



# infrastructure - making public spending more productive

**n**o matter what the label might be, it is easy for governments to waste money. Calling something 'infrastructure' does not make it either useful or productive. To agree that Australia would benefit from the existence of a more extensive infrastructure, or that it would be preferable if fixed capital formation were higher than it is, does not mean that the painstaking work to ensure we are getting value for the outlays we make can be limited to even the slightest extent.

What business wants is more productive uses made of the tax revenues governments receive. Usually the focus is placed on the gathering side of public revenues, of which business is clearly on the record seeking a more efficient tax system and lower tax rates. But just as importantly business wants government spending made more productive. As we head into the pre-budget period, during which the various government departments will commence the process of asking for more tax revenue to be allocated in their direction, it is business that wants a proper vetting process in place to ensure that more of that money is spent in ways that ensure there is an actual positive return to the nation at the end of the process.

Moreover, there should be greater private sector involvement in the development of infrastructure. It is in the private sector where real losses have to be absorbed by companies with no taxpayers to bail them out. This is just one of the ways, but one that is extremely important, to ensure there really is a positive return on the various sums invested.

There is no question that infrastructure development is crucial to Australia's long-term economic performance. Increasing the proportion of public sector expenditure devoted to infrastructure while at the same time limiting public spending overall, can have beneficial consequences. But it is crucial the approach to infrastructure development

## I N S I D E

### Fixing International Taxation is Just the Start.

The Government has commenced an inquiry into our international taxation arrangements that inhibit businesses. Yet once this exercise is over, it will be essential to return to the main game of tax reform. Australia has a tax system that is excessively complex and in need of simplification. Tax rates are too high, depriving businesses of the capital needed to reinvest and employ. And for personal taxation, marginal tax rates are excessive, and are taking a toll on industry because the returns for greater skills and effort are not sufficiently attractive to encourage individuals to acquire skills or add to their productive efforts.

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### Australia-Singapore Free Trade Agreement.

The Australia-Singapore Free Trade Agreement holds out the very real potential for improved market access for Australian exporters, and closer commercial engagement with one of the most dynamic of the Asian economies. But negotiating the ASFTA is only the first step. Realisation of the dividends of the FTA will require Australian business, especially services exporters, to look afresh at a market which has for too long been regarded as a springboard to somewhere else.

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is done appropriately if the additional outlays are not to come at a net cost to the economy overall.

Because at the end of the day, not only is it possible to have too little expenditure on infrastructure but it is possible to have too much. Once it is remembered that more spending on one set of things must come at the expense of the other things that might have been built in their place, the importance of properly assessing all proposals for greater outlays becomes mandatory.

### How Economies Grow

Economies grow only through the creation of net value. In any production process resources and labour inputs are used and must be paid for. Only if the value of the final product is greater than the value of the resources and labour which have been employed in its production is there any net value created.

Private sector activity based on profitable production continuously puts pressure on firms to ensure the value of production is greater than the value of the inputs used. If such a surplus of revenues over costs is not created, then the business will fail. Ultimately, only firms that can earn revenues high enough to repay the costs of all of the inputs used will stay in operation.

Moreover, only such firms should be allowed to stay in business. Loss-making firms only dissipate resources in pursuing objectives which lose value rather than create it. The economy in fact benefits when firms which cannot earn revenues that cover their costs diminish in size or disappear.

Loss-making firms reduce total overall community welfare. They diminish national product by returning to the community less than one dollar for every dollar spent. While there are occasions where such activities might be subsidised by a government, it should be understood that the resulting benefits to the community can never be economic. Such activities are subsidised through other profitable activities undertaken elsewhere in the economy.

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It is therefore of the utmost importance that any consideration of increased expenditure on infrastructure is seen within the context of the need to achieve a surplus of benefits over costs. The notion that any and all expenditure on infrastructure will benefit the economy must be seen as wrong. Some infrastructure expenditures will create a surplus but many others will not.

