



Policy Notes

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Trade in Services: The Domestic Reform Agenda

Introduction

Services dominate most economies. The Organisation for Economic Cooperation and Development (OECD) advises that services generate more than two-thirds of global Gross Domestic Product (GDP) and employ most workers globally.ⁱ

With the announcement of a proposed Europe-Australia trade agreement, attention naturally turns to opportunities in services trade. As a bloc, the European Union (EU) is the world's second largest services exporter after the USA and is Australia's second largest services export market after China.

The ANUCES Opportunities in EU-Australia Trade in Services Project was designed to contribute useful input to the current trade negotiations between Australia and the EU. The Project investigates the potential value of the OECD's Services Trade Restrictiveness Index (STRI) to inform trade negotiations. The STRI is useful in indicating where there are domestic regulations which potentially restrict trade in services. By analysing variations in the index between industries and countries, the project focused on identifying priority areas for trade negotiations.

A detailed Background Brief, informed by an intensive Workshop held in July 2019 with participants from Australia, EU member states and other global experts, presents the main analysis undertaken in this Project.ⁱⁱ In this Workshop there was a specific focus on financial services (Australia's largest foreign direct investment sector) and education services (Australia's largest services export and its fourth largest export overall). The Workshop also drew on views from both European and Australian services industries as to key areas on which trade negotiations should concentrate

The domestic reform agenda

A major benefit of trade negotiations is that, through the demands of the trade partner, such negotiations help to identify priorities for domestic policy reform to reduce trade impediments. Such reforms help to increase competition, reducing input costs and thus allowing firms throughout the economy to operate more competitively.

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<https://bit.ly/33mEbzk>

The purpose of this Policy Note is to discuss the domestic reform priorities identified during this project.

As noted, a particular focus of the July Workshop was trade in education services. Due to the different funding arrangements for higher education in Australia and most EU countries, domestic policy reforms in Australia dominated the agenda.

Another focus of the July Workshop was trade in financial services. One major priority identified here is regulation of the storage, use and transmission of data – a vital topic but beyond the scope of this Project. However other priorities for reform in the Australian financial services sector were identified. As regards trade negotiations on financial services, Brexit creates many uncertainties. Workshop participants recommended a 3-year review of financial services commitments in any trade treaty so these can be re-assessed once the post-Brexit landscape becomes clear.

Other priorities for domestic reform emerge from the EU negotiating text and from the negotiating priorities identified by the European Services Forum.

Education: domestic reform priorities

Australia is the third most popular study destination in the world and international students studying in Australia make a substantial contribution to the Australian economy. However, there is a tension between maximising student numbers and income and maintaining quality and standards to ensure a sustainable future demand for Australian education.

The international education market is becoming increasingly competitive. Further, while tuition in English used to be a particular advantage for Australia, now high quality universities throughout the world provide a range of courses in English. Looking to the future, if Australia wants to retain a leading position in foreign exchange education earnings we need to focus on two issues.

Firstly, we need to ensure that we further build our reputation for high quality education. Secondly, we need to ensure that incoming students have the best possible experience on all fronts. At present there are concerns that the simple pursuit of student income is compromising both these essential goals.

Australia's reputation for high-quality research is clearly a critical factor in attracting high-quality post-graduate students from overseas. Australia has also had a reputation for high quality undergraduate education, but over recent years concerns have been raised that this is being undermined by the sheer volume of overseas students in some courses.

Recently some universities have moved to cap incoming student numbers. However, attention also needs to be paid to the demands on teachers, especially administrative burdens driven by immigration policy demands. The design of courses should be a matter for universities, not a by-product of visa requirements. An ongoing issue in the tertiary sector is also the extent to which critical teaching staff are employed on a casual basis. These issues need careful handling to ensure the sustainability of education services income into the future.

There are also a number of factors that impinge on the overall satisfaction of overseas students, impacting negatively on the positive 'soft diplomacy' outcomes that could otherwise be achieved. A particularly salient example of inadequate attention to this dimension is access to student travel concessions. Where overseas students choose to walk home at night because of high transport costs, this can place them in dangerous situations, with consequent severe negative impacts on future student interest. Yet it would seem a simple matter for universities to share a small proportion of tuition fees with State governments in exchange for all their students to access student prices for local transport.

