

Financial Centres for the Future – What Role for Australia?

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Hardly a poor second cousin in a mining boom

As a resource-rich country located smack bang in a region experiencing a massive mining boom, Australia could understandably devote most of its efforts to digging up, riling and shipping minerals to China and other the booming countries of Asia. So great is the boom that we literally can't dig up and transport enough minerals to satisfy the region's voracious appetite for raw materials. The more quickly we fix these transport bottlenecks, the richer we'll become.

So why do we gather at a conference on Australia as a possible regional financial centre?

Part of the answer is that in any economy everything is linked to everything else. In economic jargon, a modern economy is a sophisticated three-dimensional general equilibrium creature, not just a two-dimensional partial equilibrium amoeba. (Okay, okay ... amoebas are three-dimensional too, but you have to admit they are pretty flat).

Mining constitutes about 7 per cent of the value of Australia's annual production of goods and services (GDP). That's tiny for a sector that attracts so much attention. But feeding the mining sector are manufactured goods (mostly imported plant and equipment, but some from Australia) and a vast array of services. Engineering, computer programming, management consulting and transport are but a few of the services upon which mining relies. And here's where you come in; someone has to organise the funds to finance the huge investments in mines and supporting infrastructure. Financial institutions enable mines to open, operate and export.

Yet the role of the financial services industry in a mining boom extends further still. In the coming financial year alone, nominal GDP is likely to be more than \$100 billion greater than it would have been if Australia's terms of trade remained unchanged from 2003–04 levels. The surge in domestic income from the mining boom appears in the form of taxation revenue, earnings of foreign owners of Australian-based mining companies and in extra dividends and capital gains for Australian shareholders. Much of this shareholder income flows into superannuation accounts and other managed funds. It's a sizeable boost for Australia's financial services industry.

But not all the fortunes of the financial services industry and the service economy as a whole are linked to the mining boom; far from it. A comparison of the contribution of the mining and the service economy to Australia's GDP before and during the mining boom makes my point. In the year 2000, before the mining boom began, mining contributed 7.6 per cent of Australia's GDP and the service economy contributed 63.2 per cent of GDP. In 2007, mining contributed 6.8 per cent of GDP and the service economy 65.9 per cent of GDP. The service economy was by far the biggest contributor to Australian prosperity before the mining boom and remains so even when the price of minerals is so strong. In fact, the share of the service economy in the total economy has increased while mining's relative share has actually fallen (owing to a run-down in oil production).

Your industry, finance and insurance, was important before the mining boom, contributing 6.9 per cent of GDP in 2000, and is even more important now, providing 7.7 per cent of GDP in 2007.

No more Mr Residual for the service economy

Australian politicians have traditionally treated the service economy as a residual after counting agriculture, mining and manufacturing. Some residual – the service economy contributes 85 per cent of employment and almost 66 per cent of GDP! Yet since Barry Jones made his maiden speech in 1981, the service economy had been mentioned in Parliament only 10 times in the ensuing 25 years – eight times by Labor MPs and three by Coalition MPs. Sharon Bird and Christopher Pyne, take a bow for repeat mentions.

The year 2007 marked what we hope will prove to be a watershed for political interest in the service economy. New Labor leader Kevin Rudd appointed me Shadow Minister for the Service Economy, Small Business and Independent Contractors. This was the first time since Federation that the Federal Parliament had a portfolio specifically covering the service economy. When Labor won the election, Prime Minister Rudd confirmed me as Minister for the Service Economy. To its credit, the Coalition followed suit, with a Shadow Minister for the Service Economy.

Until recently, the service economy did not have a parliamentary champion. From now on it seems unlikely to ever be without one.

As a Labor member of the House of Representatives Standing Committee on Economics, Finance and Public Administration, I suggested in 2006 that the Committee might inquire into life beyond the mining boom. One report was prepared on manufacturing and another on the future of service industries. The latter report, *Servicing Our Future*, was tabled last year and the Government will be responding to its recommendations around the middle of this year. Though conceived as work on policies for the service economy in a post-mining boom era, the report is, in reality, an attempt to come to grips with policy development for a large sector of the economy during a mining boom. It addresses the constraints on the service economy associated with the mining boom, including a strong currency, skill shortages and straight-out shortages of low-skilled labour.

Apart from the appointment of a Minister for the Service Economy, the Government's response to the parliamentary report and the ensuing community and business debate should go down as historic turning points in the way the service economy is viewed in this country. It will be a case of no more Mr Residual for the service economy.