But it is beyond even the question of the net profit of any particular project that the issues must be examined. There needs to be some means to compare the relative benefits of particular projects with

each other and with private sector capital formation generally. Most infrastructure expenditure is initiated by government, most of which are not being expected to directly earn revenues in excess of costs.

There is therefore a major matter of estimation of the relative value of different public sector infrastructure projects in comparison with each other and with other forms of capital outlay made by the private sector. Without the guidance of the market mechanism there is an intrinsic difficulty in making such comparisons, even where it is believed that a surplus of benefits over costs will be achieved.

### Financing Public Sector Activity

There is then the issue of financing production. It is this which when all is said and done that determines which projects go ahead and which do not. Public sector activity is generally not financed through the revenues collected in sales of final output nor is it dependent on finding customers who will meet the expenses associated with production. Such public sector activity, of which much infrastructure remains a component, is financed in the following ways:

- through tax revenue
- through borrowing from the public
- through inflation of the money supply.

Each of these methods of financing public sector activity represents a transfer of outlays from the private sector to the public sector. Although some revenue is sourced from

incomes earned through public sector activity, overwhelmingly taxes are paid by those earning income within the private sector who would have spent those incomes on privately produced goods and services. Or in the case of businesses, much of the revenues taxed away would have been spent on additional capital equipment within their own firms.

It is a similar outcome in terms of public sector borrowing. The capital used by governments for their own purposes becomes unavailable to businesses to use in the expansion of their own firms. Capital is absorbed into public sector uses rather than into private sector activity.

The final means through which governments can increase their outlays is by creating additional purchasing power through expansion of the money supply. By inflating the stock of money, resources are transferred to the public sector through an inflationary process. The government becomes the first to use the newly created money which allows it to buy in advance of the inflationary pressures it creates. Businesses find the resources they buy inflated in price as the economy feels the effects of a higher inflation generally.

Each of the methods of financing additional levels of public spending comes at a penalty to business and the community generally. The illusion of stimulus exists only because the private sector ventures which did not occur are unseen. Yet for the firms that remain, the effect is higher costs of production, higher rates of interest and upwards pressures on the price level.

### **Infrastructure Expenditure and Economic Growth**

And this assumes that the infrastructure development chosen by governments is actually productive. If such expenditures are unproductive, and cost more than the value they create, then the overall effect on the economy is negative. Wasteful forms of expenditure are no more productive in the public sector than they are in

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the private sector. They add to costs rather than revenue and the economy is slowed rather than given momentum.

Irrespective of how the financing occurs, infrastructure spending, as indeed every form of expenditure, begins a chain of employee, resource and capital utilisation that runs through the entire economy, as firms purchase inputs from each other. It thus sets up a production chain that can only be validated if the product at the end of the production chain creates more value than it uses up along the way.

The belief that unemployed resources that will easily fit the needs of infrastructure development are available is generally unlikely. Unemployed labour in Australia is seldom of the kind that would be easily absorbed into the production of bridges and roads, hospitals and harbours.

Public spending adds to production costs in the private sector by increasing the demand for each of the following inputs into the production process:

- labour
- raw materials
- capital
- finance.

Each of these comes at a cost and are often difficult to secure. Even with the relatively high unemployment at this time, finding suitably qualified employees has been a constant problem within industry. Only if resources, capital and finance are not drawn away from present uses – in other words all of the inputs into the process are currently unemployed – will there be no increase in their cost or scarcity.

Infrastructure spending has the merit of at least attempting to create value. But it needs to be recalled that outlays by government come at the expense of outlays by the private sector. Resources cannot be utilised twice. If they are used in creating infrastructure they are unavailable for use by private sector firms.

Increasing public outlays does not stimulate an economy to higher levels of activity unless it is value adding and unless the activities it replaces would not have created value to the same extent.

## Private Sector Infrastructure Development

One of the important advantages of private sector activity is that individuals are made to have a personal stake in the outcome of particular projects. There is a feedback mechanism inevitably in place through the profit and loss statement that generally ensures that costs are minimised and benefits are made to accrue to the maximum extent. The presumption then in favour of private sector activity is overwhelming.

