Other Influences on Competitiveness

Introduction

9.1 Earlier chapters outlined specific aspects of the framework relating to regulation of financial markets, competition policy, prudential regulation and consumer protection. Such regulation can affect the efficiency of firms and their ability to compete in domestic and international markets.

9.2 This chapter addresses three remaining issues where regulatory policies affect the competitiveness of financial firms. Competitiveness means the ability of the firms to compete successfully in markets.

- The first issue is the link between regulation and technology, specifically whether current regulatory arrangements facilitate innovation and the adoption of efficiency-enhancing technology. Around the world, increasing attention is being given to the role of government in technological innovation and the interaction of trade and technology policy. The Inquiry will consider these issues insofar as they relate to the financial system.
- The second issue is the impact of taxation policy on the efficiency of the financial sector. The Inquiry will not make specific recommendations on tax policy, but will report on the implications for competitiveness of certain taxation arrangements.
- The third issue is whether there is a case for government intervention directed towards developing Australia as a regional financial centre or centre of excellence in particular functions, such as corporate treasury or funds management.

Regulation and Technology

9.3 This section considers the interaction of technology and some aspects of the regulatory framework. Two developments stand out:

- technology-driven changes to cost structures; and
- regulatory impediments to technology-driven competition.

Both of these developments have implications for the role of regulators.

9.4 As noted in Chapter 3, developments in information technology have dramatically reduced the costs of storing, processing and transmitting data. While comprehensive data are unavailable, one survey indicates that Australian banks plan to increase total expenditure on technology between 1995 and 1998 by 27 per cent.[1] Moreover, investment in computer technology across the economy has been very strong and this is likely to be reflected in changes to organisational arrangements, including the methods by which parties purchase or transfer goods and services.

9.5 Regulation can be affected by technological advances to the extent that they:

- alter barriers to entry (increasing them in some areas and lowering them in others);
- change the available market and the range of potential participants; and
- create new anti-competitive structures.

9.6 While technological innovation may raise issues for the regulatory framework, it is also true that regulation can constrain innovation or limit the extent of technology-driven competition. The existing legislative framework has its foundations and limitations in paper-based evidentiary procedures and physical delivery of contracts and securities. Technology already allows the electronic delivery of data and securities but some statutory provisions impede the introduction of cost-saving technology. As the pace of

1 Ernst & Young 1996, p.89.

technological innovation is exponential and the future cannot be predicted with any certainty, a flexible regulatory framework which can quickly address legal uncertainties and changes in business structures and market conditions is a priority.

9.7 Another link between technology and regulation arises from the role of the regulator in facilitating technological change, by encouraging the development of compatible architectures and networks. The telecommunications network is central in this context as it will provide the backbone for the 'outsourcing' of functions by financial institutions, and the development of electronic commerce. Cable, microwave or satellite links between financial institutions, businesses and households will facilitate interaction among different users or terminals. Standards for 'interconnectivity' establish a common mode of interaction, enabling users to understand each others' communications. More than most industries, the finance sector will depend on cost-efficient, reliable telecommunications networks. Developments in this sector, particularly open competition from 1 July 1997 and the rollout of the broadband network for pay TV and other online services, will therefore have major implications for the financial sector.

Existing Arrangements

9.8 A number of Commonwealth Government departments and agencies have an interest in particular aspects of information technology and communications policy and regulation. Two agencies have particular roles in addressing broad co-ordination issues. These are the Department of Communications and the Arts (DoCA) and the Office of Government Information Technology (OGIT). DoCA has overall responsibility for implementing the Government's online services policy and co-ordinating a whole-of-government approach to online services. DoCA also promotes the development of multimedia and has responsibility for telecommunications policy. OGIT has responsibility for promoting and implementing a client-focused approach for improving the use of information technology and telecommunications services in the Commonwealth Government. Other departments, such as Attorney-General's provide advice on privacy, security and the copyright aspects of technology. In addition, the Insurance and Superannuation Commission, the Australian Securities Commission (ASC), the Reserve Bank of Australia (RBA) and the Australian Financial Institutions

Commission consider the implications of technology for the institutions and markets within their jurisdictions.

9.9 Organisations responsible for the regulation of, and standards for, information and communications technology and services include Austel, the Spectrum Management Agency (SMA) and Standards Australia.

9.10 Austel is the telecommunications industry regulatory authority in charge of technical, consumer and competition policy. As part of its responsibilities, Austel sets and administers technical standards relating to the telecommunications network. The SMA regulates communication services conducted by means of the radio spectrum rather than through wire or fibre lines. The SMA has statutory responsibility for managing Australia's input into setting international standards for radiocommunications.

9.11 From 1 July 1997, the Government has proposed that Austel's technical and market regulation functions be split. The SMA and Austel will be merged to form the Australian Communications Authority, and the new entity will be responsible for setting technical standards in the communications sector. Market regulation will pass to the Australian Competition and Consumer Commission (ACCC). Under the proposed arrangements, an industry body, the Telecommunications Access Forum (TAF), will be formed and be authorised by the ACCC to recommend the declaration of telecommunications services for access by third parties. In addition, TAF will have sole authority to submit a draft access code for approval by the ACCC.

9.12 Standards Australia is an independent not-for-profit organisation which publishes most technical standards in Australia. The organisation is recognised by the Commonwealth Government as the peak body in Australia for writing standards. Standards Australia follows international guidelines on how standards should be written.

9.13 The International Organisation for Standardisation develops standards to facilitate the exchange of goods and services. The Society for Worldwide Interbank Financial Telecommunications sets standards for international financial transactions. The recent development of an international specification for electronic transaction authentication is expected to result in a significant increase in the use of open networks such as the Internet. This standard is yet to be endorsed by the relevant authorities.

Views Presented in Submissions

9.14 The majority of submissions stressed the role of technology as a driver of further change in the financial system and the need for the regulatory framework to accommodate technological innovation. Chapters 5 and 7 identified some of the more important challenges posed by rapid technological change for the current institutional and product-based approach to regulation. Chapter 7 also addressed open access networks and market conduct in payments and settlement systems. Issues relating to consumer protection, privacy and law enforcement were discussed in Chapter 8.

9.15 Submissions also raised legal impediments to electronic commerce and the need for a whole-of-government approach to technology.

Legal Impediments to Electronic Commerce

9.16 A very large number of submissions observed that, while the pace of innovation and the rate of consumer acceptance could not be predicted, a regulatory framework which impeded the adoption of new technology would be detrimental to the competitiveness of the financial system.

9.17 The Australian Bankers' Association (ABA) and Advance Bank were among those that identified legal impediments to the expansion of electronic commerce. Suggested amendments to legislation included provisions to allow:

- digital/electronic signatures, to overcome the present need for customers to physically sign documents and/or visit bank premises; and
- electronic delivery of notices and documents, subject to customer agreement, and protection for financial institutions from liability arising from hardware and software they do not control.

