence and views of participants in this study.

The tourism sector is also affected by broader government policies that influence the number of visitors to Australia. These include investment in tourism-related infrastructure, the availability of skilled employees, and Australia's export assistance programs, including grants. These issues are considered in chapter 4.

Figure 8.1 Total expenses of Australia's tourism agencies, 2013-14^a
Including employee benefits, payments to suppliers, grants and depreciation



^a 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 through providing or funding 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 destination marketing and major events (increased visitor activity) can be captured by a wide variety of tourism-related businesses, and it is 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.

Evaluating the case for government involvement in destination marketing and major events

An in-principle role is a necessary but not sufficient condition for government involvement in marketing or major events. Whether governments are justified in funding or providing destination marketing or major events 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 activities 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.

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. A 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 of destination marketing and major events, they would have also overstated the extent to which government should be involved in providing or funding destination marketing or major events. 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.

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)).

- A key reason why the economic effects of major events may be overestimated is because studies often assume 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 visitors to the region 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 use input–output or computable general equilibrium models to report the increase in tourism expenditure or GSP as a result of the event. For the reasons outlined above for destination marketing, these approaches will tend to overstate the net benefits from the provision of the event.

Government involvement in the provision of destination marketing and major events should be subject to rigorous economic analysis prior to the marketing or event being funded. The Commission is mindful that projects — and the contribution of government —

can vary in size and the administrative and compliance costs of undertaking economic analysis that is not fit for purpose could swamp a small project in red tape. The complexity of this analysis should be commensurate with the value of the government funding being provided to the destination marketing program or major event. The analysis should consider the broad range of costs and benefits associated with destination marketing and major events, including the risk that government involvement can crowd out private provision (box 8.3 and chapter 4). The analysis 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).

An ex-post evaluation of the costs and benefits of the activity following the completion of the activity would provide further rigour and accountability on the use of taxpayer funds.

The Commission also emphasises the importance of transparency in the evaluation of government provision of destination marketing 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 destination marketing and major events. Such scrutiny can test the assumptions and methods of analyses of destination marketing and major events, and draw attention to where information may be missing and 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. 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 proceeding can be disclosed following the activity proceeding.

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 major 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 firms not associated with 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).

DRAFT RECOMMENDATION 8.1

The Australian, state and territory governments should:

- undertake an 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 program or major event and following the activity's completion. The complexity of this analysis should be commensurate with the value of government funding being provided to the activity
- publicly release the analyses of costs and benefits of funding or providing a destination marketing program or major event as soon as practicable
- not provide or fund a destination marketing program or major event unless an analysis of the costs and benefits of the activity demonstrates that government funding would provide net benefits to the Australian community.

Funding destination marketing

Australian destination marketing is largely funded from general government revenue, although some funding comes from other sources such as industry contributions to joint marketing campaigns (figure 8.1). 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 government 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.

It is administratively difficult and costly to identify tourism businesses and recover the costs of destination marketing from them. Businesses in the tourism sector are extremely diverse (as is the distribution of the benefits arising from additional visitor activity), and provide a broad range of goods and services to visitors, such as accommodation and transport. 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.

Although it is difficult to recover the costs of destination marketing from businesses, where possible tourism agencies should continue to seek industry funding on a voluntary basis. Some government-provided destination marketing incorporates product marketing, and is partly funded by contributions from businesses. 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).

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.

Recovering costs through visa charges or the PMC imposes direct costs on visitors, but also imposes costs on tourism-related businesses if the higher cost of visiting Australia reduces demand for tourism products in Australia. 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.

International air service arrangements

International visitors rely on air services to travel to and from Australia. Airfares comprise a large part of the total cost of a short-term visit by a visitor to Australia and a smaller, but still sizable, part of the total cost of longer-term visits (chapter 3).

Unlike most traded sectors, international aviation markets are restricted unless governments have negotiated access arrangements. The regulation of air services through these arrangements can affect the price and availability of international air services. Among other things, air services arrangements involve provisions that 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). The Australian Government has negotiated bilateral air services arrangements with 94 economies (DIRD, sub.28, attachment A). These arrangements include ‘open skies’, open capacity and other arrangements (box 8.4). Australia’s arrangement 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.

Under most of Australia’s air services arrangements unrestricted access (capacity) is provided to foreign airlines flying to and from all international airports in Australia other than those in the major gateway cities of Brisbane, Melbourne, Perth and Sydney — a policy referred to as the regional package. Under the regional package, access is restricted to secondary airports in the major gateway cities 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 international tourism research paper participants raised concerns about insufficient aviation capacity entitlements to airports in Australia’s major gateway cities. Sydney Airport (2014), Perth Airport (2014) and Austrade (2014c) 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 gateway cities and Hong Kong, Malaysia, and the Philippines.¹

In some aviation markets airlines are constrained from increasing supply to and from Australia’s major gateway cities (figure 8.2). This is primarily an issue for the airlines of Fiji, Hong Kong, Malaysia and Qatar. Australian airlines are not similarly constrained, except when flying to and from Fiji. In other markets, including China,² Indonesia and South Korea, capacity entitlements are not being fully used either by foreign airlines or

¹ Additional capacity entitlements were negotiated with the Philippines in May 2015.

² Capacity entitlements for Australian and Chinese airlines were increased in January 2015. Prior to this, capacity was constrained for Chinese airlines flying to and from Australia’s major gateway cities.

Australian airlines, although in most cases there is significantly more unused capacity for Australian airlines than there is for foreign airlines.

Box 8.4 Australia's air services arrangements

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 (for passenger flights) allow 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, although capacity is restricted for these services (DIRD 2015).

