



2004 PRE-ELECTION SURVEY: IMPROVING THE TAX COMPLIANCE PROCESS

Despite the significant overhaul of Australia's taxation regime, compliance costs remain a major concern for Australian businesses. The problem is not so much with any individual tax, but the cumulative effect of the many individual tax matters to which businesses must respond. This is of even greater concern amongst smaller businesses who have fewer resources to devote to dealing with the demands of the Australian Tax Office (ATO).

BACKGROUND

In the year 2000, the OECD released a report containing data¹ on compliance costs in 11 countries including Australia. The OECD found that the compliance costs of business regulation in 1998 were A\$40,380 per firm, or A\$14,500 just for tax compliance. In inflation adjusted terms, this figure is now A\$17,300.

As this data was compiled before the implementation of the New Tax System in Australia in 2000, it does not take into consideration changes associated with the GST and related issues. However, international studies² indicate the compliance costs of indirect taxes in UK, New Zealand and Canada were disproportionately larger for small and medium enterprises.

Supporting these concerns is ACCI's quarterly *Survey of Investor Confidence* which consistently ranks *Business Taxes and Government Charges*, and *Cost of Compliance with Government Regulations* as critical issues for business.

In addition, ACCI's 2004 *Pre-Election Survey* of 1685 firms indicates that regulation dominates the concerns of Australian businesses. A total of 88 per cent of businesses surveyed expressed either major or moderate concern with the complexity of the tax system and this result was broadly the same across all major categories – including small and large businesses, exporters and those located in regional and rural Australia (see Figure 1).

A Small Business Survey conducted by Certified Practicing Accountants (CPA) Australia in March 2003 indicated that 62 per cent of accountants resent the time needed to

I N S I D E

The Importance of Literacy and Numeracy Skills

Around the world, renewed emphasis is being placed by governments and employers on literacy and numeracy skills for all people to enhance their employability, job satisfaction, level of remuneration and community participation. While there isn't a simple solution to raising literacy and numeracy standards, a comprehensive approach involving all levels of government, business and the community is an important national priority.

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ASEAN - Australia / New Zealand Free Trade Agreement Worth Pursuing

The Association of South East Asian Nations (ASEAN) has responded positively to overtures from the Australian and New Zealand Governments for an inter-regional free trade agreement. While the likely commercial and economic dividends may not be as large as those on offer from free trade agreements with the United States and with China, they are nevertheless worth pursuing.

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comply with tax obligations and 41 per cent feel the paperwork burden has increased to the point where they question staying in business.

The lack of quantitative analysis of taxation or total regulation compliance costs since 2000 means we do not know whether regulatory reform (including the implementation of the GST) has assisted in reducing business compliance costs. There is however a growing body of evidence indicating that compliance costs remains a genuine concern.

THE GROWING TREND OF TAXATION OBLIGATIONS

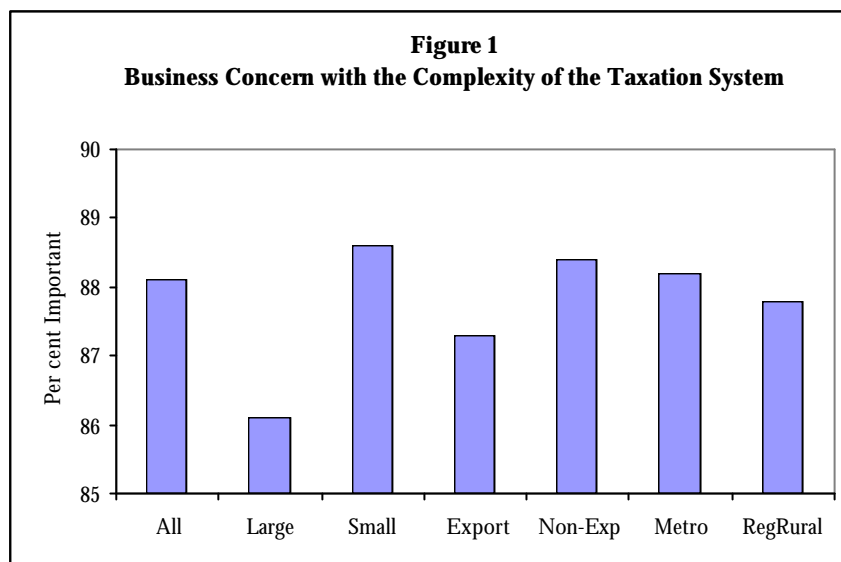
Before 2000, the need for tax reform was widely acknowledged within government, business and the general community. International experience and taxation theory suggested that a broad-based consumption tax was needed to move towards an optimal tax system.

Although there has been a rationalisation of taxation arrangements in recent years, there remain a number of immediate taxation 'threats' to business.