9.18 In addition, it was suggested that the regulatory framework explicitly recognise that information can be conveyed electronically in a variety of formats and that the Government enact national uniform legislation covering evidentiary issues.[2]

9.19 A number of other submissions emphasised the importance of ensuring that the regulatory framework be capable of accommodating electronic prospectuses, and supported the approach proposed in the ASC's electronic commerce issues paper released in May 1996[3].

9.20 Submissions from both Austraclear and the Australian Society of Corporate Treasurers (ASCT) raised difficulties with the *Bills of Exchange Act 1909.* The Act requires 'paper' to be produced whenever promissory notes, bank bills and negotiable certificates of deposit are drawn. It was noted that compliance with the Act imposed unnecessary costs because of the need to produce the paper and to ensure appropriate authorisation and physical lodgement. It was recommended that, in light of the developments in electronic securities clearing, the Act be amended to allow either paper or electronic lodgement of the security with Austraclear. Such an amendment would be consistent with scripless settlement in the equity and Commonwealth Government securities markets through the Clearing House Electronic Sub-registry System, and the Reserve Bank Information and Transfer System, respectively.

Whole-of-Government Approach to the Implications of Technology

9.21 Some submissions saw the future impact of technology as so important as to require special organisational responses. National Mutual Holdings recommended the establishment of a Technology Unit to investigate and advise on technology standards, technical issues relating to the prudential control of new payment instruments and payment systems, local and international regulation of electronic cross-border trading, electronic sales of products, advice and information, and telecommunications

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2 Australian Bankers' Association, Submission No. 126 and the Financial Planning Association, Submission No. 54 to the Financial System Inquiry.

3 Including for example, National Australia Bank, Submission No. 131 to the Financial System Inquiry.

infrastructure development. National Mutual saw the immediate priorities of such a unit as being:

- the early development of a plan to educate and protect consumers on electronic delivery of financial products and services;
- taking a proactive lead in international regulator co-operation in relation to technology-supported cross-border offerings; and
- the encouragement of innovation in electronic commerce and support for the development of essential telecommunications infrastructure.

9.22 The Australian Consumers' Association suggested a formal co-ordination group or technology unit to better co-ordinate the regulation of new technologies. Diners Club noted that, with the rapid pace of technological innovation, reviews of the impact of technology should be undertaken every 2 to 3 years to ensure that regulation keeps pace.

9.23 A possible approach was suggested to the Inquiry during discussions with Forrester Research, a United States company specialising in the impact of technology. Forrester proposed the appointment of an authority to establish technology standards. It suggested that standards be revisited frequently — at least annually — because of the likely pace of change. Forrester noted that cable capacity sufficient to allow real-time transactions was an issue of national importance.

Approach of the Inquiry

9.24 The rapid pace of innovation raises the possibility that the current regulatory environment could act as a constraint on innovation. An issue for the Inquiry is therefore to ensure that the regulatory structures and legislative provisions which have evolved to address particular issues where paper-based instruments and physical trading have been the norm do not impede the adoption of efficiency-enhancing technology.

9.25 The Inquiry will formulate its recommendations in this area taking account of its preferred approach to the broader regulatory framework. Of particular relevance is the Inquiry's aim to promote strong competition, so that new technologies deliver benefits to investors, borrowers and other users. It is also desirable to ensure that the regulatory framework does not act as a constraint on the adoption of new technology.

9.26 The Inquiry acknowledges that many of the issues raised by technology are not specific to the financial sector. However, given the important role of information technology and telecommunications networks in the further development of the financial sector, the Inquiry will consider whether there is a need for greater co-ordination of public policy relating to information technology and telecommunications.

9.27 In addition to the consumer protection and prudential issues identified in earlier chapters, the Inquiry will also consider:

- the extent to which existing Commonwealth, State, and Territory legislation impedes the adoption of cost-reducing technology;
- whether there is a need for a uniform national approach to legislation governing electronic delivery of documents and to other evidentiary issues such as digital signatures; and
- whether the pace of innovation is such that a specialist unit, within government, is required to monitor and advise on the implications of new technology, including infrastructure requirements.

Taxation

9.28 This section examines some specific taxation arrangements which may have an impact on the competitiveness of Australia's financial markets and institutions operating in those markets. It is recognised that more general features of the taxation system, including the taxation of salaries and wages, company income — indeed, virtually all taxes — may influence competitiveness, but these are considered to be beyond the Inquiry's Terms of Reference.

9.29 The issues noted here are based on those raised in submissions received by the Inquiry.

Existing Arrangements

9.30 The key elements of the Australian taxation system which have been identified in submissions as having potentially adverse direct effects on the competitiveness of Australia's financial markets are aspects of:

- dividend imputation;
- capital gains tax;
- interest withholding tax;
- the foreign investment fund regime;
- Off-shore Banking Unit (OBU) provisions;
- regional headquarter provisions; and
- State and Territory financial transaction taxes.

9.31 Aspects of the taxation of life insurance, pooled development funds and unit trusts were also raised in submissions as impeding the competitiveness of particular institutions or the operation of markets. Details on the various arrangements are given below.

Dividend Imputation

9.32 Dividend imputation was introduced in 1987 to remove the double taxation of distributed company profits and thus the bias in the tax system against domestic equity investment relative to debt. In 1988, superannuation funds were allowed franking rebates in the same way as individual taxpayers.

9.33 Imputation credits are provided only in relation to Australian tax paid by resident corporations and can be utilised only to offset Australian tax payable by shareholders. It follows that only those shareholders subject to Australian income tax can fully utilise the franked dividends.[4] Franked dividends paid to non-residents are exempt from dividend withholding tax.

4 A franked dividend is a dividend with imputation credits (representing tax paid at the company level) attached.

9.34 Dividend streaming arrangements are strategies that enable dividends to be allocated so that shareholders can best benefit from the imputation system. Franked dividends are diverted away from those shareholders to whom franking credits are of less value, such as non-resident shareholders, to shareholders who are most able to use the credits, such as those paying high marginal tax rates.

9.35 Australian law seeks to prevent a tax benefit flowing to Australian shareholders from dividend streaming. It has been argued that this constrains the performance of the Australian stock market.

Capital Gains Tax (CGT)

9.36 Capital gains tax was introduced in 1985 and applies to the inflation-adjusted capital gains on disposal of assets such as shares. Many financial intermediaries, including banks, professional trading entities and the ordinary business of life offices, have long been required to treat gains on such assets as taxable on the income account. In the 1996-97 Budget, it was announced that equity investments in SMEs made by lending institutions after 1 July 1996 may be taxed under the capital gains provisions.

9.37 The CGT rules include rollover relief provisions which apply in specified circumstances. They also include restrictions on the utilisation of losses. Submissions have argued that both of these should be liberalised to improve the competitiveness of Australian capital markets, and in particular to facilitate market interest in the securities of SMEs and in new ventures.