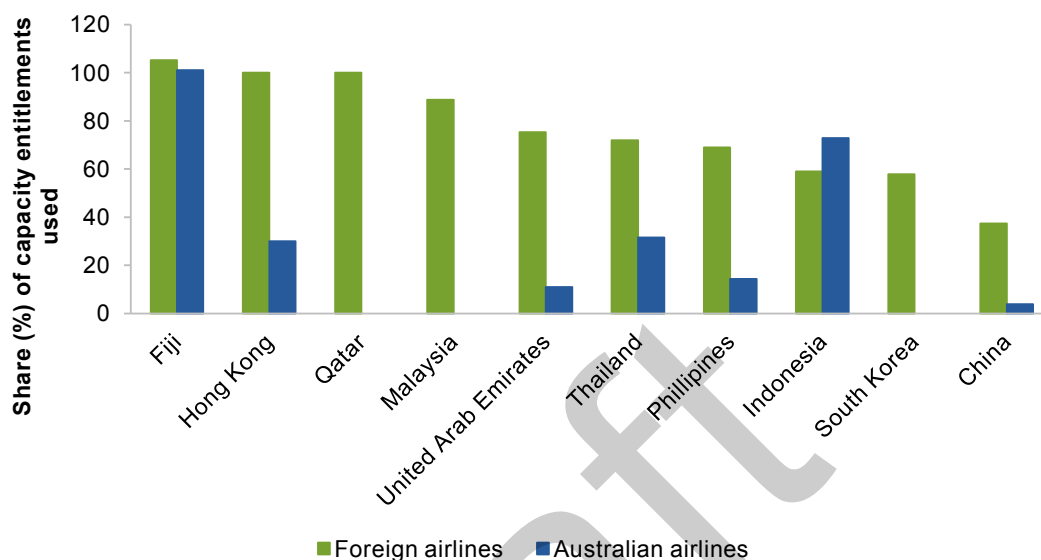
Other arrangements with pre-determined entitlements

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 gateway cities of Brisbane, Melbourne, Perth and Sydney (referred to as the regional package). 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 gateway cities 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).

Where capacity is constrained by air services arrangements, airlines cannot operate additional services to and from Australia's four major gateway cities 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 and from Australia's major gateway cities. Airlines will also be prevented from entering a market if there are insufficient capacity entitlements available to warrant servicing a new route. These effects could result in higher prices for international flights to and from Australia. Airfares that are higher than they otherwise might be could lead to a reduction in the number of international visitors to Australia and a reduction in demand for exports of tourism services. Higher airfares also increase the costs for other service exporters who rely on face-to-face delivery of their service.

Figure 8.2 Proportion of international aviation capacity entitlements expected to be used by foreign and Australian airlines, March 2015 to October 2015^a

Australia's largest uplift/discharge markets by passenger traffic^b



^a 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 gateway cities and China's major gateway cities (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 gateway cities 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. ^b 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).

Further liberalisation of Australia's international air services arrangements could lower travel costs

On balance, the Commission considers that Australia's international aviation policy settings are broadly working well and a wide ranging review of international aviation policy (such as the review conducted by the Commission in 1998) is not warranted at this time. This is not to say there is no scope for further liberalisation within the bilateral framework.

Where further 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 gateway cities.

Potential benefits of further liberalisation

Whether providing unrestricted access to Australia's major gateway cities would deliver net benefits to the Australian community depends on the extent to which existing arrangements are constraining market behaviour. As outlined in figure 8.2 above, there are unused capacity entitlements within some of Australia's bilateral arrangements — suggesting that additional capacity would have limited commercial value unless the constraint was expected to be binding in the near-term. In these circumstances, further liberalisation would have little effect. In other cases, however, capacity limits do appear to be binding and could be impeding more efficient market outcomes and reducing demand for Australian service exports.

By reducing constraints on market entry and controls on airlines' capacity, unrestricted access provides scope to increase competition. 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. Existing and new passengers would benefit from any lowering of airfares and from greater choice of airlines and/or air services. These benefits flow both to people travelling to Australia from other countries but also to Australians travelling abroad, whose welfare is improved from being able to travel at potentially lower cost and/or from better quality and more frequent air services to a wider range of destinations. Other parts of the economy would also be expected to benefit, including from greater service exports, particularly in the tourism sector but also in other service sectors where service providers rely on face-to-face delivery of their service.

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' assessment 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 gateway cities 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.

Potential costs of further liberalisation

The potential costs associated with providing unrestricted access to the major gateway cities 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. 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 partially offset any loss of profits of Australian international airlines.

Providing unrestricted access would also have costs if it results in a loss of leverage for the Australian Government in its international air services negotiations. The Department of Infrastructure and Regional Development (sub. 28) stated that access to the major gateway airports is the only ‘negotiating coin’ available to Australia in its negotiations with foreign aeronautical authorities, with the exception in some circumstances being the granting of beyond rights to the Pacific and trans-Tasman. The Department further stated that the current approach of restricting access to Australia’s major gateway airports (while ensuring capacity is sufficient for existing demand) has proven very effective in obtaining improved rights for Australian airlines.³

The value of any leverage lost from providing unrestricted access to Australia’s major gateway airports should not be overstated, especially if Australian airlines are not seeking to operate additional services under the relevant bilateral arrangements. 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. While there could be other 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. Further, as access rights are sovereign rights, the Australian Government may rescind any access previously granted if, during the course of negotiations, it is assessed that granting such rights would be contrary to the interests of the Australian community. Where restrictions to Australia’s major gateway cities are maintained to provide leverage for the Australian Government in its international air services negotiations, the benefits this leverage provides should be transparently weighed against the costs — the foregone community-wide benefits of providing unrestricted access to particular airports.