It is commonly accepted that an optimal taxation system should comprise a number of important characteristics including equity, efficiency and administrative simplicity. The following section examines recent taxation developments and issues in accordance with this framework.

Simplified Taxation System

In an attempt to simplify the tax burden experienced by small business the Simplified Tax System (STS) was introduced in 2000. The STS is an alternative method of determining taxable income for eligible small businesses with straightforward



financial affairs. The STS has three main elements:

- a cash accounting method that recognises most business income when received and expenses when paid;
- simplified trading stock rules where businesses only need to conduct stocktakes and account for changes in the value of trading stock in limited circumstances; and
- simplified depreciation rules where depreciating assets costing less than \$1,000 each are written off immediately. Most other depreciating assets are pooled and deducted at a rate of 30 per cent.

To date, the STS has not been widely adopted by small business or well supported by the accounting profession. Recent ATO reports suggest that approximately 20 per cent of eligible small businesses have taken advantage of the STS. The ATO has explained that a high percentage of small businesses did not utilise the STS provisions in the first year because they did not make the necessary creditor/debtor adjustments/preparations that were required.

Feedback from the accounting profession and from small businesses

indicates that the poor adoption rate is attributable to other factors including: a questionable perceived value in adopting the new regime; the perception that it adds another tier of rulings and therefore complexity to an already complex taxation regime; lack of awareness; and the belief that to meet the financial record-keeping of requirements of government bodies and financial institutions a small business would need to keep a 'cash' set of books as well as an 'accrual' set of books adding to compliance costs.

The outcome of the STS has been decidedly mixed.

Taxation Regime can be Too Complicated for Self-Assessment

The New Tax System is designed on the premise of 'self-assessment'. The ideal of self-assessment has merit since it *should* facilitate the internalisation of finance keeping.

However the effect in practice has been the opposite in some cases because the taxation regime remains complex. As such, small and medium enterprises (SMEs) generally do not have the confidence to self-assess, especially with the ATO expanding its audit programme. Therefore the risk of being audited under the framework of self-assessment

combined with a lack of confidence forces many businesses to employ specialist professional assistance.

Quarterly Superannuation Requirements

The Federal Government has announced that it will remove the requirement on businesses to provide written confirmation to all employees, at least quarterly, of superannuation guarantee payments made. ACCI has welcomed this announcement because the requirement creates a large and unnecessary compliance cost. The requirement increases paperwork and administration costs, particularly on small businesses with itinerant workers, while duplicating existing obligations which are generally sufficient to inform employees.

Record Keeping

There has been a general level of high uncertainty from businesses and tax practitioners concerning what records should or should not be kept. The activity of generating and storing records represents a considerable time and resource burden.

Common Mistakes in BAS Returns

CPA Australia has compiled a list of the most common mistakes in BAS returns:

- many businesses claim input tax credits when purchasing a capital asset, such as a motor vehicle, but fail to recognise that the sale or trade-in of the asset is a taxable supply;
- many small businesses are incorrectly calculating the input tax credits or GST payable under the Margin Scheme;
- claiming input tax credits when purchasing from suppliers who:

- are not registered for GST;
- do not have an ABN; or
- do not have appropriate source documents as evidence of ABN;

- overstating or overlooking private use of assets and over claiming input tax credits; and
- incorrectly including wages and superannuation in the calculation of input tax credits.

It should be noted that the vast majority of mistakes made stem from businesses not understanding their obligations or making incorrect calculations.

Knowledge Base and Competency of Advisers

Since the advent of ANTS many SMEs have simply continued to ‘outsource’ the completion (and/or overseeing) of their financial management and record-keeping while only some have made a relatively seamless transition and are able to ‘internalise’ most, if not all, of their taxation obligations. It is of concern that four years after the implementation of ANTS, many small businesses need to outsource tax administration and SMEs do not have the confidence to internalise their taxation obligations.

Anecdotal evidence indicates that professional accounting bodies are now playing ‘catch-up’, and subsequently have had to devote a greater percentage of resources to ‘doing the books’ in lieu of services such as providing high-level strategic advice which was formally a core service.

However, the ATO is making a sizeable effort to assist with tax administration through its ‘Listening to the Community’ initiative. Through this initiative, the ATO is seeking to explore means by which it

can make tax administration ‘easier, cheaper and more personalised’.

This process has identified a number of key concerns in relation to how taxation information is provided to SMEs. SMEs have indicated that they prefer support and assistance matched to their industry and individual needs, telephone advice backed up in writing within 24 hours so they have proof of the ATO’s advice, telephone inquiry lines staffed by business specialists and a more user-friendly web site.