Interest Withholding Tax (IWT)

9.38 Interest withholding tax applies to certain interest derived in Australia and paid to non-residents. The amount of tax paid is 10 per cent of the gross interest and the rate is generally unaffected by Australia's double taxation agreements. It is the final Australian tax on interest paid to non-residents. Around 37 per cent of interest payable on foreign borrowing is subject to interest withholding tax, reflecting the existence of various exemptions from IWT.[5]

9.39 The principal exemption is for interest on borrowings raised outside Australia by Australian resident companies by means of instruments offered to the public through financial markets. Foreign bank branches are subject to IWT for off-shore funding at half the normal rate.

9.40 While acknowledging the role of IWT in ensuring that income derived in Australia by overseas financiers did not escape Australian tax altogether, the Campbell Committee noted:

> *The present interest withholding tax arrangements, and especially the selective exemptions, impinge on efficiency in the financial markets because competition and choice are reduced. Overseas borrowings are thus not necessarily transacted by the most cost-effective financiers or allocated to the most efficient users.*[6]

Foreign Source Income Taxation Arrangements

9.41 The foreign source income taxation arrangements determine how off-shore investments by Australian resident individuals and companies are taxed in Australia. These arrangements are generally based on a foreign tax credit approach which entitles a resident taxpayer whose assessable income includes foreign income on which tax has been paid to a credit equal to the amount of that tax. A variety of exemptions and special arrangements aim to reduce the administrative burden of the tax where the revenue at stake is small.

9.42 The arrangements apply to Australian resident entities engaging in investment overseas, whether for the benefit of local or overseas investors. These include the Foreign Investment Fund (FIF) measures which have applied since 1993 and are designed to counter tax avoidance.

9.43 The FIF measures apply where a foreign company or trust, although not controlled by Australian residents, is an attractive investment vehicle

5 Department of the Treasury, Submission No. 143 to the Financial System Inquiry, p.172.
6 Australian Financial System Inquiry 1981, p.777.

because it allows for the accumulation of income off-shore in low-tax or tax-free countries. The FIF measures apply also to Australian residents who have invested in off-shore life bonds or other foreign life policies with an investment component. The FIF measures adopt a worldwide approach to the taxation of FIF interests, rather than the jurisdictional approach (ie listed / unlisted country). An exemption is available for direct investments in FIFs that are primarily involved in an active business and the balanced portfolio exemption allows Australian investors to hold 5 per cent of total FIF interests in non-exempt FIFs without being subject to accruals taxation.

9.44 The scope of the FIF measures has been criticised as diminishing the attractiveness of Australian-based funds management activities and as restricting 'import' competition from foreign funds.

Taxation Arrangements for Off-shore Banking Units

9.45 An OBU is an entity approved by the Treasurer as eligible for concessional tax treatment on income arising from certain activities undertaken generally with non-resident parties or other OBUs. The activities generally relate to:

- borrowing from, and lending to, non-residents;
- dealing in financial or treasury instruments like currency and interest rate swaps, hedges and futures;
- securities and futures trading;
- a range of fee-based activities such as funds management for non-residents and the provision of investment advice to non-residents; and
- foreign exchange trading.

9.46 The OBU regime was designed to attract and maintain financial activity that could be sourced in any number of jurisdictions. Under existing Australian law, those eligible to be declared an OBU are authorised banks, State banks, wholly-owned subsidiaries of banks which are already registered as OBUs and authorised foreign exchange dealers. An exemption from IWT is available to OBUs for interest paid to non-residents where the money borrowed is used for off-shore banking activities. Profits arising from eligible activities are taxed at a concessional rate of 10 per cent.

9.47 From the 1996-97 year of income, OBUs that provide funds management activities for non-residents will be allowed to invest in Australian assets. A 10 per cent limit (by value of total funds under management) will apply on the Australian asset component of each investment portfolio. In introducing the Bill to amend the taxation law, the Government said:

> *These amendments have the potential to bring about a large increase in the level of off-shore funds managed by Australian banks and enhance the development of Australia as a financial centre in the Asia Pacific region.*[7]

9.48 There are 83 licensed OBUs operating in Australia. Notwithstanding the proposed amendments to the OBU regime, submissions argued that further measures were required to develop Australia as a regional financial centre.

Taxation Arrangements for Regional Headquarters Companies (RHQs)

9.49 The purpose of a regional headquarters is to provide centralised services to the operations of a multinational company in the region or its affiliates. These services may include regional management and administration, finance and treasury services, data processing, telecommunications, research and development.

9.50 Prior to 1994, government policy to attract RHQs to Australia was generally on a case-by-case basis. In the May 1994 *Working Nation* Statement, a number of measures were announced to enhance Australia's attractiveness as a location for regional headquarters. These included the provision of a wholesale sales tax exemption for imported used computer-related equipment, tax deductibility of certain costs of locating regional headquarters in Australia, removal of withholding taxes on certain dividends distributed through Australia and streamlining of immigration procedures. There are 272 companies identified as providing RHQ services, of which 151 have

7 Short, Senator The Hon J. 1996.

commenced since the *Working Nation* Statement. Eighteen companies have been approved by the Treasurer for RHQ status.

9.51 Submissions argued that the attraction of greater RHQ activity deepens Australia's financial system and markets and that more should be done to reach Australia's full potential in this regard.

Pooled Development Funds (PDFs)

9.52 The PDF scheme was introduced in 1992 and encourages the supply of equity capital to SMEs whose primary operations are not retail operations or land development. PDF companies are required to make investments in SMEs whose total assets do not exceed $50 million. PDFs receive concessional tax treatment on profits derived from SME investments at a rate of 15 per cent. Other income is taxed at a concessional rate of 25 per cent. The concessional tax rates are conditional upon 65 per cent of the funds raised by PDFs being invested in SMEs within 5 years.

9.53 The PDF measures have been criticised because they were not designed to attract investment by superannuation funds in SMEs.

Taxation of Life Insurance Companies and Friendly Societies

9.54 The taxation arrangements relating to life insurance companies and friendly societies and their products are extremely complex and a review is under way. In brief, the present arrangements are:

- pension and annuity business of the life insurer is exempt (income is assessable in the hands of the individual on distribution);
- complying superannuation business is assessed in the same way as other superannuation funds, at 15 per cent on investment earnings and deductible contributions, and the CGT treatment applies to the sale of most assets;
- non-statutory fund class of business or income arising on shareholders' funds rather than policyholders' funds is assessed at 36 per cent;

- ordinary life insurance and accident and disability business is assessed at 39 per cent for a life insurance company and 33 per cent for a friendly society; and
- non-complying superannuation business is assessed at 47 per cent.

Taxation of Unit Trusts

9.55 The income from unit trusts (other than corporate trusts and public trading trusts) is taxable in the hands of unit holders. This treatment is the same as that applying to other trusts where beneficiaries are presently entitled to trust income. Corporate unit trusts and public trading trusts differ in that they are taxed in the same way as companies.