The Commission has not been presented with, nor found, any evidence that demonstrates that restricting access to any airport in Australia’s major gateway cities delivers net benefits (through negotiating leverage or otherwise) to the Australian community, with perhaps the exception of Sydney Kingsford Smith Airport. Sydney Kingsford Smith Airport is Australia’s largest airport — about 40 per cent of Australia’s international passengers travelled to and from Sydney Airport in 2014 (BITRE 2015).

Allowing foreign airlines to access Australia’s major gateway airports on an unrestricted basis would be expected to deliver net benefits to the Australian community, including service exporters. The Commission proposes that access to Australia’s major gateway cities be liberalised in a staged way. To begin with, the Australian Government should, as soon as practicable, provide unrestricted access for foreign airlines flying to and from Brisbane, Melbourne and Perth airports, as well as secondary airports in all of the major

³ 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).

gateway cities. 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 community.

DRAFT RECOMMENDATION 8.2

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 gateway cities. 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 community.

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. Assessing whether policy options that seek to achieve more open aviation markets are in the national interest involves weighing up a range of competing costs and benefits. In its written comments to the Commission's international tourism research paper, Sydney Airport (2014) stated that the Australian Government's approach to negotiating air services arrangements lacks transparency and it is unclear how the national interest is determined. Austrade (2014c) also reported that tourism stakeholders have in the past expressed a desire for greater transparency from the Australian Government in relation to how the national interest was derived and the dialogue that occurred during negotiations.

When negotiating an air services agreement, the Australian Government should undertake an assessment of the costs and benefits of more open international air services markets. It should publicly release its assessment of the costs and benefits of the negotiated outcome 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. The assessment should include relevant costs and benefits to the community, including the benefits to Australian passengers arising from lower airfares or gaining access to a wider range of outbound travel destinations, as well as the effects that granting and obtaining additional rights may have on Australian airlines.

In its submission to this study, the Department of Infrastructure and Regional Development stated 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). The Department did not outline in its submission what the implications would be of greater transparency of its analyses.

DRAFT RECOMMENDATION 8.3

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 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.

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, including Crown Resorts Limited (2014), the Queensland Tourism Industry Council (2014) and the Tourism and Transport Forum (2014), suggested that Australia's visa application processes were more demanding and time consuming than those in comparable countries, particularly with regard to the arrangements for Chinese visitors. Visa settings are important as they determine the ease with which short-term visitors are able to enter Australia. Issues that make obtaining a visa more difficult will reduce the demand for Australian tourism services and other services that rely on visitors travelling to Australia.

Visitors from China (and other countries such as India) must apply for a visitor visa (subclass 600), which Chinese visitors have been unable to complete online (although the Australian Government is currently trialling online visas for Chinese citizens) (table 8.1). Visitors from countries such as Indonesia are also unable to complete visas online. 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.

The process of obtaining a visitor visa was also raised by participants in this study (Advance Cairns, sub. 13; Australian Tourism Export Council, sub. 16; National Tourism Alliance, sub. 11; Tourism and Transport Forum, sub. 25). The Australian Tourism Export Council 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. The National Tourism Alliance recommended extending electronic visas to key Asian markets. The Tourism and Transport Forum (sub. 26) recommended introducing a single visa for Australia and New Zealand, to reduce the cost and complexity of visa arrangements for visitors that travel to both countries on the same trip.

Table 8.1 Visa types under Australia's visitor visa program

<i>Visa type</i>	<i>Visitor visa^a (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 nationals and some non-EU European nationalities
Eligible countries (of top 15 countries of origin for short-term visitors to Australia) ^b	China, India, Indonesia	Canada, Hong Kong, Japan, Malaysia, Singapore, South Korea, Taiwan, United States	France, Germany, United Kingdom
Cost	\$135	\$20	Free
Lodgment	Paper lodgment available to all nationalities, online lodgment being expanded to all passport types (197 as of November 2014 — does not currently include China, India, Indonesia and Vietnam)	Online lodgment	Online lodgment
Documentary evidence	Required	Not required	Not required but can be requested
Processing time service standard ^c	1 month	1 working day	1 working day
Validity	12-months, multiple entry	12-months, multiple entry	12-months, multiple entry
Maximum stay per entry	3 months	3 months	3 months
Permitted activity	To visit, study, or for business, depending on stream	To visit, study, or for business	To visit, study, or for business

^a Standard Visitor visa for offshore clients. ^b Visitors from New Zealand are eligible for a Special Category visa (subclass 444). ^c The Department of Immigration and Border Protection aims to process 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.

Sources: ABS (2015h); DIBP (2015k, 2015l).

The Tourism and Transport Forum (sub. 25) also recommended changes to Australia's border processing arrangements. These recommendations included 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.

The Australian Government is taking steps to simplify visa and border processing arrangements

The 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 2015k). Given the strong competition from other countries to attract visitors, particularly from

China (chapter 3), it is important that the requirements and restrictions attached to visa eligibility are no more burdensome than 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.
- The Government reviewed document requirements for Chinese travellers, and combined two document checklists into one shorter checklist.
- The Government has launched online visa application pilots in China and India, and is aiming to have online visas available for all nationalities by the end of 2015.

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 (TTF, sub. 25).
- The Department of Immigration and Border Protection (DIBP) is also rolling out automated departure gates (which scan the visitor's passport and match the passport image with their live image) at Australia's major international airports between 2015 and 2016 (DIBP 2015a).
- The Department of Infrastructure and Regional Development is reviewing the process for assigning border agency resources to regional airports. A permanent border agency presence was also assigned to Townsville Airport in 2015 (Australian Government 2015f).