If infrastructure development is to be increased, then it should be within a framework which incorporates an increased level of private sector participation. There are at the moment hindrances to greater use of the private sector, both in terms of legislation and attitudes of some within the bureaucracy, both federally and within the states. These are obstacles that should be systematically identified and removed.

## Building on Australia's Present Success

The Australian economy stands out as the most successful economy within the entire developed world. The economies of America, Europe and Asia are floundering, where problems seem to mount continuously.

The success of the Australian economy has been built on a number of key policy decisions, all of which are based on the increasingly important role being played by market forces and a diminished role for governments in directing resources. The present success of the economy is in large part due to each of the following:

- the elimination of the budget deficit and the continuous maintenance of a budget surplus (with the exception during the previous financial year where the budget fell into a very small deficit)
- restraint in the growth of public spending
- the ongoing program of microeconomic reform

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- past privatisations and corporatisations
- the opening of the economy to more intense international competition
- ongoing reforms in the area of labour relations which have decentralised decision making to the workplace.

In considering infrastructure development it is essential that any changes proposed recognise these successes. This is the approach that has long been advocated by business. The fact that these policies have been adopted by government and now appear to have brought with them enormous success should be seen as crucial in determining future policy proposals.

In particular, the winding back of public spending and the creation not just of surplus but of a recognition across the political

spectrum of the importance of maintaining a surplus should not be undermined by contradictory policy prescriptions.

The one area of public policy that has had a large negative impact on investment growth has been the use of monetary and interest rate policies to slow activity deliberately. These have diminished the ability of the economy to expand both directly by limiting growth and over the longer term by diminishing the capital available for further expansion.

## Increasing Infrastructure Expenditure

If outlays on infrastructure is to be increased, it is necessary to pursue this outcome within a framework of sound economic policies. In general, a policy that might be framed would include the following elements.

Firstly, within government total outlays, there should be a redirection of public spending away from recurrent, non-productive forms of expenditure and towards more productive forms of infrastructure outlays.

Secondly, impediments to private sector involvement in infrastructure development should be identified and removed.

There should be increased recognition given to the harm to investment levels that has been occasioned by the use of monetary policies designed to limit growth. Allowing faster rates of growth will permit a more sustained rate of expansion which will compound into a larger capital stock over time. Part of this growth

dividend would occur in the ability of the economy to sustain higher levels of infrastructure development.

Increases in public outlays should not occur at the expense of private sector investment.

Fourthly, proper cost/benefit studies should be conducted to ensure that any such outlays do lead to an improvement in community welfare and higher rates of productive investment rather than wasteful expenditure.

Finally, recognition should be given to the lags between identification of an economic slowdown, the gearing up of infrastructure projects and the difficulty in winding such projects down when the economy does recover, that make it extraordinarily difficult if not actually impossible to use such projects for counter-cyclical policies. Infrastructure projects should be adopted for the benefits they are assessed to contribute to the economy, not because they are expected to pick up the slack in the economy at some point in time.

### The Needed Policy

At the end of the day, this is what needs to be done. Governments should encourage investment to ensure the level and composition of infrastructure in Australia is adequate to support sustained economic growth.

This may require changes in the spending priorities of governments so that there is a larger proportion of infrastructure outlays relative to recurrent forms of expenditure within the total level of public spending than occurs today.

It may also require a greater role for the private sector in infrastructure provision.

Such increases in outlays on infrastructure should not jeopardise Australia's recent economic performance but must be funded in ways that ensure economic growth over the medium-to-longer term remains as strong as possible.

The danger in increasing outlays on infrastructure without proper assessment is that such spending will come at the expense of other forms of expenditure which have a higher economic and social return.

Infrastructure projects chosen for development must be shown to contribute to Australia's economic growth potential. Most importantly, governments must properly assess the competing projects under active consideration and must ensure the land, labour, capital and finance requirements for public projects do not absorb resources which could be applied more productively to private sector projects.

Greater support for private sector infrastructure development should be provided. Legislative inhibitions, such as through various tax provisions, and the negative attitudes of public servants who are asked to deal with private sector initiatives need to be removed.