9.56 Trust losses cannot be distributed to beneficiaries, but can be carried forward to offset against future income of the trust. Prospective amendments to the *Income Tax Assessment Act 1936* announced in May 1995 and to take effect from that date, but not yet legislated, will mean that a continuity of beneficial ownership test (or, for listed, widely held unit trusts only, a same business test) and an income injection test will apply to unit trusts. Passage of these amendments will make it less attractive for unit trusts to merge where the trust has carry-forward losses and the merged entity fails the above mentioned tests.

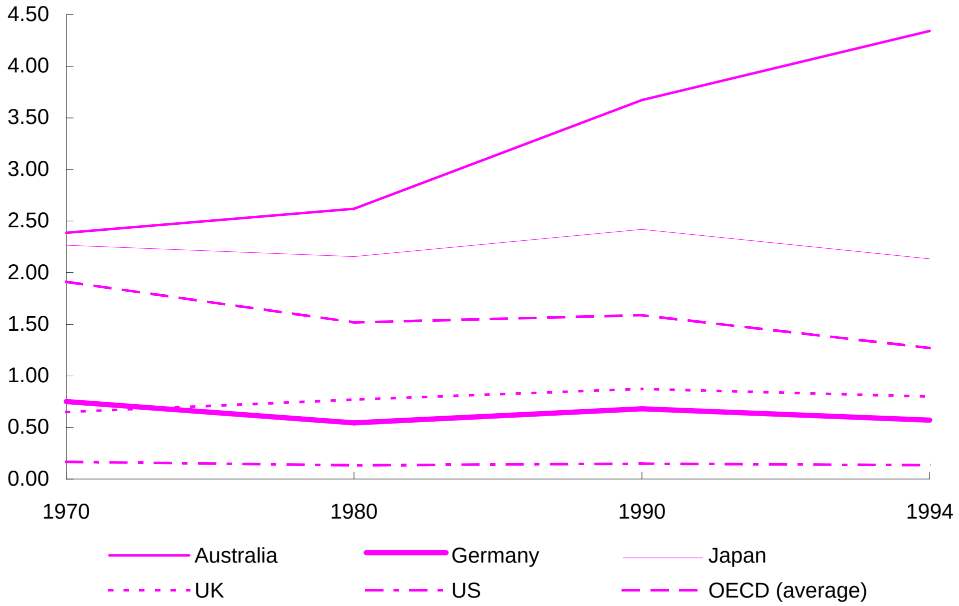
State and Territory Transaction Taxes

9.57 Financial Institutions Duty (FID), debits tax and stamp duty are imposed by State and Territory governments on certain financial transactions and instruments. Whereas FID and debits tax are principally transaction taxes, stamp duty is akin to an excise and applies to the documentary evidence associated with prescribed financial or capital transaction. The most important stamp duties are those levied on contracts and property conveyances, insurance contracts, transfers of marketable securities and loan securities, and motor vehicle registrations.

9.58 Taxes on financial arrangements in Australia have almost doubled over the past 25 years, increasing as a proportion of total tax revenue from 2.4 per cent in 1970 to 4.3 per cent in 1994. In most OECD countries the importance of taxes on financial arrangements has declined over the same period. Australia has the highest incidence of tax on financial transactions of any OECD country.[8] Figure 9.1 shows trend growth in Australia's financial taxes compared to that in some other OECD countries.

Australia's Financial Taxes are High and Rising . . .

Figure 9.1: Financial Taxes as a Proportion of Total Tax Revenue



Source: OECD 1996.

9.59 The Campbell Committee considered that the total abolition of stamp duties had much to commend it, but recognised that revenue considerations might make abolition impracticable. The Committee therefore recommended:

> *The agreement of the States should be sought at an early date to abolish the existing system of stamp duties on financial transactions and instruments*

8 OECD 1996.

> *and replace it with a uniform and Australia-wide duty for similar kinds of financial transactions and instruments.*[9]

9.60 Partly as a result of the Campbell Committee recommendations, FID was introduced by New South Wales and Victoria with effect from 1 December 1982. However, reflecting the threat that electronic data exchange and direct entry posed to a tax base centred on paper-based instruments, revenue requirements were also an important consideration. With the exception of Queensland, all States and Territories have since introduced FID. However, there is no uniformity in the application of FID across jurisdictions. Stamp duties have also been retained in all jurisdictions.

9.61 The FID tax base covers prescribed 'receipts' of 'financial institutions'. With the exception of the Northern Territory and the Australian Capital Territory, where the threshold is zero, 'receipts' above a threshold are dutiable. There is also a cap in all jurisdictions on the maximum FID payable. For FID purposes, 'financial institutions' are generally taken to include licensed banks, non-bank financial institutions, dealers, trustee companies, credit providers (including retailers), and any person whose sole or principal business is the provision of finance.[10] The administrative complexity arising from FID is shown in Figure 9.2, which replicates Westpac Banking Corporation's Ready Reckoner Guide to FID.

9.62 Most concern about the FID centres on the distinction between the legal incidence of the tax and its economic incidence. Transactions involving the movement of funds between bank accounts held by the same person, transactions involving the movement of funds between entities within a corporate group and transactions involving the physical deposit of monies in one jurisdiction to the credit of an account in another jurisdiction are all subject to FID even though there may have been no change in the economic ownership of the asset.

9.63 Debits tax was a Commonwealth tax from its inception in April 1983 until it was relinquished to the States from 31 December 1990. The debits tax base is a tax on debit entries to accounts on which cheques or like payment

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9 Australian Financial System Inquiry 1981, p.777.

10 Australian Society of Corporate Treasurers, Submission No. 120 to the Financial System Inquiry, ASCT Reference Paper No. 1 on FID, p.25.

instruments (other than credit cards) can be drawn. Variable rates of debits tax are levied by the States.

9.64 In 1995-96, FID and debits tax revenue was $1.9 billion, while stamp duty revenue was $5.3 billion.[11] In 1995, Heads of Treasuries moved to establish the Financial Taxes Review Committee to examine and report on the reform of financial taxes.[12]

11 State and Territory Budget Papers.
12 Department of the Treasury, Submission No. 143 to the Financial System Inquiry, p.192.

Figure 9.2: Westpac's Ready Reckoner Guide to FID

INTERSTATE TRANSFERS — ALL STATES

The following matrix can be used as a 'ready reckoner' to determine whether a FID liability exists when a deposit is made in one state for crediting of an account in another state. For example:

> If a deposit is received in Tasmania for credit to an account in NSW, the deposit in Tasmania will be dutiable at the Tasmanian FID rate of 0.06%, unless the deposit comprises of, or includes, customers own cheques* or transfer between accounts,** which are to be treated as non-dutifiable and should be excluded from FID calculation.

*NOTE: 'Own cheques' are defined as cheques drawn by the customer on their Westpac account held in the State where the deposit is being made (the Remitting State).