Another regular complaint from SMEs is that the schedules, rulings and various pieces of information issued by the ATO are too complicated and not tailored to their business. Put simply, information is not expressed in ‘layman’ terms.

REVIEW OF SELF ASSESSMENT

The Department of Treasury is currently undertaking a Review of Self Assessment. ACCI has welcomed this review, and has made a number of proposals for improving the system which are outlined below.

General Interest Charges

The ATO wins only 52 per cent of cases it takes to court, yet the general interest charges that are added to outstanding amounts include a punitive element.

The general interest charge is based on the 90 bank accepted bill rate plus 7 per cent.

It is inappropriate to levy punitive interest charges in circumstances where there is no evidence of deliberate dishonesty.

Normal commercial rates of interest should only apply where a business has made an ordinary error in the

interpretation of the relevant provisions.

Rulings and Decisions

A number of tax practitioners have claimed that the system of public rulings is becoming increasingly unworkable, not least because of the huge number in existence. Further avenues for the independent assessment of ATO administrative decisions are required.

Prior to the introduction of the self-assessment system, as long as a 'full and true disclosure' was made, a business was protected from prosecution. A business must now establish that they had a 'reasonably arguable position' in order to escape prosecution. It is not entirely clear that the ATO consistently applies this standard or what it actually entails.

SUGGESTED REFORMS TO THE ADMINISTRATION OF TAXATION

The Chairman of the Productivity Commission, Gary Banks, raised a number of concerns with regulation at an ACCI function in 2003:

- more and more pieces of legislation or regulation are being passed relative to previous periods;
- these Acts are on average longer in length than what they used to be, and consequently are more complex and impose greater compliance stipulations;
- there are more departments, agencies, ministerial councils and national standard setting bodies designing and implementing regulation than ever before;
- governments have not improved their performance in making regulations 'non-prescriptive, clear, and concise';

- the methodology used by Commonwealth agencies (i.e. Regulatory Impact Statements (RISs) in estimating the economic costs of proposed regulation is not yet to a satisfactory standard;
- RISs are too often used as a means to justify the introduction of a regulation rather than a means to impartially assess whether it is suitable or not; and
- regulations often do not differentiate between small, medium and large businesses.

These concerns are of particular relevance to small business. Because of their limited resources, small businesses do not always have the capacity (time, money, and skills) to decipher and comply with all regulation. The effect is that the regulatory compliance cost burden, when compared with dollars per turnover, has a greater, disproportionate impact upon small firms. In other words, compliance costs are regressive.

The RIS process already applies to taxation legislation. It might also be appropriate to apply similar standards to the administration of taxation.

The primary role of an RIS is to improve government decision-making processes by ensuring that all relevant information is presented to the decision-maker. RISs should include an assessment of the impacts of the proposed regulation and alternatives on different groups and the community as a whole.

The Government should consider adopting similar measures in assessing the provisions of the Tax Act by introducing a Tax Administration Impact Statement (the TAIS) to be administered by the Inspector General of Taxation.

This should include:

- surveys of the time and money that business spends on complying with the Tax Act;
- the introduction of a range of initiatives to assist business to identify, understand and implement new and existing taxation requirements. Information programs for small business in particular should involve all components of the small business network;
- a requirement that quantitative estimates of compliance costs, based on detailed proposals for implementation and administration, be attached to any new tax proposal. Estimates should be based on consistent methodology in line with international best practice;
- regular reviews of the accuracy of compliance estimates in the TAIS for regulations with a major impact on business;
- Greater education, skill development, resources and priority within agencies. The Inspector General, in conjunction with the Commissioner of Taxation, needs to address the corporate culture within the ATO to ensure that the TAIS is carefully constructed when each new tax change is proposed.

EXAMINATION OF TAX CONSULTATION PROCESSES

The fact that taxation is an integral aspect of Australia's commercial landscape makes it imperative that both the Government and the business community are able to interact and discuss issues of importance in a meaningful manner. At present the Government has a number of consultative committees set up which enhance the administration of many taxes.

It is the view of many in the business community that the present structures, while helpful, do not allow adequate business input at the development stage of tax legislation.

The business community is in a unique position to identify and recommend policy initiatives that substantially improve the operation of Australia's taxation system. At present however, this pool of knowledge and talent is being seriously underutilised by the public sector.

The following is an overview of the existing mechanisms.

The Inspector General of Taxation

The Inspector General of Taxation was set up to primarily represent the interests of the business community to the Government and the ATO with the objective of improving the administration of the tax system from the taxpayer's perspective. The Inspector-General is independent of the ATO.

The role of the Inspector General is not associated with designing new taxation policy or implementing new policies. This is clearly stated in a report to the Minister of Revenue and Assistant Treasurer:

“Subject to Ministerial direction, the Inspector-General should be able to establish the office's own work program priorities. The Inspector-General would focus on the efficiency and effectiveness of existing tax systems, and would need to avoid becoming involved in the establishment of new systems.”