Broader initiatives to ensure student safety are important for their well-being while studying in Australia. As well as maximising access to public transport concessions, these would include enhancing the affordability of accommodation. In addition, greater attention to student support services and interactions with domestic students could pay dividends. The impact of such initiatives would continue well after students left Australia. As such, they are a significant element in Australia's soft diplomacy portfolio.

A further important issue for the quality of incoming students' experiences is the proportion of overseas students on any course. Where incoming students dominate, they will have less opportunity for the kinds of informal learning and cultural exchange that are so critical to a positive overall experience and to the longer-term 'soft diplomacy' benefits of providing education to overseas students.

The current practice of devolving English language testing to institutions raises the risk that students who are not well equipped to succeed in a foreign learning environment will nonetheless be enrolled. This policy should be reviewed and revised.

Other domestic reform priorities

The figure on the next page uses the OECD's STRI data to identify sectors with the greatest trade restrictiveness. The height of each bar shows the overall degree of trade restrictiveness, with a value of zero being least restrictive. The maximum value is 1. The most restrictive sector is courier services, followed by air transport.

The small triangles show the average OECD score for each service sector, and in general Australia performs well, with restrictiveness values generally below the OECD averages. However, if Australia aims to excel in services trade then the relevant metric is not the OECD average, but the OECD minimum – the score achieved in the best-performing country. These minimum scores are shown by the pink crosses. While Australia is close to the minimum in road and rail freight, there is room for substantial improvement in the 20 other sectors.

Issues relating to commercial banking and insurance are dealt with below, as the July Workshop looked intensively at financial services trade. Before that, however, we turn our attention to the many other specific services sectors.

Courier services and air transport

On the face of it these look like two sectors in most need of domestic reform. However, the high scores at least partly derive from how the OECD treats industries where the government intervenes to ensure that Community Services Obligations (CSOs) are met. A quirk of the OECD's STRI is that the reservation of the letter trade to Australia Post – to ensure that all Australians have a letter service – provides a high score. It is not currently possible to exclude the letter service monopoly and re-calculate the scores for the more commercially interesting and competitive sub-sectors. Our detailed assessment of the scores on elements of trade restrictions for courier services suggests that in all other areas of courier services there are few restrictions to foreign competition.ⁱⁱⁱ

Although air transport is one of Australia's most restrictive trade sectors, Australia and New Zealand are amongst the least restrictive countries across the OECD and other major world economies largely by virtue of allowing foreign ownership in their domestic carriers.^{iv}

Logistics and maritime transport

The four logistics service sectors and maritime transport are critical to the efficient movement of goods. While there were substantial reforms in some of these sectors in the 1990s, it is clear that Australia still lags behind OECD best practice. Maritime transport is one sector high on the EU's negotiating agenda and this might provide the impetus for further essential domestic reform.

Professional services

For the four professional services sectors – accounting, architecture, engineering and legal services – Australia's regulatory environment is relatively unrestrictive by world standards. Australia applies labour market tests for workers seeking to provide services as intra-corporate transferees, contractual services suppliers or independent services suppliers.

These appear to create greater restrictions to the movement of people for accounting and architecture than for engineering