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 people from visiting Australia (BARA 2014; Flowers 2014; QTIC 2014; Tourism NT 2014b; TTF 2014). In this study, the National Tourism Alliance (sub. 11), the Australian Tourism Export Council (sub. 16) and the Tourism and Transport Forum (sub. 25) recommended that these 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).

The DIBP and the Customs and Border Protection Service noted 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’ (2014, p. 5). Similarly, visa charges are not set on a cost recovery basis (DIBP 2014b). As neither the PMC or 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 Australia as a whole.

Evidence on the effect of visa charges and the PMC on Australia 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 some changes to border charging arrangements in its 2015-16 budget. These included increasing the cost of 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 (table 8.1). Other recommendations of the review, including those in relation to differentiated border processing services, remain under government consideration. The review has not yet been publicly released. As border fees and charges have been reviewed in 2015, and the review has not yet been released, the Commission has not made recommendations on this area in this study.

Is there scope for differentiated border processing arrangements?

Participants in this study raised the prospect of differentiated border processing arrangements (or premium arrangements) being offered to visitors on a cost recovery or commercial basis. The National Tourism Alliance (sub. 11) stated that premium border processing services, such as concierge services, could be offered. The Alliance also raised the possibility of services such as priority visa applications and off-terminal clearance services. The Australian Tourism Export Council proposed similar options in its submission to the review of border fees and charges (ATEC, sub. 16, attachment. 1), and the Tourism and Transport Forum raised the possibility of a user-pays premium visa processing model (TTF, sub. 26).

In November 2014 the review of border fees and charges released a position paper on differentiated border processing services for consultation. The position paper noted the DIBP does not currently have a cost recovery framework in place for differentiated 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 2014, p. 6). Similarly, the Tourism and Transport Forum (sub. 26) noted that premium border processing services are provided on an ad hoc basis, with no cost recovery process in place.

Increasing the provision of differentiated services would have benefits for the tourism sector, potentially including increased visitor numbers to Australia, increased demand for tourism services, 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.

The Commission is broadly 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 differentiated services to be provided without undermining the ability for the DIBP to undertake its standard visitor clearance processes.

DRAFT RECOMMENDATION 8.4

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

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 8.2). 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 that country (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.

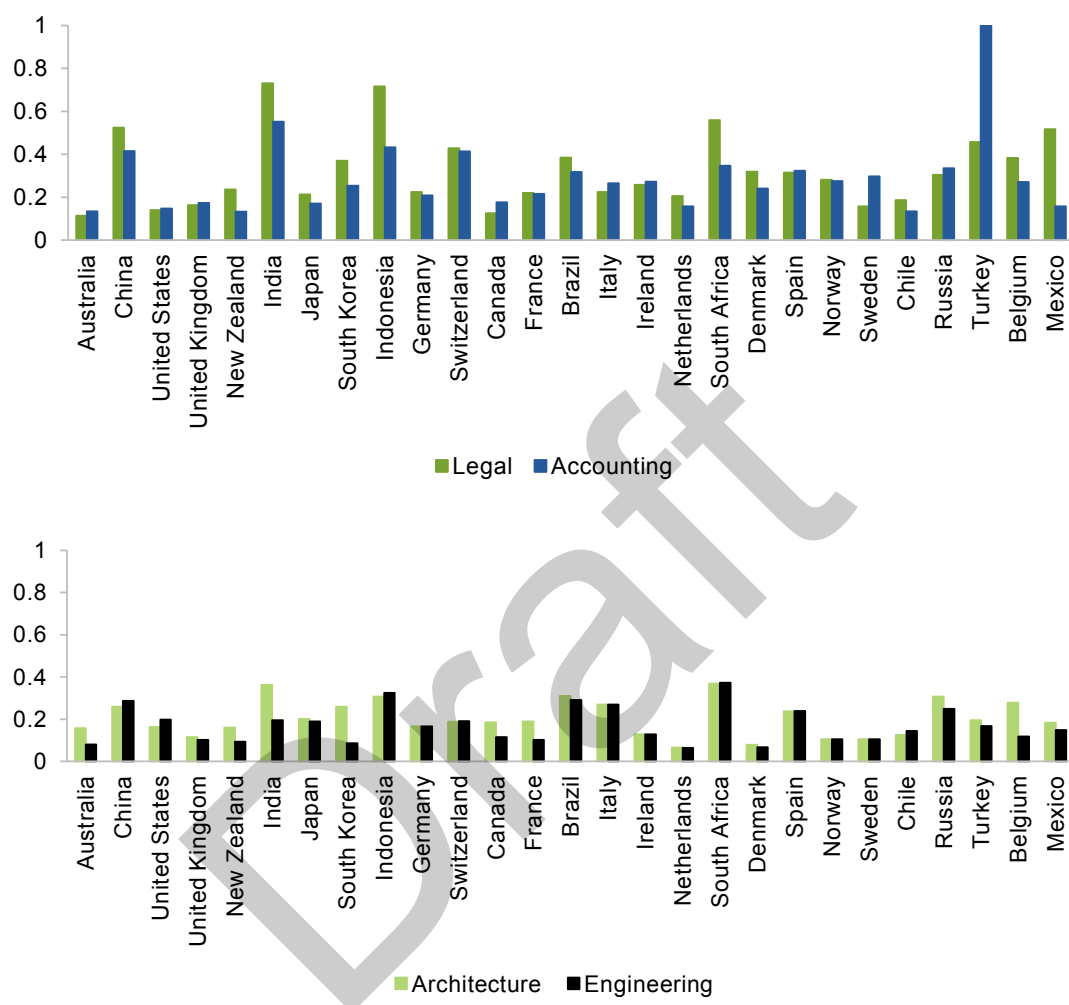
- For legal services, the Law Council of Australia (sub. 26) noted that Australia provides liberal terms of market access. For the practice of foreign country law in Australia, foreign legal service providers do not need to obtain a full practicing certificate, are subject to less onerous requirements 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).
- 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 — registration can be a restriction on trade for professional services (chapter 5).
- When discussing professional regulation, 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.