The Board of Taxation

The Board of Taxation is mandated to help the Government design tax laws and improve their operation through bringing a business and community perspective to the decision making process. The Board

of Taxation undertakes consultation with business on Government proposals to reform Australia's tax system.

The Board provides advice to the Treasurer on:

- the quality and effectiveness of tax legislation and the processes for its development, including the processes of community consultation and other aspects of tax design;
- improvements to the general integrity and functioning of the taxation system;
- research and other studies commissioned by the Board on topics approved or referred by the Treasurer; and
- other taxation matters referred to the Board by the Treasurer.

There is concern about the access business has to the consultation process via the Board of Taxation and whether or not it has become merely a conduit for the Government to disseminate its taxation policy. The above principles are mostly to inform the Treasurer on administration matters and on matters the Government initiates. There is no formal process for business to initiate tax policy.

The Australian Taxation Office (ATO)

The ATO has a number of consultative committees including the Corporate Consultative Committee, the Small Business Consultative Committee and the National Tax Liaison Group. These committees focus on issues of mutual concern about the management and administration of the tax system that impact on the ATO and taxpayers.

ACCI is represented on several of these committees and finds them

useful in communicating issues to the ATO.

Department of Treasury Consultation

The glaring omission at present is the lack of a formal consultative approach at the development stage of tax policy, which is now managed through Treasury. This would allow business to raise policy issues of concern which are often neglected because of existing structures.

Currently, Treasury consultation largely occurs on specific policy issues after the policy parameters have been decided.

It would be preferable for business to provide input through the development stage.

A structural committee similar to the Corporate Consultative Committee at the ATO should be formed whose aim is to tap into business concerns and experience in the development of tax legislation and its administrative arrangements.

CONCLUSION

ACCI acknowledges that the Australian Government has, over a number of years, sought to reduce taxation complexity and we appreciate what the Government has already done.

There are however a number of taxation compliance issues that still warrant attention.

In our consultations with business, ACCI has come to the conclusion that rather than proposing a solution to every one of these many issues, it would be better to focus on systemic answers to the issues that arise.

In other words better regulatory assessment processes for tax administration and better

consultation mechanisms need to be put in place.

ACCI proposes that the Australian Government should consider introducing a Tax Administration Impact Statement (the TAIS). The details of this proposal are outlined above.

ACCI also proposes that the Treasury should establish a committee, similar

to the Corporate Consultative Committee at the ATO, to make Treasury aware of business concerns and experience in the development of tax policy, legislation and administration.

FOOTNOTES

¹ OECD Report, The OECD Public Management Service Multi-Country Business Survey: Benchmarking

Regulatory and Administrative Business Environments in Small and Medium Sized Enterprises, pp 45-47.

² For example, Cnossen, S (1994) Administrative and Compliance Costs of the VAT.

THE IMPORTANCE OF LITERACY AND NUMERACY SKILLS

Around the world, renewed emphasis is being placed by governments and employers on literacy and numeracy skills for all people to enhance their employability, job satisfaction, level of remuneration and community participation. Recent OECD research has indicated that raising a country's literacy score by 1 per cent leads to a rise in productivity of 2.5 per cent with a flow-on increase of 1.5 per cent in GDP.

While there isn't a simple solution to raising literacy and numeracy standards, a comprehensive approach involving all levels of government, business and the community is an important national priority.

THE EXTENT OF THE PROBLEM

A lack of employee literacy and numeracy skills is of particular concern for business.

Estimates in the USA indicate 40 per cent of the population have literacy and numeracy problems and the UK Government acknowledged in July 2003 that millions of adults lack the reading and maths skills that are expected of the average 11 year old. In Canada, 22 per cent of people have serious problems dealing with any printed materials with a further 24 per cent only able to deal with simple reading tasks.

Canada has reported that these problems cost employers \$4 billion (Canadian) per year and \$10 billion

for the nation as a whole. Scotland has estimated it cost employers £500 million in lost production, returned orders and additional recruitment costs.

Comparative figures on the cost of literacy and numeracy problems to Australian business are not currently available.

ACC I SKILLS SHORTAGE RESEARCH

Satisfactory literacy and numeracy skills are amongst the most important of employee attributes and are central to enhancing business goals.

ACCI's quarterly *Survey of Investor Confidence* focuses on the direction of investment and constraints placed on investment by various economic and institutional factors.

The July 2004 Survey showed that for the first time in 14 years, the *Availability of Suitably Qualified Employees* has become the number one constraint on future investment

decisions. The ratings for this constraint over the last twelve years are provided in Figure 2.