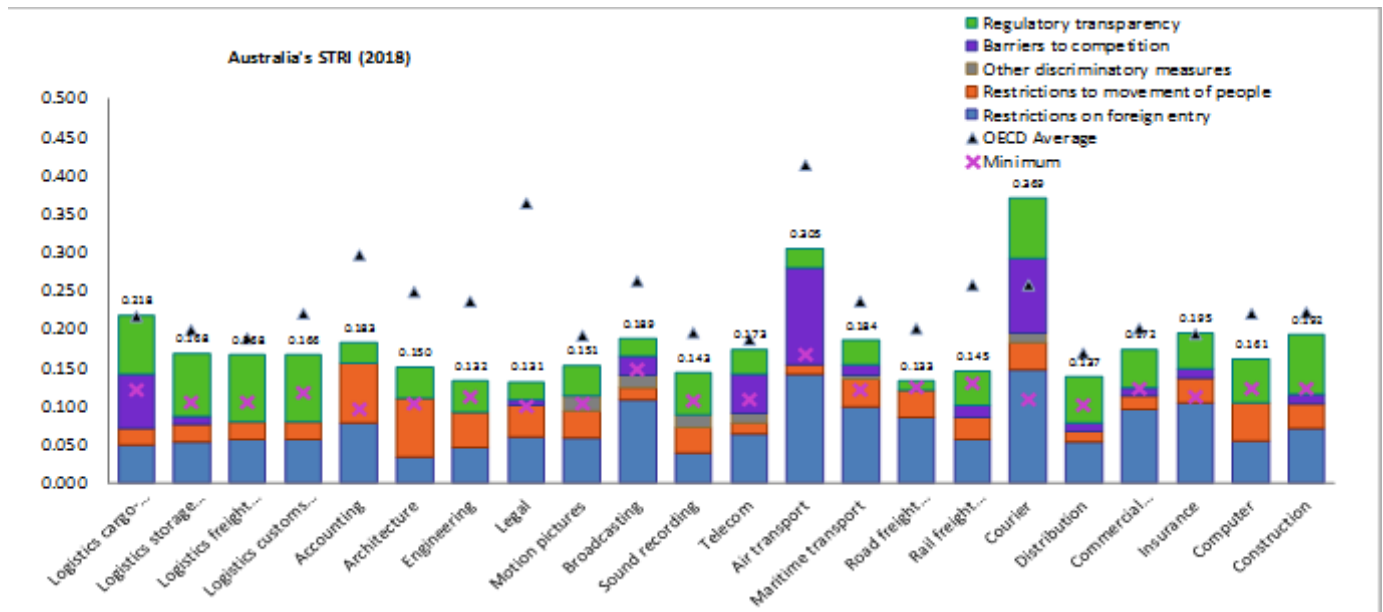


Figure: Australia's services sectors: restrictiveness index values

Source: own analysis using OECD Services Trade Restrictiveness Index data – from Steve Nerlich and Sihui Ong, 2019, Identifying Opportunities in EU-Australia Trade in Services, ANUCES Briefing Paper: 10:3, November 2019.

or legal services. This difference suggests an entry point for investigating whether the greater restrictions in accounting and architecture are trade-limiting or not. Review of these restrictions on the movement of accountants and architects should be a priority. Both accountants and architects are listed on the medium and long term strategic skills list which determines points for assessing working visa applications.^v

We note that the EU-Canada Comprehensive Economic and Trade Agreement (CETA) encourages relevant institutions to adopt mutual recognition of qualifications (MRQ) and that the first steps under this provision have been in respect of architects. It would be useful for Australia to investigate whether this initiative has been productive as this will provide insights into whether the CETA MRQ provisions are adequate to maximise liberalisation in the professional services.

Mutual recognition of qualifications

Barriers to movement of professionals (e.g. architects, engineers) are primarily about licensing requirements of which qualification recognition is just a part. Regulatory requirements can make the process of being able to work in technical fields in another country very complex. Usually, however, partnering with local professionals can provide adequate work-arounds to licensing restrictions.

MRQ is fundamental to the movement of professional and skilled workers. The Workshop noted that while full degrees are already well-recognised, there may be issues to resolve in respect of the recognition of diplomas, noting these qualifications are targeted at meeting specific workplace needs.

Some Workshop participants felt it is currently difficult for foreign tradespeople to be able to work in Australia. Services such as VETASSESS^{vi} facilitate the cross-border mobility of technically skilled people, but may need to be improved.

Financial services reform in Australia

The financial services sector is one of the most heavily regulated sectors in developed economies. This is because of the sector's central intermediary role in every economy. However, the sector is highly sensitive to external shocks so regulators have to strike a fine balance between liberalising financial services to promote efficiency through competition, and ensuring sound prudential policies to limit systemic risks and sustain financial stability. Related to prudential regulation are goals of protecting consumers and investors.