**NOTE: 'Transfer between accounts' are defined as Paperless (Card initiated) or Westpac Withdrawal forms.

	ACCOUNT DOMICILE (State where the deposit account is held)
Deposited in New South Wales	**VIC, SA, WA, QLD, NT, TAS, ACT** FID payable at the NSW rate of 0.06% except for OWN CHEQUES /TRANSFERS which are non-dutiable. Max. $1,200 for deposits of $2M or over.
Deposited in Victoria	**NSW, SA, WA, NT, TAS, ACT** No interstate FID payable. **Queensland** FID payable at the VIC rate of 0.06% for ALL deposits made by Cash &/or Cheque. Paperless or Paperbased withdrawals (ie Cards or a RED withdrawal form) are exempt (treat as Transfer) Max. $1,200 for deposits of $2M or over.
Deposited in Western Australia	**NSW, VIC, SA, NT, TAS, ACT** FID payable at the WA rate of 0.06% for ALL deposits made by Cash and/or Cheque. Paperless withdrawals or Paper withdrawals from Westpac accounts held in W.A. are exempt. Max. $1,200 for deposit of $2m or over. **Queensland** FID payable at the WA rate of 0.06% for ALL deposits. Max. $1,200 for deposits of $2M or over.

	ACCOUNT DOMICILE (State where the deposit account is held)
Deposited in Queensland	**All States** No FID payable in QLD
Deposited in Northern Territory	**NSW, VIC, SA, WA, QLD, TAS, ACT** FID payable at the NT rate of 0.06% for TOTAL deposit. Max, $1,500 for dep. of $2.5M or over NOTE: OWN CHEQUES and TRANSFERS ARE DUTIABLE
Deposited in Tasmania	**NSW, VIC, SA, WA, QLD, NT, ACT** FID payable at the Tas rate of 0.06% except for OWN CHEQUES and TRANSFERS which are non-dutiable. Max. $1,200 for deposits of $2M or over.
Deposited in ACT	**NSW, VIC, SA, WA, QLD, TAS, NT** FID payable at the ACT rate of 0.10% except for OWN CHEQUES and TRANSFERS which are non-dutiable. Max. $1,200 for deposits of $1.2M or over.
Deposited in South Australia	**NSW, VIC, WA, QLD, TAS, NT, ACT** FID payable at the SA rate of 0.065% except for OWN CHEQUES and TRANSFERS which are non-dutiable. Max. $1,200 for deposits of $1,846,154 or over.

FID SCALES

NSW, VIC, WA, TAS	0.6 Cents per each $100.00 Max $1,200 deposits of $2M or over
SA	.065 Cents per each $100.00 Max $1,200 for deposits of $1,846,154 or over
NT	0.6 cents per each $100.00 Max $1,500 for deposits of $2.5M or over
ACT	10 Cents per each $100.00 Max $1,200 for deposits of $1.2M or over
QLD	NO FID

Source: Westpac Banking Corporation, Submission No. 90 to the Financial System Inquiry, p.170.

Views Presented in Submissions

9.65 A significant number of submissions recorded frustration at what are seen as adverse features of the Australian taxation system and difficulties in achieving reforms in this area. A common theme was a desire to see reforms in the financial area matched by complementary reforms in the areas of taxation policy adversely affecting the financial sector.

9.66 These can be broadly categorised into 3 groups:

- policies which restrict Australia's competitiveness in international financial markets;
- policies which are perceived as inimical to the promotion of savings or as distorting the pattern of savings; and
- policies which are seen as anti-competitive, by favouring some institutions over others.

Policies Which Restrict Australia's Competitiveness in International Financial Markets

9.67 A large number of submissions argued for amendments to tax legislation applying at both the Commonwealth and State levels on the grounds that existing arrangements adversely affected Australia's international competitiveness as well as impeding innovation and competition within Australia.

9.68 One area of concern was the dividend streaming provisions of the dividend imputation arrangements. For example, the Australian Stock Exchange (ASX) noted that the value placed by the share market on the franking credits of the major listed companies had been estimated to be at least $21 billion so that the present exclusions relating to dividend streaming represented a significant disincentive for foreign companies listing in Australia. Colonial Mutual observed:

> *In our considered view, the Australian tax system is more likely to limit international expansion by Australian banks and other financial services companies than the so-called need for critical mass. This is because imputation credits apply only to Australian, and not foreign corporate taxes ... International dividend streaming to allow franked dividends to be*

> *biased towards Australian shareholders would greatly assist local companies competing in international markets and encourage the development of Australia as a key global financial centre.*[13]

9.69 Various aspects of the CGT regime were criticised in submissions. AusAsean noted that, in ASEAN countries, Australian banks cannot price competitively as the profits on transactions are subject to Australian tax, including CGT. The ASX and the Australian Business Chamber were concerned that CGT discouraged investment in SMEs, pointing to the lack of rollover provisions and the fact that CGT can only be offset against capital gains rather than all income.

9.70 The ASCT argued that interest withholding tax was anti-competitive and that changes to legislation failed to address the wider issue of inequality arising from existing exemptions.

9.71 Another issue raised in submissions was the effectiveness of the current OBU and RHQ regimes, with a common theme being that current arrangements fell short of what was necessary to develop Australia as a regional financial centre. These issues are considered further in the next section.

9.72 While recognising the importance of globalisation and international tax competition, the Department of the Treasury suggested that:

> *the best strategy for Australia is to pursue a policy of keeping its effective corporate tax rate no higher than that applying in the major capital exporting countries and generally 'in touch' with those of its regional competitors; and*
>
> *Australia improve its performance on the more important non-tax factors, including via continued emphasis on microeconomic reform.*[14]

9.73 Bankers Trust Australia noted that the record keeping and compliance requirements for FIF were such that managers normally organised their affairs so that they fell below the threshold on balance date.

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13 Colonial Mutual Life Assurance Society, Submission No. 88 to the Financial System Inquiry, p.42.

14 Department of the Treasury, Submission No. 143 to the Financial System Inquiry, p.165.

The joint submission from Australian Investment Managers' Association (AIMA), Life, Investment and Superannuation Association (LISA) and Investment Funds Association of Australia (IFA) supported the view that the FIF regime was highly complex. That submission also noted that the FIF regime affected the ability of a domestic investor to invest internationally and created a barrier to entry to the Australian funds management industry. This view was also put by Fidelity Investments, a large United States funds manager. Fidelity advised the Inquiry that the FIF regime was a constraint to Fidelity offering retail funds management services in Australia from the United States. In addition, the small size of the Australian market meant that the establishment of new funds management activities within Australia was unlikely to be economic, given scale economies in funds management.

9.74 Many submissions noted that FID and debits tax were regressive, economically inefficient and damaging to Australia's international competitiveness.[15] Westpac and the ABA were among those that argued that FID and debits tax were impeding the adoption of financial electronic data exchange and electronic commerce by business. This was because with paper-backed instruments, institutions are able to bank a number of cheques as a single deposit and gain the advantage of the FID cap. With electronic payments, however, it is not always possible to aggregate deposits.