ACCI considers that poor literacy and numeracy levels are an important component of this worsening trend.

TACKLING THE PROBLEM

Addressing literacy and numeracy problems requires action at all levels of the education system as well as in the workplace.

Primary and Secondary School Level

ACCI has long promoted the importance of a good general education for students, which include the need for strong literacy and numeracy skills.

Key aspects of ACCI education and training policy include:

- improving and regularly measuring literacy and numeracy standards on a nationally agreed and consistent basis;

- strengthening the focus on sound basics, such as literacy and numeracy, at primary school level; and
- acknowledging, developing and assessing employability skills in a contextual manner.

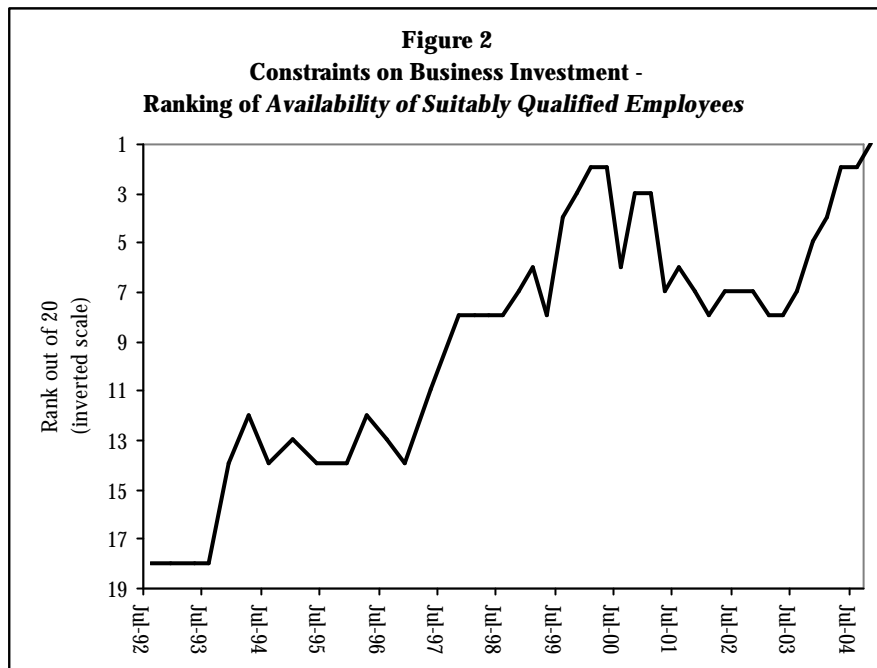
There is a continuing emphasis on the need for all Australians to benefit from a sound education platform which provides adequate literacy and numeracy skills. We recognise that these skills will be built upon in later years.

ACCI supports the Australian Government’s National Literacy and Numeracy Plan which has established a range of interventions in the early years of school, in particular the testing of young people against agreed benchmarks for Years 3, 5 and 7.

Early intervention is important and provides confidence to parents on the proficiency level of their children.

During consultation with employers while developing the Australian Chamber of Commerce and Industry /Business Council of Australia (BCA) *Employability Skills for the Future* report in 2002, a number of key literacy and numeracy themes emerged including:

- that the acquisition of literacy and numeracy skills was strongly supported and seen as the key objective of compulsory education;
- that these skills should be rated higher than others;
- that literacy and numeracy also includes understanding the workplace use of these skills (functional literacy) as well as information technology skills which often combine both; and



- that school reporting on exit in this area must show performance against set national criteria.

Vocational Education and Training Level

Employers expect that applicants for New Apprenticeships will satisfy basic literacy and numeracy requirements and they are often required to sit short written tests examining standard workplace literacy, numeracy and general skill requirements.

Unfortunately, the results of these tests are often unsatisfactory.

In one particular 2003 apprenticeship intake by a building and construction company, 126 applicants were tested of whom 80 per cent failed to satisfy the selection criteria. The same test has been used over a number of years and the successful attainment rate has fallen.

This finding is mirrored by many other companies across sectors recruiting for New Apprenticeships. In some instances, this issue has been exacerbated by the applicant successfully completing a lower

vocational education and training (VET) certificate level offered through VET in Schools.

Unsurprisingly, this raises doubts in some employers’ minds about training outcomes.

Unfortunately, national statistics on the incidence of insufficient literacy and numeracy skills have been difficult to obtain. An important recent development in VET has been the requirement to ensure industry developed and endorsed Training Packages clearly outline literacy and numeracy outcomes and skill requirements in specific work competencies. This step is strongly supported by industry.

The updated Training Package framework which is expected to result from the Australian National Training Authority’s High Level Review of Training Packages provides another opportunity for Industry Skills Councils to ensure the qualification and competency requirements in Training Packages are re-examined to reduce duplications and take account of required literacy and numeracy standards.

