

Australia as a Financial Centre: Opportunities, Obstacles and Risks

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Why Is It Worth Developing Australia as a Financial Centre?

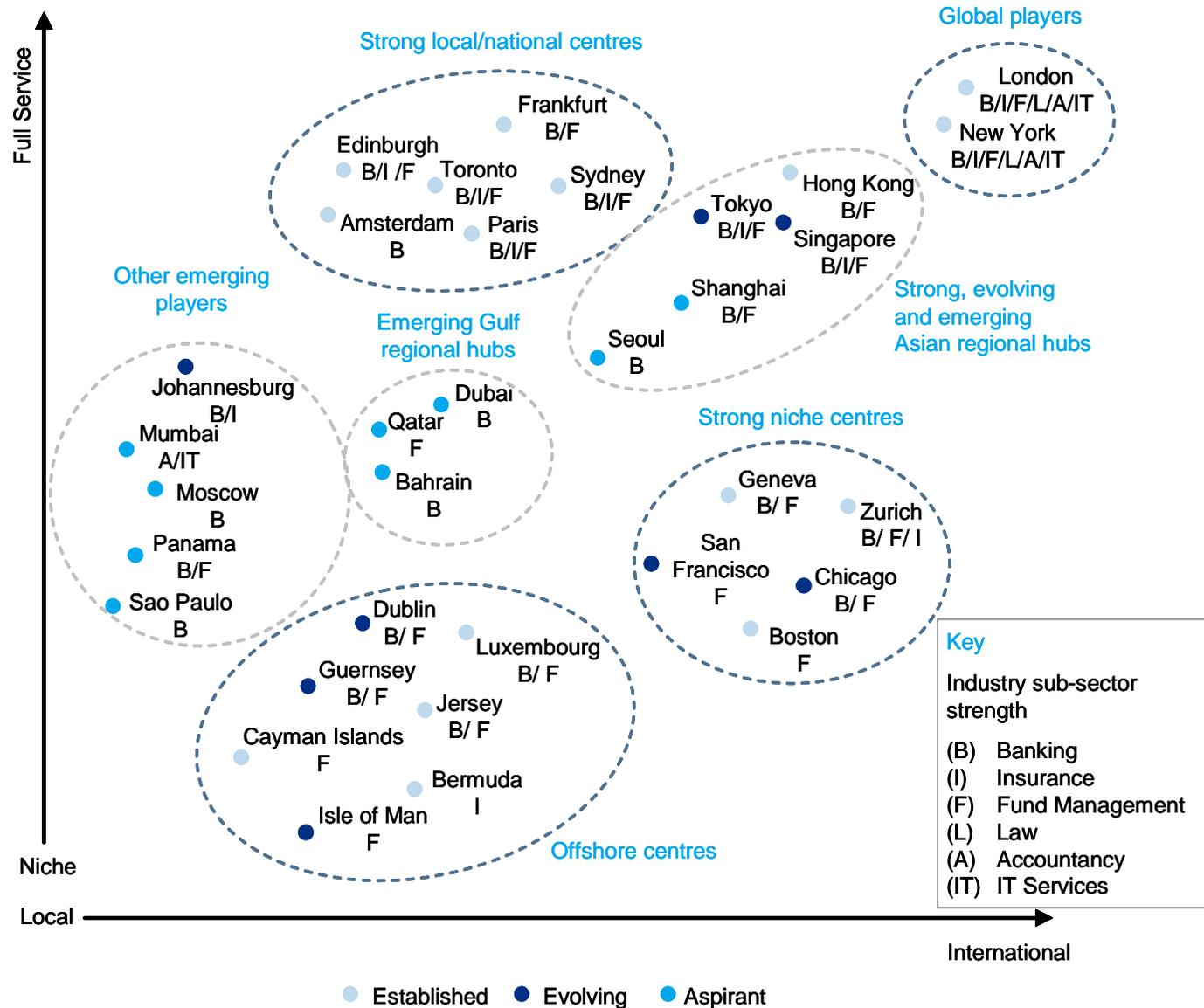
- Well-established causal link in academic literature from financial sector development to economic growth.
- Countries that have highly efficient and competitive financial sectors are also likely to be exporting those services, *unless* there are major constraints to doing so.
- Most independent assessments rank Australia's financial sector very highly.
- Taking full advantage of our comparative advantage provides benefits in terms of jobs, income, and economies of scale leading to lower fees and charges for financial services.

What Kind of Financial Centre Do We Want?

- Important issue in post-GFC debate: Turner Report
- One approach: major tax and other concessions to international financial services companies.
- Unrealistic and undesirable approach for Australia:
 - current fiscal environment; and more importantly
 - hard lessons learnt from tariff policy debate
- Most important characteristic of a **sustainable** leading financial centre: open, efficient, full service, competitive, innovative and well regulated.
- Secondary characteristic: high degree of 'internationalisation': i.e. financial transactions involving offshore parties that are transacted through the centre.