Rudd and ministers support Australia as a financial hub

Your deliberations today have centred on the potential of Australia to become a regional financial centre. Enormous scope exists for Australian funds management, banking, insurance and financial advice to expand into Asia.

You have heard of Australia having more than \$1 trillion in funds under management (and I'd add, much of it owing to the far-sighted superannuation guarantee introduced by the previous Labor Government). You have heard of the natural advantage we enjoy over financial centres like Luxembourg and Dublin of being in the same time zone as Asia. You are aware of the astonishing growth of the middle classes of China and India that will continue at a breathtaking pace for the indefinite future, such that funds under management in Asia are expected to grow by 14 per cent a year. You have been

advised of the advantage we enjoy in having a competent regulator. And you have been reminded that just under one million Australians speak Asian languages and more than 70,000 university graduates speak Chinese.

When Kevin Rudd first appointed me as Shadow Minister for the Service Economy he spoke of his aspiration for Australia to become a regional financial centre. He obviously had the same conversations with Nick Sherry, our Minister for Superannuation and Corporate Law, and Chris Bowen, our Assistant Treasurer. Both are full of energy and enthusiasm for the financial services industry and are proving to be very effective policy innovators.

Nick Sherry has won the in-principle agreement of the States for the Commonwealth to be the single national regulator of mortgage broking, margin lending and major non-deposit taking lending institutions. Nick has already secured agreement for the regulation of trustee companies.

And last week's Budget confirmed Chris Bowen's initiative of reducing the 30 per cent withholding tax on certain distributions from Australian managed funds to non-resident investors to a final rate of 7.5 per cent over three years. Yet the then-government said at the time of the budget reply in 2007 when Labor leader Kevin Rudd foreshadowed this policy:

*'His (Rudd's) main Budget announcement was foreigners investing in Australia will get a tax cut. Why he would give foreigners a tax break rather than help Australians is a bit beyond me'*¹

The Rudd Government actually believes in the idea of Australia as a regional financial hub. Although this measure is estimated to cost the revenue \$630 million over the Budget period, the Rudd Government considers it to be a wise investment in Australia as a regional financial centre and through it, in the nation's future prosperity.

On further tax reform directly affecting the financial services industry, the Access Economics report on the export potential of Australian funds management services commissioned by the Investment and Financial Services Association (IFSA) notes that Ireland used its tax regime very aggressively to develop Dublin as a financial hub for Europe, but that:

'Australia's circumstances differ from Ireland's and it is doubtful that it would be to the benefit of the Australian economy overall if we were to compete aggressively on the basis of tax rates. Rather, it is in the area of simplicity and convenience where most effort should be directed'.²

Access Economics points out that most of the concerns expressed during its consultations with industry related to the complexity of the tax arrangements rather than the rates themselves. No doubt the review being headed by Treasury Secretary Ken Henry will take an interest in the unending challenge of simplifying the tax system without creating unintended loopholes.

Further policies for Australia as a financial hub

The Rudd Government will do everything it feasibly can to remove impediments to and enhance the capacity of the financial services industry to form a financial hub in the Asia-Pacific region. We will help remove impediments by reforming business regulation and negotiating improved access for financial services in Asia. And we will enhance the industry's capacity through our education policies including Asian languages and through immigration.

1. Reforming business regulation

Government regulations can act as a strong impediment to Australia becoming a regional financial hub.

Just as the Hawke and Keating Labor Governments assumed the mantle of regulatory reform in creating Australia's open, competitive economy, the new Rudd Labor Government and the State and Territory Labor Governments are taking on a bold new regulatory reform program.

COAG's regulatory reform program is designed to help create what the Business Council of Australia and the 2020 Summit have described as a 'seamless national market'.

We know that complying with inefficient business regulation is costly for Australian businesses. Estimates of these costs are not easy to obtain, but the Productivity Commission cites an estimate of up to four per cent of GDP, which is more than \$40 billion per annum.³

Many of these inefficiencies arise from inconsistency and overlap in Commonwealth, State and Territory laws and regulations. Some regulatory areas are covered by nine separate, often inconsistent and sometimes conflicting laws, regulations and administrative systems.

A recent OECD report found that Australia ranks *last* among 30 OECD countries in the harmonisation of regulations affecting service industries.⁴

Despite the urgent need, often repeated during the course of the last decade, to reduce and harmonise business regulation in Australia, the previous Government inflicted on business what the Business Council of Australia describes as the '*creeping re-regulation*' of the economy, which it cites as an example of '*how the benefits of past reform can be quietly eroded over time*'.⁵

On 26 March, COAG endorsed a plan to ease the regulatory burden on Australian businesses. It was an historic meeting with COAG agreeing to a reform program that now covers an unprecedented 27 areas of overlapping and inconsistent regulation across the Commonwealth, States and Territories.