Higher Education Level

There is an expectation by employers that higher education graduates will possess high literacy and numeracy skills along with a high level of academic achievement.

One important development in this area has been the recent establishment of the Graduate Skills Assessment (GSA) test, which is conducted on a voluntary basis at entry and following the completion of a Bachelor degree. Skills assessed include written communication and problem solving and each skill is assessed against three described skill levels.

The test involves a two-hour multiple-choice test with a written communication section lasting sixty minutes. In addition to its use as a university entry and exit level assessment tool, the GSA has also been used as a student admission selection tool and as part of a subject's student assessment.

There are problems currently with the perception of the importance of the test by students and industry. There is no doubt there is a lack of knowledge and understanding of the GSA by employers and it does not reflect the current directions of employers and industry on industry developed employability skills.

Consequently, universities have been cautious when allocating funds to administer the test.

The three key changes required for the GSA to gain employer support are to:

- modify the GSA to align it with the ACCI/BCA Employability Skills Framework;
- promote the GSA to employers encouraging its use as one of the available recruitment tools; and

- use the GSA as a research base to inform industry, Governments and providers on the achievement of employability skills in the higher education and other education and training sectors.

In the Workplace

There is some disagreement amongst employers over whether literacy and numeracy standards have fallen after schooling and other education, or whether the new knowledge economy has created a demand for higher levels of proficiency for entry-level positions.

ACCI believes there is a need for detailed research on this topic with the involvement of employer organisations.

There is little disagreement however with the proposition that better educated people have better literacy and numeracy skills and that those who are marginal to the labour market, such as the long term unemployed, tend to have more significant problems in this area.

Nevertheless, overseas studies have shown that better education is not always a guide to satisfactory employer recruitment. United States studies indicate that 52 per cent of high school graduates lack the skills required to do their jobs adequately with 16 per cent of college graduates still having inadequate skills.

This has often led to an increase in employers requiring applicants to undertake simple literacy and numeracy tests for entry level positions, sometimes prior to formal interview.

The United States Chamber of Commerce has conducted surveys of members on literacy and numeracy standards of applicants and reported in 1996 that 19 per cent lacked maths and reading skills

required for the jobs they applied for with this rising to 36 per cent in 1998. This is in the context of the skill requirements for non-supervisory jobs increasing over the 1990s.

In Australia, there is a strong view amongst employers that a similar situation exists here, with renewed support for revitalised pre-vocational programs emphasising literacy and numeracy prior to commencement in the workplace and calls for more accurate assessment and reporting of an individual's attainment.

Often individual applicants are not aware of their weaknesses in the area. American research again indicates that while 41 per cent of males have poor or inadequate literacy skills, only 19 per cent of those believe it is their problem. Only 20 per cent of American males think that low literacy and numeracy skills limit their ability to get a job with 80 per cent believing it had no effect on job opportunities at all.

A potential approach to early intervention for this group is a mechanism which allows employers to utilise government employment and training providers or provide workplace assistance when the new employees begin work.

While an examination of best practice human resource practices involving large, medium and small enterprises would be a useful tool to promulgate through employer organisations, this approach should not be at the expense of concerted efforts by governments to ensure all school graduates possess adequate literacy and numeracy skills.

Employability Skills for the Future

While a lack of employee literacy and numeracy skills is of particular concern to business, an

understanding from an employer perspective of how literacy and numeracy fit in with other employability skills necessary for effective participation in the modern workforce is useful when considering possible future action.

In 2002, ACCI and the BCA published the report *Employability Skills for the Future* which was based on collaborative research undertaken on behalf of our two organisations and funded by the Department of Education, Science and Training and the Australian National Training Authority.

As well as the need to improve literacy and numeracy skills, the report found there was strong support for the recognition of the skills areas of communication, teamwork, problem solving, enterprise and initiative, learning, planning and organising, self management and technology.

Employers also expect employees to have an understanding of the wider work environment and skill competencies that will allow them to contribute in a meaningful way to the output of the firm. Basic budgeting and financial accounting skills that are likely to be used in everyday business situations are relevant examples.

Similarly, employability skills include the ability to work as part of a team, and make a contribution to work through active listening, speaking and recording responses.

The skills required in the modern workplace are not just technical or academic. The Employability Skills Framework clearly identifies employability skills as being as

relevant as job specific or broad technical skills and in some cases even more important.

Evidence since the publication of the original report has reiterated the importance of employability skills from an employer viewpoint.

In a survey of over 400 employers conducted by ACCI in October 2003, a total of 86 per cent said employability skills were more important than technical skills, especially for new entrants to the workforce.