How Does Australia Rate on These Characteristics?

(a) open, full service, competitive, innovative and well regulated



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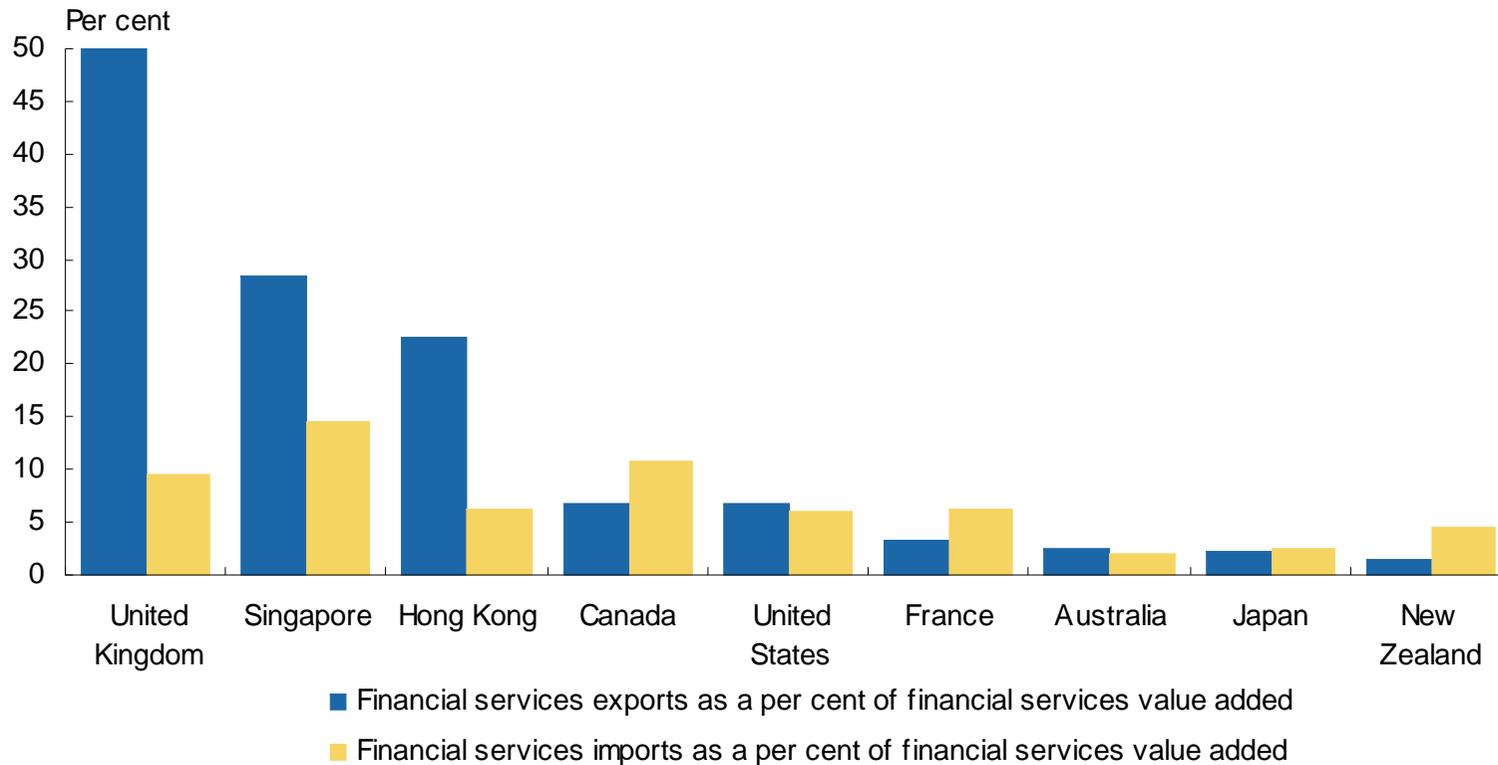
- The Economist Intelligence Unit (Feb 09) ranks Australia seventh in the world in terms of the quality and attractiveness of its business environment.
- Sep 09 Governance metrics International: fourth in the world and highest in the region for its corporate governance.
- Dun & Bradstreet's 09 *Global Risk Indicator* places Australia amongst the top four out of 131 countries.
- 09 Index of Economic Freedom (Heritage Foundation, WSJ): third out of 183 countries.
- World Economic Forum's *Global Competitiveness Report 2009-2010*: Fifteenth out of 133
- Milken Institute's *Opacity Index 2009*: third best in the world.
- World Economic Forum's *Financial Development Report 2009*: second amongst the world's financial centres, behind the UK but ahead of the US, Singapore and Hong Kong.

Conclusion: arguably the most efficient and competitive 'full service' financial sector in the Asia-Pacific region.

How Does Australia Rate on These Characteristics?