Noting that mandatory registration of engineers has not been acceptable to 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 system of engineering registration. ACIL Tasman (2012) estimated that there would be significant benefits associated with a mandatory registration scheme due to improvements in quality.

Figure 8.3 International barriers faced by professional service sectors^a
Countries in the OECD database that are in Australia's top 40 trading partners, and Australia



^a 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).

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, such as poorly qualified engineers signing off on work. 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 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 mandatory registration 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.

8.3 Information technology

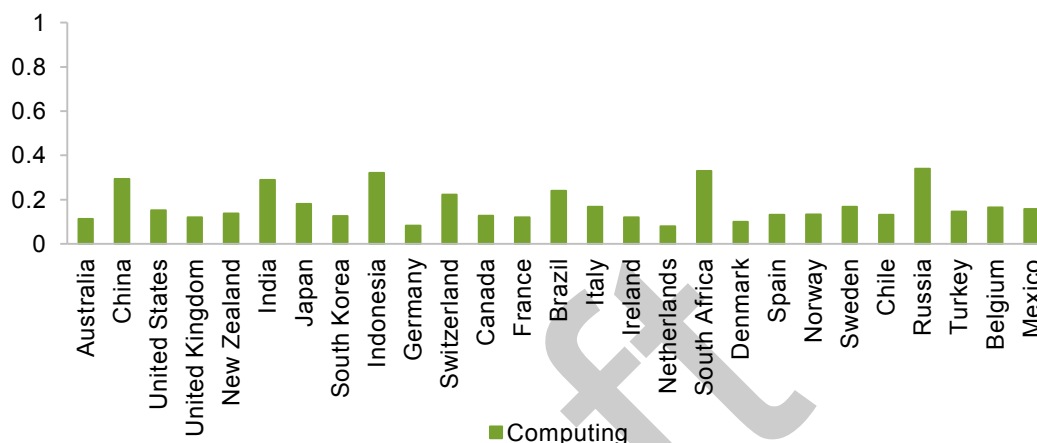
Australia’s information technology (IT) sector includes services such as hardware and software consulting, software licencing and data processing, cloud and database services. About two thirds of the value of Australia’s IT exports in 2013-14 were hardware and software consulting services, although this 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). 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.

Figure 8.4 International barriers faced by the information technology sector^{a,b}

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 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).

The Commission has not identified any barriers specific to the export of services from the IT sector. The Commission welcomes further information on the barriers faced by IT businesses when exporting their services.

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the research report.

Draft

9 Addressing international barriers to service exports

Key points

- International barriers to Australian service exports are a result of policy and regulatory settings in other countries, both at and behind the border. Addressing these barriers ultimately requires commitment and action from governments in other countries.
- The Commission has identified four areas where the Australian Government could take steps to address international barriers.
 - Cross-border data flows — the Australian Government should work through trade negotiations and in international forums, including the APEC project on harmonising standards for the movement of data across APEC economies, to ensure that standards for the movement of data across borders are consistent and that measures impeding cross-border data flows are the least restrictive necessary to address privacy or security concerns.
 - Intellectual property rights — the Australian Government should focus on plurilateral or multilateral negotiations, such as through the World Trade Organization and Asia-Pacific Economic Cooperation, when seeking to encourage enforcement of intellectual property rights in key export markets. Intellectual property provisions should not be included in future trade agreements unless a published economic assessment shows that the effects of any provisions generate net benefits to Australia.
 - 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 for developing and implementing mutual recognition through trade (or other) agreements.
 - Investment — the Australian Government can use trade negotiations to address some barriers that impede service providers from establishing a commercial presence abroad. Behind the border barriers to investment are more 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.

9.1 Introduction

Evidence outlined by the Commission in previous chapters indicates that international barriers to service exports are reducing demand for Australian service exports, and raising the costs of providing Australian service exports, in four key areas.

- *Cross-border data flows* — there are impediments to the free 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).
- *Intellectual property rights* — violations of intellectual property (IP) rights in export markets affect some service providers, such as architects, engineers and software service 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 (chapter 5).
- *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 services 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 (chapter 5). The financial services sector, which provides the majority of its service exports through foreign commercial establishments, is substantially affected by these barriers.

A key challenge in addressing international barriers to Australian service exports is that international barriers relate to domestic legislation and 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. Also important is the removal of barriers to trade within Australia that serve to reduce the productivity of Australian businesses, including service providers. Pursuing domestic policy and regulatory 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 similar barriers to service exports in other countries.

9.2 Mechanisms for addressing international barriers

A range of international regulatory cooperation mechanisms can be used to address international barriers to service exports. Regulatory cooperation mechanisms range from informal exchange of information, technical assistance through intergovernmental networks and organisations, and recognition of international standards and mutual recognition agreements (MRAs), to more formal cooperation through international agreements and treaties, such as trade agreements and tax treaties. Regulatory cooperation mechanisms are not mutually exclusive and effective trade liberalisation may require action on multiple fronts. For example, trade agreements have been used to facilitate market access for service providers and have been used in addition to technical assistance initiatives to encourage adoption of good practice regulatory arrangements in other countries.

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. The mechanisms for addressing international barriers to service exports considered in this chapter are:

- trade agreements
- other international agreements such as taxation treaties
- MRAs or the adoption of international standards or regulatory harmonisation
- technical assistance and cooperation to facilitate domestic regulatory reform in other countries.