## fixing international taxation is just the start

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etting our international tax arrangements right is important. The Government has commenced an inquiry into those features of the Australian tax system that inhibit businesses from achieving a better outcome for Australia. There are a host of issues that can be fixed, and should be. And what makes the entire exercise somewhat odd is that the background paper put together by Treasury shows without doubt that the nature of the problems are understood by one and all. It is a question of having the will to make the needed changes while assessing the associated risks to the integrity of the tax system. But that the tax system creates problems that inhibit growth and deter foreign investment, of this no one is in much doubt.

However, the issue of the moment is international taxation and how best to mesh the Australian economy into the world economy beyond our borders. The dilemma faced is clear cut although

solutions are difficult to find. On the one hand taxation continues to inhibit certain kinds of activity. But on the other governments need revenues and cannot allow opportunities to avoid tax to open

nor should large sums of government revenues be spent correcting problems that will have only a limited benefit to the economy overall.

The increasing relevance to Australia of foreign direct investment has generally not been reflected in changes to the tax system that improve the processes involved. If Australia is to engage in a more globalised world economy then such changes need to take place as soon as possible. Indeed, a trend towards more open financial borders will continue to change and influence the vitality of economic markets.

The intention is to bring about positive change at both the corporate and individual level as well as increase Australia's economic activity. This can be achieved through input into changes to Australia's taxation system, which ultimately affects the distribution of capital and labour in this country and how productively those resources are used.

### **Importance of International Taxation**

The present focus on international taxation arrangements is important because of the inefficient international tax system Australia now maintains. Ways need to be identified through which changes to Australia's treatment of international income flows can mature the Australian economy and increase real incomes. It is also about making Australian industry competitive with the rest of the world in attracting foreign capital and skilled migrants.

Consideration of these issues is not only relevant to large Australian multinational corporations, it is also important to smaller companies wishing to expand offshore either now or in the future. Policies need to be adopted to make Australian business as internationally competitive as possible. Although,

the adoption of competitive benchmarks is constrained by practical considerations of compliance and administration, Australia's national interest is to protect its share of taxing rights, and demand that others meet their international obligations to us within the international consensus of such rights and responsibilities (to the extent it exists).

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### **The Imputation System**

The first of the issues under consideration is the imputation system. Because of the structure of the tax system, large Australian multinational companies that raise the majority of their capital domestically encounter a bias against individuals investing in domestic firms with offshore income. The removal of such a bias would encourage multinational companies to maintain their operations and control in Australia. The present system actively discourages their remaining in Australia. As Treasury has noted in its own paper addressing these issues, the bias towards domestic investment occurs because:

" Australian resident shareholders receive franking credits on dividends paid by resident Australian companies only for Australian company tax paid. Australian resident shareholders do not receive credits for foreign company tax (usually the main tax on a company's offshore investments) paid by a branch or offshore subsidiary of an Australian company."

Multinational companies based in Australia that source the majority of their equity from abroad and have major shareholders, as non-residents, of which there may only be a small number, will not be as affected by the current imputation system.

Any bias of the nature discussed above will generally affect smaller businesses that wish to expand, or continue expanding, into international markets. These firms are forced to source all their funds domestically and therefore require a higher pre-tax return on their investment in order to raise the necessary amount of capital.

The introduction of the imputation system in Australia has largely helped to develop and maintain one of the highest share ownership rates in the world. To that end the system has largely been successful.

Returns to shareholders derived from foreign source income are, however, currently subject to double taxation. This double taxation of shareholder income in turn affects the cost of capital paid by firms. The lack of credits for foreign company tax paid to shareholders produces a situation where the pre-tax return for foreign investments must be higher than domestic investments in order to attract investors. In

essence, the imputation system has led to a preference towards investing in firms with domestic income only, rather than in firms that earn both international and domestic income.

There therefore exists at the shareholder level a bias towards domestic firms. To what extent this affects the cost of capital is the important question that has required detailed examination. Obtaining answers to these questions is made all the more precarious because of the difficulty of accurately measuring the benefits to the economy overall from removing such a bias.