(b) high volume of cross-border financial transactions

Internationalisation of financial services sectors



Constraints to Greater Cross-Border Financial Transactions

- the breadth of domestic opportunities, in part springing from our compulsory superannuation system;
- a view by many Australian financial services companies that the business risk associated with looking for offshore opportunities is too great;
- offshore brand recognition issues;
- offshore market access constraints.
- ***Tax uncertainties***

Constraints to Greater Cross-Border Financial Transactions: Tax Uncertainties

- *Permanent establishment*: what determines, for tax purposes, where an organisation carries on its business;
- *Source*: what determines where it earns its income;
- *Tax residency*: the tax implications of where management decisions are taken; and
- *Capital v. revenue*: what determines what type of income it is deemed to have earned, in particular whether that income is a capital gain or revenue.

Tax Uncertainty: Behavioural Consequences

- discourages international financial services companies looking to establish regional headquarters or parts of their regional operations in Australia;
- encourages financial entities to ensure that particular financial transactions or decisions that could have occurred through an Australian based broker or exchange are instead transacted offshore or not at all;
- unwillingness on the part of many potential offshore investors to invest via Australian based vehicles or to use Australian based investment advisers; and
- unwillingness on the part of some Australian fund managers to actively seek to expand their funds under management from offshore clients, or alternatively a decision to do so by setting up offshore vehicles which are run offshore

Tax Uncertainties: Economic Cost

The combined effect of these industry uncertainties and concerns as to how cross-border transactions will be taxed is that:

- potential financial transactions, investment flows and new business opportunities are driven away from Australia;
- negative implications for the liquidity of domestic markets, exports and job opportunities;
- negative implications for revenue from the fees that would otherwise be generated by the Australian based investment advisers, brokers or other intermediaries.

All of these effects run contrary to the objective of developing Australia as a leading financial centre.

Key Recommendations: Funds Management Package

- Investment Manager Regime: greater tax certainty
- Funds management vehicles: right structures
- Asia region funds management passport: market access

Key Recommendations: Cross Border Financial Transactions

Offshore Banking Unit Regime

- Purpose: to encourage offshore financial transactions between non-residents to be conducted through an Australian institution
- Concessional 10% tax rate on “eligible activities”
- Not widely used because:
 - internal accounting and incentive schemes inadequate
 - very unclear definition of “eligible activities
 - ATO tax ruling on “Choice”
 - application process

Key Recommendations: Access to Offshore Capital

(a) Objectives

- As an importer of capital, it is vital that Australia has access to offshore savings pools at competitive rates.
- Given the key role played by the banking sector in funding the CAD, this also feeds through into lower funding costs for domestic borrowers.
- foreign bank and non-bank financial institutions are an important source of competition to domestic banks: important to ensure that there are no policy related impediments to their ability to access capital from parent companies.

Key Recommendations: Access to Offshore Capital

(b) Recommendations

- Abolition of withholding tax on interest paid on foreign-raised funding by Australian banks; on interest paid to foreign banks by Australian branches; and on financial institutions' related party borrowing;
- Removal of LIBOR cap on deductibility of interest paid on branch-parent funding;
- Removing any tax or regulatory impediments to the development of Islamic finance products in Australia.

Key Recommendations: Improving Domestic Competition and Efficiency

(a) Objective

- reducing the cost and increasing the range of financial products available to consumers and business in Australia.

(b) Recommendations

- a one stop online ‘online gateway’ to facilitate foreign financial services companies considering setting up businesses in Australia;
- abolishing state taxes and levies on insurance;
- standardizing state regulations relating to the insurance sector,
- increasing competition on exchange traded markets;
- making it easier to issue corporate bonds to the retail sector while maintaining necessary consumer protection; and
- encouraging offshore funds looking to offer their funds management products in Australia via the Asia funds passport proposal.

Key Recommendations: Maintaining a Best Practice Regulatory Framework

(a) Objective:

- maintaining the right balance between systemic stability, consumer protection and financial innovation

(b) Recommendations:

- Soft: fully testing and evaluating all significant new regulatory proposals to ensure they are necessary, effective and impose as small a compliance burden on industry as possible. c.f. Regulatory Impact Statements
- Hard: periodic regulatory reviews focused on ensuring that our regulatory rules and framework remain best practice. But not yet!

Key Recommendations: Ensuring Effective and Ongoing Policy Reform

(a) The Issues:

- policies with good intent have not always been implemented or administered as effectively as they might have been;
- policy changes have often not been regularly updated and amended over time;
- policy changes in Australia are taking place against a background of rapid policy change in other countries and financial centres in the region.

(b) Recommendation:

- Financial Centre Task Force

Australia as a Financial Centre: Risks

- **Timing:** are we swimming against the tide?
- **Politics:** tax breaks for banks? You must be kidding!
- **Counterparty risk in an uncertain world:** didn't we partly get through the crisis in good shape *because* we were domestically focused?