Employers are clear about they want. The challenge is for the education and government sectors to meet those needs and work together for a mutually beneficial outcome.

CONCLUSION

As international labour and capital becomes more mobile and as overseas governments act to improve the ability of their citizens to compete in the global marketplace, it is important to ensure that Australian-educated employees are not left behind.

ACCI believes that governments, the business community and education providers should work together to:

- develop a comprehensive national approach for government, industry, education providers and the community on the issue of improving employability skills;
- undertake research to better identify the economic impact of literacy and numeracy deficits on Australian employers;

- undertake further research on whether literacy and numeracy standards are falling after the completion of schooling or whether there are higher levels of proficiency required for entry-level positions in the knowledge economy;
- support national literacy and numeracy benchmarking in Years 3, 5 and 7;
- modify the Graduate Skills Assessment Test to better align it with the ACCI/BCA Employability Skills Framework;
- promote the Graduate Skills Assessment Test to employers encouraging its wider use;
- use the Graduate Skills Assessment Test as a research base to inform industry, governments and providers on the attainment of employability skills in the higher education and other education and training sectors;
- establish a new early intervention program for applicants identified by employers as failing entry requirements for literacy and numeracy but who meet other standards;
- prepare case study material across enterprises of all sizes on human resource best practices; and
- use the Employability Skills Framework to pursue further policy work in the areas of literacy and numeracy.

ASEAN - AUSTRALIA / NEW ZEALAND FREE TRADE AGREEMENT WORTH PURSUING

The Association of South East Asian Nations (ASEAN) has responded positively to overtures from the Australian and New Zealand Governments for an inter-regional free trade agreement. While the likely commercial and economic dividends may not be as large as those on offer from free trade agreements with the United States and with China, they are nevertheless worth pursuing.

ASEAN was formed in 1967 by Indonesia, Malaysia, the Philippines, Singapore and Thailand with the vision of promoting regional co-operation for peace, stability, progress and prosperity.

Over time, and with changes to regional political and strategic circumstances, ASEAN membership expanded to include Brunei (in 1992), Vietnam (in 1995), Laos and Burma (in 1997) and Cambodia (in 1999), taking its membership to 10 countries.

While ASEAN has made substantial progress in expanding its membership base, it has not been so successful in deepening its economic integration.

The adoption in 1977 of a limited preferential trade agreement produced few outcomes, reflecting high domestic content requirements and long lists of exclusions.

To overcome the under-performance of this initiative, in 1992 ASEAN embraced a proposal from Thailand for an ASEAN Free Trade Area (AFTA), which would eventually lead to the elimination of trade barriers amongst member countries.

Tangible economic outcomes from the realisation of the AFTA were expected to include enhanced efficiency, productivity and competitiveness and raise ASEAN's appeal as a destination for foreign direct investment.

Tariffs on goods were to be reduced to less than 5 per cent within 15 years under a common effective preferential tariff (CEPT) arrangement.

Substantive commitments on services trade liberalisation were made in 1998, in the form of the ASEAN Framework Agreement on Services (AFAS).

By contrast, the Closer Economic Relations (CER) agreement between Australia and New Zealand is fairly straightforward - it is one of the purest free trade agreements in the world.

The CER agreement entered into force in the early 1980s and within a decade was largely complete. Any outstanding issues are now generally regarded as being at the margin.

The challenge for the ASEAN and the CER partners is simple - how can we formally link the two groupings to realise additional economic and commercial benefits for both sides beyond those which may flow from our continuing on separate paths.

THE GAINS FROM CLOSER LINKAGES

Neither ACCI nor the Australian Government has embarked on the ASEAN-CER FTA initiative with stars in our eyes.

For its part, the Australian Government commissioned a series of econometric modelling projects

to look at the gains and losses for ASEAN and the CER partners of the creation of a free trade area between the two groupings - one published in 1997 and another released three years later.

In essence, the 1997 report concluded the economic dividends from any ASEAN - CER FTA would not be huge in either absolute terms or relative to those which could be gained from implementation of the APEC liberalisation agenda.

The authors however, (quite validly) pointed out that available data and modelling techniques used at the time were likely to under-estimate the likely gains from inter-regional trade liberalisation.

The Australian Government commissioned a second work that was released in 2000 which made a number of analytical advances on the first study.

For example it was able to give greater attention to dividends from the liberalisation of the trade in services than the original report which looked only at the trade in goods and take into account the expected improvements in productivity which would flow from trade liberalisation and the resulting increased competition.

This report based its estimates on the assumption of the ASEAN and CER partners realising a Free Trade Area between them within five years

with zero tariffs on all goods and services.

The main econometric findings from the 2000 report were that a bolder and broader agenda for an ASEAN-CER FTA would deliver greater benefits than those estimated in the 1997 project - by a factor of around three times.