9.75 In addition, it was noted that the financial sector is the only industry in Australia subject to a tax on transactions. Moreover, Australia is said to be the only country which directly taxes financial transactions (as distinct from *ad valorem* stamp duties).[16] Together with the very high compliance costs associated with FID and debits tax, these factors were cited as further damaging the international competitiveness of the financial sector and its ability to innovate. A study by Coopers & Lybrand on the impact of FID and

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15 See for example the Commonwealth Bank of Australia, Submission No. 186; ANZ Banking Group, Submission No. 94; Australian Custodial Services Association, Submission No. 51; Australian Association of Permanent Building Societies, Submission No. 43; National Credit Union Association, Submission No. 95; Dr Kim Hawtrey, Submission No. 37; and Victorian Department of Treasury and Finance, Submission No. 190 to the Financial System Inquiry.

16 See for example National Australia Bank, Submission No. 131; Westpac Banking Corporation, Submission No. 90; Australian Bankers' Association, Submission No. 126; International Banks and Securities' Association, Submission No. 146; and The Australian Society of Corporate Treasurers, Submission No. 120 to the Financial System Inquiry.

debits tax reported that 65 per cent of businesses with annual turnover in excess of $750 million maintain off-shore foreign currency accounts. Forty three per cent of this group cited FID as a major or decisive factor in the decision to maintain off-shore accounts.[17]

9.76 A common theme of submissions was that FID and debits tax should be abolished. Recognising the importance of FID and debits tax for State revenue bases, it was acknowledged that this could not be achieved overnight. A number of interim measures were therefore proposed. These included addressing the biases against electronic funds transfer and inconsistencies in FID legislation and administration between jurisdictions, exempting transfers between accounts held by the same person and inter-company transfers, as well as exempting foreign currency accounts.

9.77 Domestic institutions also noted that initiatives by State governments to encourage RHQ and OBU operations by providing exemptions to FID and debits tax placed Australian institutions at a competitive disadvantage.

9.78 The Department of Foreign Affairs and Trade noted that the ASX is facing a strong challenge for listings by other regional markets, in part due to taxes which do not apply to the same degree in many overseas markets. The ASX argued:

> *Stamp duty impedes the development of an internationally competitive securities market in Australia and is a disincentive for the listing and trading of securities of foreign companies in Australia.*[18]

9.79 Reflecting the importance the ASX placed on increasing the liquidity of the Australian market, the ASX recommended that the Commonwealth and States should agree on a scheme, including compensation arrangements, for the reduction and eventual abolition of stamp duty on transfers of quoted marketable securities.

9.80 A number of financial institutions argued that stamp duty distorted the loan market and interfered with interest rate signals.[19] Stamp duty was

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17 Coopers & Lybrand 1996, p.70.

18 Australian Stock Exchange, Submission No. 65 to the Financial System Inquiry, p.24.

also cited as a significant impediment to the further development of securitisation and to the merger of unit trusts.[20]

Policies Which Inhibit or Distort Savings

9.81 A number of submissions argued that the tax system creates significant distortions in the pattern of savings. For example, Treasury and Bankers Trust raised concerns with the taxation of life insurance.

9.82 Other submissions drew attention to the taxation treatment of unit trusts, suggesting that they acted as a barrier to efficiency and mergers. For example, ANZ Banking Group noted that CGT is incurred on the merging of trusts and that the prohibition on the carry-forward of tax losses after a merger reduces the value of assets in an under performing trust. The joint submission from AIMA, LISA and IFA suggested other amendments which would allow a unit trust to pay tax on retained income at the company rate. This proposal would also require adaptation of the dividend imputation scheme.

9.83 Another area of concern was the preferential taxation treatment given to certain asset classes, such as superannuation and owner-occupied housing, over other investment vehicles such as bank deposits.

Policies Advantaging Some Institutions

9.84 A number of submissions argued that IWT was anti-competitive. For example, the International Banks and Securities Association (IBSA) argued that foreign bank branches were at a competitive disadvantage by virtue of their liability for IWT on intra-bank funding. The RBA noted that IWT was one of the two factors commonly cited by foreign banks as inhibiting conversion of non-bank subsidiaries to bank status.

9.85 Another issue raised related to the taxation treatment of PDFs. The Australian Business Chamber noted that superannuation funds prefer to

19 See ANZ Banking Group, Submission No. 94 and National Mutual Holdings, Submission No. 32 to the Financial System Inquiry.

20 Including for example, Aussie Home Loans, Submission No. 176 and Australian Securitisation Forum, Submission No. 204 to the Financial System Inquiry.

invest development capital via a unit trust because income is taxed in the hands of the beneficiary. Because PDFs are taxed as companies, income is taxed prior to distribution. In the view of the Australian Business Chamber, this created an impediment to investment in PDFs by superannuation funds. The Department of Industry, Science and Tourism (DIST) pointed to a 1995 report by Marsden Jacob Associates which found that the structure of the superannuation industry does not favour investments in SMEs.

9.86 In some cases, the problems identified related to the administrative burdens of taxation imposed on financial institutions. The Commonwealth Bank of Australia, ANZ and Westpac, for example, instanced the costs of the *Financial Transactions Reports Act 1988* (a compliance mechanism) as an example of overheads imposed by government. Westpac also drew attention to a 1992 ABA survey of 18 member banks which estimated that the ongoing annual costs incurred in complying with the requirements of the *Taxation Laws Amendment (Tax File Numbers) Act 1988* was $6 million and that the banks' fixed costs were $25.5 million.

Approach of the Inquiry

9.87 Under its Terms of Reference, the Inquiry may not make recommendations on policies for the taxation of financial arrangements, products or institutions, and it accordingly does not present any options or findings in this paper. In its Final Report, however, it will present its views on how existing specific taxation arrangements might:

- affect the international competitiveness of financial markets and their ability to innovate and adapt to changing circumstances;
- impede organisational changes or restructuring in the financial sector which would reduce costs or increase competition; and
- damage competition due to their differential impact on one class of institution relative to another and, in particular, limit new entry to financial markets.

9.88 However, it will be recognised that such findings do not represent a complete analysis of all of the matters that governments would need to address in making decisions on these or other features of the taxation system.

Even if a tax has an adverse effect on competitiveness, it remains necessary to consider whether alternatives would have worse impacts or are feasible.

9.89 Over the past 12 months at least two major studies have been completed by the private sector on the impact of FID and debits tax.[21] A Commonwealth/State review is examining the economic efficiency of FID and debits tax. The Inquiry therefore will not seek to duplicate this work.