9.3 Trade agreements

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).

WTO rules allow countries to form bilateral, regional or plurilateral trade agreements. Preferential trade agreements¹ (also commonly referred to as free trade agreements) are now widespread and have emerged due to difficulties in reaching agreement to further

¹ Preferential trade agreements entail the exchange of 'concessions' (or preferences) between partner countries to the agreement (PC 2010a).

liberalise services trade at the multilateral level. The Australian Government has nine preferential trade agreements in force, with New Zealand, Singapore, Thailand, the United States, Chile, ASEAN (including New Zealand), Malaysia, South Korea and Japan. An agreement with China was signed in June 2015. Another five agreements are currently being negotiated — two bilateral (with India and Indonesia) and three regional (the Trans Pacific Partnership Agreement (TPP), the Regional Comprehensive Economic Partnership Agreement (RCEP) and the Pacific Agreement on Closer Economic Relations (PACER Plus)). The Australian Government is also a party to negotiations on a plurilateral services-only trade agreement, the Trade in Services Agreement (TiSA) (discussed below).

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 only as burdensome as required to ensure the quality of the service. Member economies are free to designate the sectors in which they will assume obligations.

The GATS contains two sets of legal obligations governing market access and national treatment.

- *Market access* provisions are aimed at progressive elimination (through negotiations) of 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).

Experience with trade agreements to address barriers for services

Some participants to this study considered that trade agreements are a necessary precursor to facilitating opportunities for service providers seeking to export their services (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 specific instances where trade agreements had assisted them in their export activities. One example, referred to by the 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 FTAs 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. 27–28)

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 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.

Preferential trade agreements typically contain provisions that aim to address behind-the-border barriers to services trade. 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 2015a). The ASEAN–Australia–NZ 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).

As a general rule, trade agreements are of limited use in directly addressing barriers that are behind the border, although they can provide a framework to establish supplementary measures, such as mutual recognition and harmonisation of standards (discussed below).

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 2015b)
- 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 2015e; 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 2015c)
- 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. They may guarantee existing levels of market access and hence prevent reversion to more restrictive measures. Further, many barriers to investment are behind the border making them difficult to identify and address (chapter 5). Participants have also 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).

The Commission has previously highlighted a number of issues regarding preferential trade agreements. 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 (PC 2015f). 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 are used for the purposes of ‘denial of benefits’ to service providers from countries not party to the agreement (PC 2015f) (box 9.3).

The Commission has also pointed to some matters contained within preferential trade agreements, such as those relating to IP (discussed further below) and investor state dispute settlement provisions, that risk imposing net costs on the community (PC 2010a, 2015f). The complexity of preferential trade agreements and the potential for provisions to impose net costs on the community presents a compelling case for the negotiated text of an agreement to be comprehensively analysed well before signing (PC 2015f). A two-stage assessment process involving a comprehensive, independent and published analysis — a pre-negotiation analysis and a final text analysis — could be used (Harris 2015).

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 effects 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.

The discretionary nature and vagueness of the services and investment rules of origin leave a number of questions as to the actual or potential effect of the rules of origin on services trade and investment activity.

Source: PC (2015f).

The Commission's views on the effectiveness of preferential trade agreements — outlined in a number of 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 was a need to pursue plurilateral, regional and bilateral agreements and proposed that Australia focus on negotiating a services plurilateral agreement.

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 Architects, sub. 2, Export Council of Australia, sub. 32). The AIIA (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. The program includes the delivery of seminars with businesses throughout Australia, and trade agreement ‘kits’ which will include fact 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 (Export Council of Australia, sub. 32; AIIA, sub. 7).

There is an in-principle 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 (chapter 4). 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 market entry and the trade agreement tool.

Sources: Export Council of Australia (2015a, 2015b).

Using trade agreements to address intellectual property rights issues

International efforts to persuade countries to meet their commitments to protect and enforce IP rights agreed through the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) are ongoing, with some countries yet to establish IP rights enforcement mechanisms. Most of Australia's bilateral trade agreements have reaffirmed commitments on IP agreed under the TRIPS, although two of Australia's bilateral trade agreements (with Chile and the United States) have wider coverage than the TRIPS and other bilateral trade agreements. Extension of IP protections under the Australia–United States trade agreement is likely to have imposed net costs on Australia (a net importer of IP) (chapter 5). Parties to the Trans-Pacific Partnership are also considering the protection and enforcement of IP rights (USTR 2015b).

Most of the benefits from efforts to promote adherence to existing IP rules in Australia's trading partner countries can be expected to accrue to third parties, such as rights holders in the United States (PC 2010a). Thus, plurilateral or multilateral settings would be the most effective mechanisms for addressing IP issues. The Australian Government should focus on multilateral or plurilateral international negotiations (including through the WTO, World Intellectual Property Organization and Asia-Pacific Economic Cooperation (APEC)) when seeking to encourage enforcement of IP rights in export markets.

Any IP provisions that are proposed for a particular trade agreement should only be included after a published economic assessment of the effects, including on Australian consumers, shows that implementing the provisions would generate overall net benefits for Australia.

DRAFT RECOMMENDATION 9.1

The Australian Government should focus on plurilateral or multilateral negotiations when seeking to encourage enforcement of intellectual property rights in export markets. The Australian Government should not include intellectual property provisions in future trade agreements unless a published economic assessment shows that the effects of any provisions, including on Australian consumers, generate overall net benefits to the Australian community.