If the cost of capital were not influenced by the current imputation system then the associated costs to government revenue and the benefits to shareholders would not necessarily dictate change. The Government's primary focus must be to maintain economic conditions conducive to growth and this should be its overriding concern.

The use of franking credits for Dividend Withholding Tax (DWT) to reduce the bias may in theory work. It would not, however, adhere to ACCI's principle of trying to remove such forms of taxation through negotiation with Australia's trading partners. Given that this principle is currently being applied by the Government, credits for DWT may be part of a solution but one that will become less relevant over time.

Allowing for dividend streaming of foreign source income only benefits companies with non-resident shareholders which is generally not the case for small or expanding companies. The full

benefits of streaming are only derived when the proportion of foreign income to non-resident shareholders is equal, a situation unlikely to exist in many Australian firms and therefore streaming is unlikely to be fully effective.

Given these problems, if any of the options listed is chosen then the preferred option is that a foreign dividend credit be given to

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shareholders. The amount of the credit, if this option is adopted, should form the basis for further discussions. However, this should only occur following a study which has shown that the costs of providing this credit are greatly exceeded by the future flow of benefits to the Australian economy overall.

### **Controlled Foreign Company and Foreign Investment Fund Rules**

Reducing the compliance cost and uncertainty associated with investing internationally will produce tangible gains. The Australian taxation system has in place an array of different measures to reduce tax avoidance thereby ensuring the integrity of the tax

base. These are measures which business fully supports.

It is the anomalies that increase both unnecessary complexity or are revenue raising in nature which add to business's frustration and reduces their competitiveness internationally. Australia's Controlled Foreign Company (CFC) and Foreign Investment Fund (FIF) rules are examples of tax measures whose high level of complexity businesses investing offshore must contend with in their daily operations.

Because of the current anomalies in the taxation system Australian firms are being disadvantaged in terms of being able to use capital and labour resources effectively. The taxation of conduit income has led to Australia being avoided as a location to set up regional headquarters. The same system also acts to discourage skilled workers from taking up employment positions that add to the overall productive capacity of Australia.

### **Residency Tests and Treaty Negotiations**

Other issues of importance to the future development of tax policy are the current form of Australia's residency test and treaty negotiations. The residency test while being understood by business has been unable to adapt to changes in technology and therefore makes it difficult to ascertain when residency applies. This adds further uncertainty for businesses due to the ambiguity created by the residency test in determining where jurisdictional tax boundaries lie.

The Australia-US treaty negotiations process has generally been successful, especially with respect to dividend withholding

tax. This process should continue with the aim of making Australia a more competitive place to invest for international companies. Another aspect that needs change is the lack of information for business about the negotiations. Furthermore, business should strive to be a part of the negotiation process given that such developments have the ability to substantially affect the business community.

### **Integrity of Australia's Tax Base**

A source country for international taxation purposes is one in which income is derived through economic activity carried on in that country but by the resident of another. Australia and other nations have agreed to the principle that a source country has the right to tax non-residents on their domestic income. However, this system raises the possibility of double taxation whereby the source country exercises its rights to such income and then that income is taxed again in the country of residence of the company or person.

Australia has adopted the principle, however well applied, that when appropriate it should not tax non-residents on income gained through foreign source income. This arrangement adheres to the source principle. This arrangement also provides no disincentive to foreigners wishing to invest through Australian companies while making the creation of domestic holding companies in Australia more attractive. If a country is not involved as either a source or resident of economic activity then income must not be taxed on the way through.

ACCI supports the exclusion of taxation by the Australian Government on foreign source income accruing to non-residents. Nevertheless anomalies still exist within the legislation. This principle often leads to complications in Australia's tax legislation although the underlying principle of not acting to double tax income is sound. Business also supports the right for the government to enforce the integrity of its tax base.

### **Simplicity and Certainty in the Taxation System**

Parts of Australia's international taxation laws need to be revised in terms of the burden they place on Australian multinational and newly expanding businesses. Simplicity in a tax system allows businesses to allocate resources towards areas that are most productive rather than having to comply with inefficient and wasteful compliance processes.