Coverage of financial services within the OECD STRI is limited to the commercial banking ("commercial..." in the figure above) and insurance sectors.

From these data we can see that there is room for increased competition in both sectors. The different coloured parts of the columns in the figure identify the kinds of barriers to international trade in each sector. A major issue for both sectors is restrictions on foreign entry (the blue part of the column), followed by areas where regulatory transparency needs improving (the green part of the bar).

Australia's commercial banking sector is highly concentrated, thus limiting the degree of market competition. The 2018 Productivity Commission report on Competition in the Australian Financial System^{vii} pointed to the need to enhance competitiveness within the sector while maintaining stability. Given this, Australian businesses and consumers would be well served by listening carefully to EU proposals for greater market access across all financial industry sub-sectors.

The European Services Forum (ESF) has proposed granting the EU exemption from the current prohibition on the provision of life insurance by foreign companies through branch operations. The ESF have also suggested Australia-EU trade agreement negotiations will also offer opportunities for fresh approaches to greater regulatory coherence in financial services. This major

suggestion draws on the shared experience of the global financial crisis which demonstrated the deeply interconnected nature of global financial markets and the need for greater cooperation and regulatory consistency.

We also note that the cost of funds management in Australia exceeds that in some EU member states, such as the Netherlands. Given the compulsory Superannuation Guarantee levy, better pricing for funds management would benefit many Australians. The proposed EU Treaty might provide a useful means to achieve the increased competition that could deliver such benefits.

Several Workshop participants identified the UK's imminent exit from the EU as a significant background issue to the EU Treaty negotiations, noting that the UK has been the EU's largest centre for financial services. As the consequences of Brexit for the EU financial services sector are currently indeterminate, a useful suggestion from Workshop participants was to include in the Australia-EU Treaty a clause providing for revision of financial services elements approximately 3 years after Brexit. This would provide both parties with a useful opportunity to ensure that sensible trade-enhancing provisions would provide both parties with a useful opportunity to ensure that sensible trade-enhancing provisions for financial services were realised for the post-Brexit environment.

The need for more data

Good policy analysis depends on good data. While data on trade in services have been much improved, there are still major

gaps, particularly with respect to the activities of foreign affiliates. Regular Foreign Affiliates Trade Statistics (FATS) data for Australia would provide a more complete picture of economic activities of locally-based firms across the globe, thus enhancing the analysis of service trade and related financial flows. The ABS currently undertakes one-off surveys on the business activities of Australian firms abroad. The publication of more frequent survey results, or even better, the regular collection of FATS data, would fill the data gap. We note and welcome the fact that the Australian Bureau of Statistics is currently collecting new FATS survey data for Australia and look forward to this becoming a regular data collection exercise.

An education services STRI would also be a useful development as the issues involved in trade in education differ somewhat from those affecting other service sectors. Australia's Productivity Commission has undertaken exploratory work in developing an STRI for education services.^{viii}

ⁱ <http://www.oecd.org/trade/topics/services-trade/>

ⁱⁱ <https://politicsir.cass.anu.edu.au/centres/ces/research/publications/trade-services-briefing-paper>

ⁱⁱⁱ See ANUCES Trade in Services Background Brief (endnote 2).

^{iv} <http://www.oecd.org/trade/topics/services-trade/documents/oecd-stri-sector-note-air-transport.pdf>

^v <https://www.visabureau.com/australia/visas-and-immigration/skilled-migration/medium-and-long-term-strategic-skills-list>

^{vi} <https://www.vetassess.com.au/>

^{vii} Productivity Commission, *Competition in the Australian Financial System*, Report 89, 28 June 2018.

^{viii} <https://www.pc.gov.au/research/supporting/education-Restrictiveness>



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Identifying Opportunities in EU-Australia Trade in Services

The project focuses on planned services trade liberalisation negotiations between Australia, New Zealand and the European Union (EU). It investigates trade barriers in different service industries using the quantitative analyses of services trade restrictions prepared by the OECD and cross-matching this with actual services trade. The outcome of this analysis will provide practical insights for trade negotiators.

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