The Trade in Services Agreement

As noted above, Australia is part of a group of countries negotiating a services-only trade agreement — the TiSA.² The group of countries party to the TiSA collectively account for around 70 per cent of global trade in services (DFAT, sub. 31). The objective of the TiSA

² 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 2015l).

is to negotiate an agreement that: is compatible with the WTO 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. The Department of Foreign Affairs and Trade (DFAT) website states that:

... new and enhanced disciplines similar to chapters in [Free Trade Agreements] will outline additional commitments that will apply to all parties. Negotiations currently include Air and Maritime Transport, Domestic Regulation and Transparency, Financial Services, Professional Services, Temporary Entry of Business Persons, Electronic Commerce and Telecommunications. Discussions to include additional proposals on Competitive Delivery Services, Energy, Environment and Government Procurement are at an early stage. (2015f)

The extent to which the TiSA will generate additional benefits for Australian service providers, and the Australian community, 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, South Korea, New Zealand 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 2015l). Expansion of the TiSA to include other countries could provide additional benefits to Australian services firms.

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 TiSA, and indeed, whether there are any provisions that could potentially result in net benefits (or net costs) for Australia. Again, this highlights the need for the negotiated text of trade agreements to be comprehensively analysed well before signing.

One emerging area of relevance for services trade where the TiSA could address barriers for Australian service exporters relates to cross-border data flows. DFAT's website states that the transfer data across borders is something that the TiSA is well placed to address (DFAT 2015f). 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.

9.4 Other international agreements affecting service exports

In addition to trade agreements, other agreements and treaties can be used to address issues relating to trade in services. Tax treaties can be 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).

International tax treaties

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 to 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 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 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 some 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 (to facilitate trade, including in services, between signatory nations). 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, particularly 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). They affect the efficiency of domestic and international investment markets (with flow on effects to most sectors of the economy), and have domestic tax and revenue implications.

9.5 Mutual recognition or harmonisation of standards

Can mutual recognition help to address barriers to service exports?

Mutual recognition involves two or more countries agreeing to allow service providers who meet the licensing, registration or qualification requirements of the other countries to practice in the relevant country. The benefits of MRAs include a reduction in costs (through reduced 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'.

Increased market access arising from MRAs can also facilitate service exports and drive competition between local and foreign service 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. 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.

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.

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 2015e). 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 been successful (PC 2003, 2015e).

There may be several 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 may be necessary to address substantial and unnecessary differences in regulations between countries before mutual recognition can occur (discussed below).

Experience with mutual recognition agreements for services

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. 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. Some of Australia's trade agreements include a framework for progressing MRAs through a working group or committee (box 9.5).

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] 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. (2015k, 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.

Box 9.5 Provisions for mutual recognition in trade agreements

Some of Australia's trade agreements including with China, Malaysia, 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 which, 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 2015d).
- 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 9.5). Engineers Australia stated that Australia's trade in engineering services would benefit from elevating the level at which MRAs for professional services are dealt with in all preferential trade agreements.

Professional services working groups and committees established under trade agreements can help to facilitate collaboration between regulators and professional bodies that could lead to the development of MRAs or harmonisation of standards. The ANZ (sub. 23) pointed to the recent trade agreements with South Korea and Japan as having achieved significant gains by improving clarity and strengthening regulator consultation. The FSC (sub. 20) identified the Financial Services Committee under Australia's trade agreement with the United States as a useful template to support MRAs for licensing and professional qualifications. This Committee comprises representatives from the Australian and US Departments of Treasury as well as the Office of the US Trade Representative and Department of Commerce. The Committee is responsible for supervising the implementation of the financial services chapter of the trade agreement and for considering ways to further integrate each country's financial services 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 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 services industry groups.

The Trans–Tasman Mutual Recognition Arrangement (TTMRA) for the registration of occupations agreed between Australia and New Zealand also 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 9.6).

Box 9.6 Effective governance is needed to support mutual recognition arrangements

The Commission's draft report on the MRA between Australia and New Zealand (the TTMRA) and the Mutual Recognition Agreement (within Australia) found that the MRAs are generally working well, but that there was scope to strengthen oversight of the schemes. The issues identified by the Commission, which risk eroding the benefits of the MRA and TTMRA, are indicative of weak oversight and coordination among the participating jurisdictions. These issues include: occupation-registration bodies not always implementing mutual recognition as required; few individuals exercising their right to challenge the decisions of occupational regulators; the Cross Jurisdictional Review Forum (the body responsible for monitoring the schemes and responding to reviews) not meeting for almost four years; and governments failing to update Ministerial Declarations of occupational equivalence in Australia.

The Commission proposed a number of reforms to address these concerns. A key element of the proposed reforms is to strengthen the Cross Jurisdictional Review Forum by giving it more specific responsibilities, time frames and outputs, such as a requirement to develop an annual work program.

The Commission also proposed that individual jurisdictions improve oversight of how their regulators implement the MRAs. 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 revised by a tribunal under the mutual recognition legislation.

Source: PC (2015e).

The Australian Government can help facilitate the development of MRAs by establishing a framework for progressing MRAs when it negotiates trade agreements. To improve the prospects of an MRA being successful in facilitating services trade, the establishing framework should include clear actions and timeframes, involve relevant regulators and government bodies, and include a process for consulting with industry stakeholders. Cooperation on MRAs need not only occur under the umbrella of a trade agreement and can also take place through other arrangements, for example through international forums such as APEC, as well as collaboration and cooperation between regulators.

DRAFT RECOMMENDATION 9.2

The Australian Government should put in place a framework for developing and implementing mutual recognition arrangements as part of, or following, the inclusion of mutual recognition provisions in trade (or other) agreements. The framework should include clear actions and timeframes, involve relevant regulators and government bodies, and include a process for consulting with industry stakeholders.

Can the adoption or harmonisation of international standards help to 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 to 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 development of international services 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. As noted in chapter 6, Australia's conservative approach to risk in its prudential regulation, considered overly burdensome by some stakeholders, was recognised as beneficial in the context of the global financial crisis.