Uncertainty in the tax system is often a result of anomalies through the different treatment of similar economic entities or activities. The use of basic principles in decision-making allows for the treatment of activities to be consistent, transparent and less open to interpretation.

### **Attracting Skilled Workers from Overseas**

For Australian businesses to remain and become more competitive companies need to develop and have access to skilled workers from around the world. Given the competition that is currently taking place for such individuals, disincentives that

make Australia unattractive can have serious consequences in terms of business's ability to compete.

It is, however, important that incentives are not offered to foreign expatriates that exceed those available to domestic employees. This situation would be unacceptable to the business sector and would introduce new biases that did not previously exist.

Australia must act quickly to undertake changes to the current system so that Australian firms have access to the best resources and can compete in international markets. The very fact that this has become an issue is evidence that it is the entire tax system, not just international but domestic as well, that needs closer review. Because not only is our tax system deterring recruitment from overseas, there is the equal but opposite effect where skilled Australians relocate to overseas economies because of the better after-tax income possibilities found there.

### **Need to View Tax Measures within Full Budget Context**

There is one final cautionary note that needs to be included. It relates in particular to the issues surrounding the bias in the imputation system but also has a much wider currency to this review. Where measures have a cost to revenue, as many of the recommendations in this submission do, they must be assessed within the context of the entire budget process. Budgets must be kept in surplus and measures which require significantly higher levels of expenditure or reductions in government revenue cannot be looked at in isolation from the budget as a whole.

In regard to the bias introduced into the tax system by the introduction of imputation there are two very large unknowns. There is, firstly, the extent to which removing the bias would increase the growth potential of the Australian economy. But secondly, there is the issue of the cost of any remedy introduced. Both the benefit to the economy and the cost to government revenue have not been adequately estimated making hard and fast recommendations difficult.

It is therefore essential that a proper cost-benefit analysis is conducted before any decision is taken, and then, given that there are large potential costs to revenue, there must be an assessment of the relative importance of correcting this bias in the tax system against all of the other economic measures under consideration at the same time.

Thus while the efficient allocation of resources is a fundamental economic objective improving the taxation system must be seen in the context of other domestic considerations and must not be dealt with in isolation from other significance issues. To the extent that inefficiencies in the tax system do exist their remedies chosen should not place other priorities in jeopardy. The Government must not, in its efforts to address international tax issues neglect sound economic management and should view the changes more to the tax system within the context of other budget imperatives.

The Government has a responsibility to maintain stable fiscal policy. The Government's position of producing surpluses has had a positive effect on the

businesses of Australia. Although, we understand the importance of changes to the current international taxation system our overriding consideration is for good domestic policy overall.

**Once this present exercise is over, it will be essential to return to the main game of tax reform. Australia has a tax system that is bizarrely complex and in need of simplification. Beyond that, tax rates are too high, depriving businesses of the capital needed to reinvest and employ. And for personal taxation, marginal tax rates are excessive, and are taking a toll on industry because of the disincentives that have become an inbuilt design feature of the tax system.**

### Looking to the Future

Improving international tax arrangements cannot, however, be a one-off measure. There is an ongoing need to monitor international developments. There is constant innovation even in tax policy.

Australia must ensure its own tax system is world best practice. The processes for reviewing change and seeking comment towards improving the tax system generally should remain high on the Government's agenda. No change should be seen as the final word in tax development since no change is ever likely to be.

Yet once this present exercise is over, it will be essential to return to the

main game of tax reform. Australia has a tax system that is bizarrely complex and in need of simplification. Beyond that, tax rates are too high, depriving businesses of the capital needed to reinvest and employ. And for personal taxation, marginal tax rates are excessive, and are taking a toll on industry because of the disincentives that have become an inbuilt design feature of the tax system. The post-tax returns for greater skills and effort are not sufficiently attractive to encourage individuals to acquire those skills or add to their productive efforts.