Australia as a Regional Financial Centre

9.90 The increased globalisation of capital markets has been matched by a trend towards disaggregation of some functions. This means that a country may be a centre for some financial functions but not for others. In this section, therefore, a regional financial centre is defined both as a base for the regional headquarters of financial institutions and multinational companies and as a base for specific aspects of an institution's business.

Existing Arrangements

9.91 The APEC Capital Markets Working Group[22] defined regional financial centres as those where financial service providers concentrated on one or more of the following functions:

- issuance and trading of equity in foreign businesses;
- issuance and trading of debt instruments denominated in foreign currencies;
- management of foreign stock and bond portfolios;
- clearing, settlement, custody and other post-trade operations associated with the above;

21 Two recent reports are those by: Arthur Andersen (commissioned by the Australian Society of Corporate Treasurers) November 1995, referred to in the Australian Society of Corporate Treasurers, Submission No. 120 to the Financial System Inquiry; and Coopers & Lybrand 1996.

22 APEC Capital Markets Working Group 1995, p.7.

- regional headquarters activities, especially treasury operations;
- off-shore banking activities;
- markets related to the above, including foreign exchange, derivatives and insurance; and
- specialist legal and corporate advisory services.

Australia's Advantages

9.92 The maturity and sophistication of Australia's financial markets are among the key advantages Australia can offer as a regional financial centre. For example, IBSA claimed:

> *Australia's domestic financial markets are better developed than those elsewhere in the region, Japan included. A wider range of more sophisticated financial products are offered to consumers of financial services here than is offered to consumers elsewhere. The domestic financial markets in Singapore and, to a lesser extent Hong Kong, are more controlled and not as well developed as those in Australia ... Australia's financial sector is probably the most efficient and competitive in the region at the wholesale market level, where trade in international financial services takes place.*[23]

9.93 In addition to these advantages, Australia has a number of attributes which suggest that it is well placed to develop as a regional financial centre. These include:

- a time zone that spans New York and Tokyo;
- excellent transport linkages to regional commercial centres;
- cheap and reliable telecommunications networks with comprehensive geographic coverage and price stability, operational integration and technical strength;
- a sound banking system and a reputation for strong and well-enforced regulatory standards;

23 IBSA, Submission No. 146 to the Financial System Inquiry, p.91.

- a highly-skilled, multicultural workforce with English as the native language;
- competitive wage and salary costs by regional standards;
- excellent living conditions, good social infrastructure and relatively low cost of living;
- a large and growing volume of pooled domestic funds;
- a strong legal system based on the British model, which is widely in use in the region;
- political and economic stability; and
- a large natural resource sector with highly-developed commodity markets.

Australia's Disadvantages

9.94 A number of reports analysing Australia's potential as a regional financial centre have suggested that Australia's geographic location is a weakness because there is a perception in major financial centres that an Asian office must be located in Asia to keep track of the 'noise' of local markets and to maintain relationships with key market participants and with regulators.[24] For these reasons, Hong Kong is ideally suited to enter China's emerging market while Singapore is seen as the best location from which to penetrate the South-East Asian market.

9.95 The APEC Capital Markets Working Group was of the view that negative perceptions about Australia's geographic isolation could be reversed but only with high-level public commitment backed by the development of a facilitative and supportive administration receptive to foreign investment. Measures cited by the APEC Capital Markets Working Group and others in this context include simplification of tax administration and other regulation, streamlining of immigration procedures, co-ordinated

24 Including APEC Capital Markets Working Group 1995 and the Sydney Financial Centre Taskforce 1992.

marketing of Australia in international fora and better co-ordination between Federal and State governments.[25]

9.96 If geographic location is an important consideration for firms establishing regional financial operations, then transport and telecommunications links assume greater importance for countries such as Australia. The 1992 Sydney Financial Centre Taskforce Report identified accessibility to Sydney's international airport and expansion of capacity as important to the development of Australia as a regional financial centre.[26] More recently, it has been suggested that the 'tyranny of distance' can be defeated through technological developments and by placing greater weight within firms on developing staff with extensive experience in Asia so that 'attitudinal separation' is overcome.[27]

9.97 The recent report on financial services commissioned by DIST concluded that Australia's principal weaknesses were the depth, liquidity and maturity of its financial markets relative to those in Hong Kong and Singapore, taxation policies and the lack of commitment in government and business to full engagement with the Asia Pacific market.[28]

9.98 Australia's approach to financial sector development is frequently contrasted to that pursued in Singapore and Hong Kong. Both the Hong Kong and Singapore Governments have targeted international financial business and encourage good dialogue between government and the financial markets and institutions. It is claimed that these policies have resulted in strong growth in financial markets because development opportunities consistent with broader public policy objectives are maximised. The role of current regulation in promoting Australia as a financial centre and in developing financial markets is examined in the following section.

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25 See APEC Capital Markets Working Group 1995, p.8 and Allen Consulting Group 1996, pp.166-167.
26 Sydney Financial Centre Taskforce Report 1992, p. 30.
27 Allen Consulting Group and Arthur Anderson 1996, p.28.
28 Allen Consulting Group and Arthur Anderson 1996, pp.iv-vii.

Recent Developments

9.99 To date, Australia has secured some data processing and software development business but few treasury functions. Some recent developments include the following.

- Westpac is centralising the processing of all its off-shore branch financial markets transactions in Australia.
- American Express has established a Regional Servicing Centre in Sydney to deal with card member complaints, collections activity, merchant servicing and fraud for all card member accounts throughout Asia.
- Bank of Scotland has established a regional headquarters of its subsidiary, Capital Finance Australia Limited, to provide marketing, finance, accounting, information processing and support for its regional operations.
- Bankers Trust has established in Sydney a regional headquarters for its global custody and regional processing operations. In addition, the Australian funds management arm of Bankers Trust last year took over responsibility for all Bankers Trust international funds management activities, including those run out of New York.
- State Street Bank & Trust Company has established its Asia Pacific headquarters in Sydney to undertake its regional custody operations.[29]

9.100 Compared with other regional centres, the scorecard for Australian financial markets shows mixed results. For example, the average annual growth in trading value for the ASX between 1991 and 1995 was 24 per cent, below that of Singapore (35 per cent) and Hong Kong (30 per cent).[30] However, by average market capitalisation, the ASX was ranked third in the Asia Pacific region in 1994, behind Tokyo and Hong Kong.[31] Similarly, while growth in the volume of contracts traded on the Sydney Futures Exchange (SFE) over the period 1989 to 1995 was lower than that for both Hong Kong

29 Information from Westpac Banking Corporation, Submission No. 90 and International Banks and Securities Association, Submission No. 146 to the Financial System Inquiry.
30 Securities Industry Research Centre of Asia-Pacific (SIRCA) 1996, p.59.
31 Allen Consulting Group 1996, p.20.

and Singapore, the SFE remains one of the most significant futures exchanges in the region.[32]

9.101 As noted in Chapter 2, the over the counter (OTC) markets are the largest markets in Australia representing 72 per cent of Australian financial market turnover in 1995-96.[33] The average annual growth rate in Australian OTC markets over the 3-year period to 1995-96 was 3.91 per cent, or one tenth of the growth in international markets over the same period.[34] In addition, there have been real declines in some product markets such as long-dated securities and interest rate and foreign currency options.[35] In absolute and relative terms, Australian OTC markets are declining in importance and risk becoming illiquid. Poor liquidity and reduced scale will affect the efficiency of domestic financial markets.