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 emerging issues, such as cross-border data flows, can also help to avoid the emergence of new barriers to services trade.

Developing a consistent approach to regulating cross-border data flows

One of the areas where the Australian Government is contributing to the development of internationally consistent regulations and standards for services relates to rules governing cross-border data flows (chapter 5). 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 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 2015f).

The APEC cross-border data flows project provides an opportunity for the Australian Government to help ensure emerging 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 restrict cross-border data flows, such as data localisation requirements. As noted in chapter 5, while there is an-principle case for measures that promote data security and privacy, security protocols may be more important in protecting data than where data are stored. Data owners may also be able to rely on contracts or laws to ensure that data stored offshore meets the required standards for data protection.

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 restrict cross-border data flows. This work should focus on ensuring that measures restricting cross-border data flows are the least restrictive necessary 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) could not achieve the same objective at a lower net cost.

DRAFT RECOMMENDATION 9.3

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 consistent
- measures restricting cross-border data flows are the least restrictive necessary 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) could not achieve the same objective at a lower net cost.

9.6 Encouraging regulatory reform through technical cooperation

The complexity of regulatory issues relating to services trade and the predominance of behind-the-border barriers highlights the importance of effective regulations and institutional arrangements relating to services. The Australian Government can help to address behind-the-border barriers to services trade by providing technical assistance, either bilaterally or through international forums, to improve the ability of countries 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. For example, 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:

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. For the most recent round of funding, priority was given to proposals that, among other things: supported strengthening public sector capability in developing countries to address constraints to trade and economic growth; improved developing country government policy, planning and service delivery; and supported government accountability and transparency (DFAT 2015j)

- 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–NZ 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 9.7). 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).

Box 9.7 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 2015e).

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 2015d). 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).

There could be benefits from Australia participating, through its regulators and policy makers, in technical assistance programs. Technical assistance that leads to more open services 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 and regulatory arrangements.

9.7 Further information on addressing barriers

In this chapter and the previous chapters the Commission has identified a number of ways Australian governments could address barriers to service exports. Further information on approaches used to address barriers in other countries could provide opportunity to identify additional action Australian governments could take in this area. The Commission is seeking examples of effective policy approaches that have been used overseas to address barriers to service exports that could be adopted in Australia.

INFORMATION REQUEST

The Commission seeks further information on whether there are effective policy approaches used overseas to address barriers to service exports that could be adopted in Australia, including:

- the barrier that the policy was designed to address, and the costs that the barrier was imposing on providers seeking to export services*
 - why the policy approach would be expected to generate net benefits in an Australian context*
 - the likely costs and benefits of using the policy approach to address barriers to Australian service exports.*
-

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. A total of 32 submissions were subsequently received (table A.1). These submissions are available online at <http://www.pc.gov.au/inquiries/current/service-exports/submissions>.
- As detailed in table A.2, consultations were held with representatives from the 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 survey (table A.3) of which 14 are public and contained in appendix B.

The Commission thanks all parties who have contributed to this study and now seeks additional input for its final report. The Commission welcomes further submissions to discuss the substance of the draft report, including responses to the information requests and draft recommendations.

Table A.1 Submissions^a

<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
Australian Business Deans Council (ABDC)	21
Australian Council for Private Education and Training (ACPET)	8
Australian Financial Markets Association (AFMA)	14
Australian Information Industry Association (AIIA)	7
Australian Institute of Professional Education (AIPE)	22
Australian Services Roundtable	30
Australian Tourism Export Council (ATEC)	16
Cox Architecture Pty Ltd	2
Department of Foreign Affairs and Trade (DFAT)	31
Department of Infrastructure and Regional Development (DIRD)	28
Engineers Australia	3
English Australia	19
Export Council of Australia	32
Financial Services Council (FSC)	20
Forsyth, Peter	6
Independent Schools Council of Australia (ISCA)	24
Insurance Australia Group (IAG)	10
Insurance Council of Australia	12
International Student Experience Association (ISEA)	4
Law Council of Australia	26
Name Withheld	1 *
National Tourism Alliance	11
Overseas Students Ombudsman	5
Service Skills Australia	27
Standards Australia	9
Tasmanian Government	29
Tourism and Transport Forum (TTF)	25
Universities Australia	17
University of Tasmania	18 #

^a An asterisk (*) indicates that the submission contains confidential material NOT available to the public. A hash (#) indicates that the submission includes attachments.

Table A.2 Consultations

*Individual or organisation***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 (AIIA)

Australian Trade Commission (Austrade)

Dee, Phillipa

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

International Education Association of Australia (IEEA)

Place Associates

Professionals Australia

Royal District Nursing Services (RDNS)

Tourism Victoria

Victorian Department of Economic Development, Jobs, Transport and Resources

Victorian TAFE International

(continued next page)

Table A.2 (continued)

*Individual or organisation***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 (AFMA)

Australian Prudential Regulation Authority (APRA)

Australian Securities and Investments Commission (ASIC)

Australian Services Roundtable (ASR)

Australian Taxation Office (ATO)

Commonwealth Bank of Australia (CBA)

Consult Australia

Cox Architecture Pty Ltd

DEC International

Export Council of Australia

Financial Services Council (FSC)

Insurance Council of Australia (ICA)

NSW Department of Premier and Cabinet

Ramsay Health Care

Russell Investments

Westpac Banking Corporation

Table A.3 Questionnaire respondents

Individual or organisation

ACT

Independent Schools Council of Australia (ISCA)

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

DRAFT REPORT

This draft report is no longer open for consultation. For final outcomes of this project refer to the research report.

Draft

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