The tax system, by its nature, discourages certain forms of activity and encourages others. Activity will flow towards areas where *after-tax* returns are the greatest, and in an important sense earning the greatest after-tax returns includes an understandable reluctance to become entangled with complex arrangements and high compliance costs. To the extent, therefore, that the Australian tax system needlessly adds to business costs or lowers profitability then to that extent Australia is penalising itself by limiting the potential for greater growth and higher living standards.

Lower taxes within a simplified tax system must be the aim. We are depriving ourselves of the momentum that a genuinely efficient tax system would give. Once the review of international taxation is complete, it will be essential to move onto the next stage and make serious headway against the difficulties that our poorly designed, overly complex and excessively onerous system of taxation now creates.

# australia-singapore free trade agreement

**t**he Australia-Singapore Free Trade Agreement (ASFTA) holds out the very real potential for improved market access for Australian exporters, and closer commercial engagement with one of the most dynamic of the Asian economies. But negotiating the ASFTA is only the first step. Realisation of the dividends of the FTA will require Australian business, especially services exporters, to look afresh at a market which has for too long been regarded as a springboard to somewhere else.

The ASFTA will play an important part in the trade and foreign policies of both countries.

For Australia, the FTA is about further enhancing our linkages with south-east Asia, and one of the most dynamic countries within that region, and will be an important mechanism for our broader policy objective of promoting trade and investment liberalisation around Asia and the Pacific.

For Singapore, the FTA is expected to reinforce its competitive advantages, most notably its key strategic location, given the island States' previous emphases on manufacturing export driven growth which are under challenge from some of its lesser developed regional neighbours.

For both countries, the FTA can act as a useful lever to advance their commitments to the multilateral trade and investment liberalisation agenda, in particular in the World Trade Organisation and its recently launched Doha Round of negotiations.

## General Benefits

The ASFTA is likely to provide a number of worthwhile specific benefits to both countries.

The Agreement will establish a more open, predictable and transparent trade and investment relationship between Australia and Singapore,

across a broad range of areas such as investment, services, competition policy, government procurement and intellectual property protection.

For Australian investors and services exporters it offers improved market access, and stronger and more transparent regulatory frameworks, while for manufactures exporters undertakings in the trade facilitation area cover technical standards, electronic commerce and simplified customs procedures.

In broader trade and foreign policy terms, the FTA will strengthen Australia's bilateral relationship with Singapore, and further embed our engagement and integration with Asia.

Australia and Singapore have a long-standing and very positive relationship, ranging across commerce and trade, education, defence and strategic issues, and tourism.

Both countries also belong to, and/or co-operate in, a range of regional initiatives whose objectives include promoting closer commercial and trade relations.

These include the Asia Pacific Economic Co-operation (APEC) grouping, the Indian Ocean Rim

Association for Regional Co-operation (IORARC), and the ASEAN Free Trade Area – Closer Economic Relations (AFTA-CER) dialogue between the 10 ASEAN countries, and Australia and New Zealand.

More particularly, the Australian and Singaporean Governments have standing inter-governmental dialogue processes, in the form of a biennial Joint Ministerial Committee, and business-to-business relations, through a dedicated bilateral business association.

## The Commercial Relationship

Singapore is Australia's largest trade and investment partner in the south-east Asian region, and our seventh largest trading partner overall (largely reflecting the island State's role in entrepot trade, rather than the size of its domestic market).

Australia's merchandise exports to Singapore last calendar year were valued at some \$A 5.4 Billion (making it our sixth largest export market overall), while our imports from Singapore were just under \$A 4 Billion (making it our eighth largest source of such imports).

Services are a key component of the bilateral trade relationship, particularly education.

Last calendar year, Singapore was the largest single source of overseas students at Australian educational institutions, providing more than 20,900 students at campuses both on- and off-shore. It was also our largest tourism market in Asia, after Japan, and our fifth largest source of short-term visitors (some 260,000 persons in 2001).

The bilateral foreign investment relationship is also strong, with the stock of Australian investment in Singapore valued at around \$A 13.9 billion, while Singaporean investment in Australia totalled around \$A 25 billion (both figures for end-June 2001).