9.102 One explanation for the failure of Australian financial markets to match the growth rates of Singapore and Hong Kong may be the strong local currency focus in Australian trading. For example, in both the Singapore and Hong Kong foreign exchange markets, local currency trading represents less than 15 per cent of total trading whereas, in Australia, 34 per cent of trading is in Australian dollars.[36] Table 9.1 provides details on regional volumes in currency markets.

Table 9.1: Regional Volumes in Currency Markets

Country	1989	1992	1995
	Per cent	Per cent	Per cent
Singapore	41.4	45.4	44.8
Hong Kong	36.8	36.8	38.4
Australia	21.8	17.8	16.8
Total	100	100	100

Source: Securities Industry Research Centre of Asia-Pacific.

32 SIRCA 1996, p.68.
33 SIRCA 1996, p.39.
34 SIRCA 1996, p.44 and Australian Financial Markets Association, Submission No. 129 to the Financial System Inquiry, p.15.
35 For a full discussion of these issues see SIRCA 1996.
36 SIRCA 1996, p.63.

9.103 Looking beyond market turnover and growth rates, financial service providers in Australia, Hong Kong and Singapore were recently surveyed to gauge the relative competitiveness of the three centres in financial products. The survey found that Australia lagged behind the other two centres in derivatives, foreign exchange, cash management, settlements/back office functions and corporate banking. In addition, Australia ranked behind the leader, Hong Kong, in portfolio management, retail funds management, equity issues, equities trading, advisory functions and listed companies research.[37]

Views Presented in Submissions

9.104 The principal issues raised in submissions were how to enhance Australia's position as a regional financial centre and the regulatory and other impediments to achieving this.

9.105 A large number of submissions called for greater co-ordination between all levels of government and the financial sector to enable Australia to realise its potential as a regional financial centre. Some submissions argued that further amendments to existing tax arrangements and/or tax concessions were necessary, while others suggested that some fine-tuning of existing arrangements was necessary. Minimal regulation, comprehensive disclosure requirements and continued high standards within the markets themselves, as well as ongoing innovation, were cited as necessary, but not sufficient, features of the industry framework to allow Australia to develop as a regional centre.

9.106 The ASX argued that, in the absence of change in Australia, institutional money would be pushed towards global off-shore trading centres which offered greater liquidity and transparency as well as lower dealing costs. In IBSA's view:

> *The Inquiry represents a unique opportunity to market Australia as an international financial centre. It provides an opportunity for the government to provide a clear, totally unambiguous signal to the world about its commitment to Sydney as a financial centre. Australia has*

37 Allen Consulting Group and Arthur Anderson, p.iv.

> *significant competitive advantages, but some of these have a 'use by' date . . . It is important that the Government act now.*[38]

9.107 The ASX, Australian Financial Markets Association (AFMA) and IBSA suggested that, in addition to changes to tax arrangements noted in the previous section, the establishment of regional funds management operations was dependent on modifications to the OBU and RHQ tax regimes. The ASX recommended extending the existing OBU tax concessions to all substantial international fund management groups wishing to operate in Australia and suggested that the categories of OBU income eligible for concessions include fees derived from funds management, back office and custody activities and fees for advisory services.

9.108 AFMA recommended the simplification of the OBU legislation, in order to minimise the cost of administering OBUs, and the removal of the requirement to maintain separate bank accounts for OBUs. IBSA argued that the thin capitalisation requirements applying to OBUs were an obstacle to the transfer of global proprietary trading books to Australian OBU operations. It therefore suggested that the thin capitalisation requirements be reviewed. AFMA recommended the exemption of OBUs from the thin capitalisation rules.

9.109 It was also suggested that the RHQ and OBU regimes be unified for RHQ treasury operations[39] and that OBUs be given a full foreign tax credit for withholding tax paid off-shore.[40] Other recommendations included broadening the definition of RHQs to encompass regional service centres, including those which operated as a specified department within an otherwise domestic business.

9.110 AFMA noted that there was a trend towards a reduction in the level of resources allocated to the OTC financial markets and a reduction in the level of activity in those markets. AFMA's view was that the export of highly skilled staff was already discernible in Australian markets. In addition to hampering innovation, this would mean that those staff would generate income in countries which are direct competitors to Australia. Should the

38 IBSA, Submission No. 146 to the Financial System Inquiry, p.95.
39 IBSA, Submission No. 146 to the Financial System Inquiry, p.94.
40 AFMA, Submission No. 129 to the Financial System Inquiry, p.21.

trend towards regional relocation away from Australia continue, AFMA considered that those regional financial centres would increasingly dominate market activity. In AFMA's view, these developments will be difficult to reverse and it will require urgent and concerted industry and government action to arrest this trend.

9.111 AFMA noted that interaction between the wholesale financial markets and all levels of government for much of the period since the Campbell Report has been confrontational and adversarial. A number of submissions supported the concept of a Financial Markets Council, reporting through Treasury to the Treasurer. AFMA recommended that the Council comprise both public and private sector interests and its terms of reference include oversight of the interface between government at all levels and industry. AFMA considered that the Financial Markets Council should be responsible for formulating a range of strategies to arrest the decline in Australia's importance.

9.112 The need for Federal and State governments to upgrade their efforts to establish Australia as an international financial centre and location for RHQs, together with developing some mechanism for dialogue between industry and government, was a theme repeated in other submissions from industry.[41]

Approach of the Inquiry

9.113 Data so far presented to the Inquiry suggest that growth in Australian financial markets has been strong in recent years, but that it has failed to keep pace with that of the region. Australian markets appear to have a stronger domestic focus than markets in Singapore and Hong Kong, making them more susceptible to the domestic economic cycle.

9.114 The Inquiry will consider any regulatory impediments to the development of financial markets and Australia as a regional financial centre.

41 Including for example, International Banks and Securities Association, Submission No. 146; Westpac Banking Corporation, Submission No. 90; and AAP, Submission No. 174 to the Financial System Inquiry.

9.115 The Inquiry will examine the constraints identified in submissions and earlier studies to determine why Australia's relative position in regional markets appears to be in decline. Of particular relevance to the Inquiry will be:

- whether there are specific regulations which limit the competitiveness of Australian markets and exchanges;
- factors which could account for the relatively weak international focus of financial markets;
- whether Australia's policy co-ordination has been defective and whether measures have been frustrated by significant gaps and defects, or by unsympathetic implementation; and
- whether Australia's attempts to market its advantages lack general credibility.