Fully implemented, the COAG regulatory reform program should lift the productivity of the financial services industry. The Business Council of Australia points out that the service economy contributed more than three-fifths of Australia's productivity growth during the 1990s productivity boom, with finance and insurance among the pacesetters.⁶ Yet nine out of 10 service industries have recorded a decline in productivity growth during the present decade, among them the finance and insurance industry.⁷

The Government is keen to work with the finance and insurance industry in reforming regulations adversely affecting your productivity and competitiveness.

2. Negotiating reductions in trade and investment barriers in Asia

World trade has been growing at three times the rate of world output. Yet at a time when Australia has been experiencing its longest-ever commodities boom, net exports have made a positive contribution to economic growth in just two out of the past 11 years. Net exports are currently subtracting a full percentage point from Australia's economic growth.

For this reason, the Rudd Government's trade minister, Simon Crean, has announced a comprehensive review of Australia's export policies and programs to improve our trading performance.

The Rudd Government will restore the primacy of multilateralism in our trade policy. Our top trade negotiating priority is a successful conclusion to the Doha Round, which would deliver substantially improved trade opportunities for Australia, including in services.

We will also seek to revitalise our engagement with the region via APEC and the ASEAN plus 6.

APEC is producing an investment facilitation action plan and is also undertaking work on facilitating services trade. For instance, through APEC's Legal Services Initiative, APEC will promote information sharing on best practice models for the supply of foreign and international law in the APEC region.

At the bilateral level, the Rudd Government is pursuing Free Trade Agreements (FTAs) that are comprehensive and deliver genuine liberalisation. These are FTAs that are consistent with WTO rules and principles and that build on the liberalisation achieved through the multilateral process. As part of its broader program of FTA negotiations, Australia is currently negotiating FTAs with a number of countries in the Asian region, including China and Japan, as well as an FTA that Australia and New Zealand are negotiating with the countries of ASEAN.

3. Education

The Budget is investing in education at all levels, including \$3.0 billion for schools, \$1.8 billion to strengthen Australian universities, \$1.9 billion to fund up to 630 000 new training places and \$2.4 billion on early childhood education and care initiatives to ensure our youngest Australians have the best possible start in life.

The Budget also establishes an \$11 billion Education Investment Fund to support capital expenditure and renewal and refurbishment in universities and vocational institutions as well as in research facilities and major research institutions. Of particular benefit for the financial services industries, the Budget boosts languages funding by \$62 million over three years to help give Australian school students the language skills to engage with our Asian neighbours. From January 2009, the new National Asian Languages and Studies in Schools program will support additional

Asian languages classes in high schools and specialist curricula for students who display advanced abilities in Asian languages and studies.

4. Immigration

The Government announced last week an increase of 31,000 skilled migrants for 2008-09. This record increase in the number of places in the permanent skilled migration program is good news for business and the economy. It gives some immediate relief for businesses suffering from skills and labour shortages.

Overall, permanent skilled migration will make up 133,500 places in the migration program in 2008-09, out of a total of 190,300 places.

We can do it

By working together I am confident that the Rudd government and the financial services industry can establish Australia as a regional financial hub. Australia has the natural advantage of being in the right time zone. Through far-sighted government policies and your good management, Australia has far more funds under management as a share of our GDP than countries like the United States, Britain and Japan. You have access to a talented workforce and to an increasing number of Asian-speaking university graduates. The Rudd Government has demonstrated its faith in you by announcing a \$630 million tax incentive. We see the financial services industries as a vital player in our efforts to expand Australian trade and investment in services. Together, we can do it.

¹ Then-Treasurer Peter Costello quoted in *The Weekend Australian*, 12 May 2007, p 9.

² Access Economics (2007), *The export potential of Australian funds management services*, Report for Investment and Financial Services Association, Canberra, July, p. 20.

³ Productivity Commission (2007), *Potential benefits of the National Reform Agenda*, Canberra, p. 351.

⁴ Organisation for Economic Co-operation and Development (2008) *Economic Policy Reform: Going for Growth 2008*, Paris, pp. 120-121.

⁵ Business Council of Australia (2007) *Policy that counts: reform standards for the 2007 federal election*, Melbourne, p. 5.

⁶ Business Council of Australia (2007), *Underserved: why Australia's service economy deserves more attention*, Melbourne, July, p. 6.

⁷ Australian Industry Group (2008), *How fast can Australia grow? III*, Melbourne, February, p. 24.