Since then however, the world has moved on and regional relations have continued to evolve, most notably through the realisation of the Australia - Singapore, and the Australia - Thailand Free Trade Agreements.

While Australia's bilateral agreements with two of ASEAN's most important members will lead to an early harvest of some of the potential dividends from any ASEAN - CER FTA, there are other, hard to estimate gains that would likely flow from such an agreement, especially for other developing countries considering similar initiatives but keen to look first at similar experiences elsewhere in the world.

A bold and comprehensive FTA between ASEAN (a largely developing country grouping) and the CER partners (two developed countries) could well encourage trade liberalisation elsewhere in the world, and particularly between developing and developed countries/groupings.

Trade Complementarity

One of the most powerful drivers for realising closer commercial and economic relations between Australia and the ASEAN grouping is our generally strong trade complementarity.

That is, our economic and trade profiles are complementary, rather than competing. In plain English, each tends to produce what the other wants to buy.

But, complementarity per se does not deliver trade results.

Opportunity has to be turned into outcomes.

Several years ago, ACCI undertook a major research study into the trade complementarity and competitiveness of Australia and the 10 member ASEAN grouping over much of the 1990s.

In overview terms, we found that Australia was a good market match with the ASEAN countries and that Australia's export performance was better than would be expected based on conventional trade considerations but that there has been a trend decline in Australia's market share in ASEAN countries.

Our analysis looked at several measures of trade performance - trade intensity, country bias and trade complementarity.

The degree of trade intensity is an indicator of aggregate market shares, and looks at Australia's exports to ASEAN relative to ASEAN's importance in the global import market.

Our main finding here was that Australia generally achieved very good measures of market share during the early part of the 1990s, although there was a notable step down in performance in the mid 1990s.

The degree of country bias indicator looked at how well Australian exporters realised Australian export potential into ASEAN and is sometimes viewed as a measure of the impact of trade barriers.

Our research on this point found Australian exporters performed better than potential would have suggested until the mid 1990s but we were unable to say whether Australian exporters became less

resilient in tackling ASEAN trade barriers, or whether more barriers were erected.

The degree of trade complementarity measures the extent of market match between Australia and ASEAN or how well does each sell what the other wants to buy.

In technical terms, it measures the composition of Australian exports to ASEAN with their imports from the world.

On this measure we did very well, and improved over the 1990s, with an almost 50 per cent (one-half) improvement in the index measure. This is a trend which we expect continued into the current decade after allowing for the short run dip associated with the Asian financial turmoil of the late 1990s.

The Closer Economic Partnership

The Closer Economic Partnership (CEP) framework agreed between the ASEAN and the CER partners in 2001 is the foundation for strengthening commercial and economic relations between the two regions.

The CEP was salvaged from the ashes of the earlier (failed) overture from Australia and New Zealand to the ASEAN countries to initiate negotiations on a formal inter-regional free trade agreement.

For ASEAN collectively, the CEP was the most they were prepared to commit to, at least in the short to medium term. For the CER partners, the CEP was a means of progressing the FTA initiative, albeit on a slower and more circuitous track.

Unlike negotiations on a free trade agreement, which focus intensively on trade and investment liberalisation, the CEP processes

aimed to progress the still laudable objective of broadening and deepening economic co-operation, and expanding trade and investment flows through action on a trade facilitation agenda.

In short, rather than the trade liberalisation agenda of FTA negotiations, the CEP has a (still complementary and supportive) trade facilitation program.

Without providing an exhaustive listing of the work plan for the CEP, several activities have had particular appeal to the business-trading community.

Under the heading of non-tariff barriers to trade, this means addressing difficult issues such as licensing and standards and conformance testing arrangements, while in customs co-operation it includes measures to streamline rules and regulatory procedures.

In the area of capacity building, the CEP identifies expanded assistance to the ASEAN countries in the enforcement of intellectual property rights, while trade and investment facilitation and promotion calls for measures to enhance information dissemination and to address market impediments to foreign direct investment.

CONCLUSION

The invitation issued by the ten ASEAN nations for Australia and New Zealand to begin negotiations on a possible FTA drives a final stake into the argument of some commentators that pursuing an Agreement with the USA jeopardised Australia's standing in Asia.

Australia is a global player – and our major trading partners recognise it.

The 10 member ASEAN group represents a market of over 550 million people. Together with the US and possibly China, Australia stands poised to enjoy freer trade relations with a significant proportion of the international business community.

ACCI has long been an advocate of an ASEAN-CER FTA and the existing ASEAN – CER Business Council, which will provide business input into the negotiating processes, is chaired by ACCI Deputy President Peter O'Brien.

We look forward to continuing our solid support in the months and years ahead.

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