### FTA Key Elements

The ASFTA will deliver meaningful market openings in a number of areas of importance to Australian exporters, especially those engaged in the trade in services.

For manufactures exporters, the FTA will mean the complete elimination of all tariffs and commitments from both countries not to use export subsidies, while for services exporters it means both countries will have to deliver comprehensive and transparent 'negative lists' of services sectors (those sectors which are not to be covered by the Agreement, with everything else to be included).

Amongst the biggest winners from the FTA will be Australian exporters of financial, professional and telecoms services.

Under the FTA, Singapore has undertaken to ease over time their restrictions on the number of wholesale banking licences they make available, and Australian law firms will find it easier to establish

joint ventures with their Singaporean counterparts.

Singapore has also committed to liberalising residency requirements for Australian professionals, and to further progress mutual recognition agreements on practicing rights for Australian architects and engineers.

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The FTA will also strengthen the position of Australian investors in Singapore, by providing formal protection against expropriation, while investment restrictions in Singapore's government-linked companies (an important element of its economic infrastructure and strategy) will be made more transparent.

Australian firms will get national treatment status (that is, being treated the same as local firms) in government procurement by some 47 Singaporean government agencies, and there will be stronger intellectual property protection in government tender processes.

Movement of business people will also be liberalised, with short-term entry for Australian business people extended from 1 month to 3 months, with long-term

business residents allowed to stay in Singapore for a total of 14 years and their spouses will be able to work in business administration-style jobs.

The Singaporean Government has also committed to address anti-competitive business practices, with consultation-upon-request for any such practices of concern to Australia. They will also apply competitive neutrality disciplines to government business enterprises (that is, such entities will not be allowed any net benefits by reason of their government ownership alone).

The two governments have also agreed to co-operate more closely in eliminating the trade in goods breaching intellectual property rights, and to adopt rigorous measures to prevent the export of goods that infringe copyright or trade marks.

Electronic commerce will also benefit from the FTA, with initiatives to promote the take-up of e-commerce, such as electronic signatures, committing to no customs duties on bilateral electronic transmissions, and to facilitate paperless trading especially in the form of digital trade documentation.

### Economic Impact

While a number of individual industries are likely to do well out of the ASFTA, the overall macro-economic impact of the ASFTA on Australian manufacturers is likely to be modest.

At present, around 84 per cent of our imports from Singapore enter Australia tariff free, while 15 per cent of imports are subject to a

general tariff of up to 5 per cent, with the remaining 1 per cent attracting tariffs of more than 5 per cent.

Given such a large share of Australian imports from Singapore enter this country either duty free or at nuisance tariff levels, any adjustment effects on the manufacturing sector as a whole from the FTA are likely to be miniscule.

Even in those sectors where tariffs were above 5 per cent, namely textiles, clothing and footwear, and automobiles, the impact on Australian industry is expected to be only slight, given the absence of such industries in Singapore.

Indeed, economic modelling commissioned by the Australian Government in anticipation of the FTA found the impact of tariff elimination on manufacturing was ostensibly too small to reliably estimate.

From the investment and services perspective, the ASFTA will only require modest changes to Australia's domestic arrangements, legislation and regulations.

**Last calendar year, Singapore was the largest single source of overseas students at Australian educational institutions, providing more than 20,900 students at campuses both on- and off-shore. It was also our largest tourism market in Asia, after Japan, and our fifth largest source of short-term visitors (some 260,000 persons in 2001).**

The FTA will not require any changes to Australia's foreign investment screening processes,

nor to current foreign ownership restrictions on entities such as Qantas and Telstra.

On the services front, given the already very open nature of the Australian services sector, the commitments made under the ASFTA largely mean binding (that is, undertaking not to increase) our existing limitations and restrictions.

The State and Territory Governments will also be covered by the FTA, particularly in the areas of investment and services.

While they are covered by the general national commitments made in the FTA, the State and Territory Governments will have one year after the entry-in-force (that is, before mid 2004) to advise of their reservations (elements they do not want included) to the investment and services chapters of the Agreement.

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