

Commonwealth Governments; in 1995/96, 18 full sales were made, rising to 24 in 1996/97. Privatization has tended to be concentrated in the services (including telecommunications, transport, banking and insurance services) and utilities (such as electricity, water, gas) sectors.<sup>141</sup> In services, the most significant privatization thus far has been that of the Government-owned telecommunications services provider, Telstra, the partial sale of which raised around \$A 14 billion in 1997 and 1998 (\$A 8.3 billion in the first instalment in 1997) (Chapter IV(5)(v)). The Commonwealth Government has raised approximately \$A 26 billion from privatization since 1994. Overall, according to Government estimates, reforms to the GBEs have resulted in significantly lower costs for a number of services.<sup>142</sup>

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<sup>141</sup>The concentration of privatization and other reforms in these areas are partly explained by an agreement between the State and the Commonwealth Governments ensuring that the States would receive financial assistance from the Commonwealth to implement competition policy reforms, on condition that these reforms would include electricity, gas, water and road transport (King, (1997).

<sup>142</sup>A survey of 58 Commonwealth, State and Territory GBEs showed that prices fell by around 10% during the period 1989/90 to 1995/96 (Treasury, 1997c).

#### IV. TRADE POLICIES AND PRACTICES BY SECTOR

##### (1) Overview

1. Since the 1994 Review, Australia has continued the process of gradual reductions in overall assistance, including tariffs and direct subsidies, especially to the manufacturing sector. Agriculture and mining remain liberalized, although quarantine restrictions are significant in agriculture, while overall protection has declined in the manufacturing sector. In parallel, regulatory and structural reforms implemented during the 1990s have resulted in a reallocation of resources and substantial improvements in productivity. The inclusion of all sectors (including services) as well as State and Commonwealth government business enterprises into the overall competition policy framework will introduce further competition in the economy.

2. The previous Review noted a major decline in overall assistance to the manufacturing sector. While this trend has continued, with average MFN tariffs and overall effective rates of assistance declining, the services sector has undergone the most radical change since the early 1990s. Many parts of this sector, which accounts for around 70% of Australian GDP, were essentially closed to competition until very recently; the lack of competition, in turn, has impaired the competitiveness of industries using these services as inputs. As a result of broad-ranging liberalization policies, many sectors are now open to national and foreign competition; the Government is gradually reducing its presence in the services sector by privatizing state-owned enterprises; and the extension of competition policy to this sector will ensure that government business enterprises are subject to competition rules, like their private sector counterparts.

3. Thus, for much of the period under review, attempts have been made to introduce a more level playing field for producers and exporters; regulatory impediments to competition are to be examined and changed, and new legislation concerning competition policy (Chapter III(4)(vii)) and industrial relations (Chapter 1) has been introduced. Despite the benefits of the reform programme, however, certain mature industries, notably textiles, clothing and footwear, and passenger motor vehicles, are still relatively highly protected, with tariff rates around three times the average for the sector. This relatively highly protection for these industries will be continued until 1 January 2005, and may prove to be counterproductive, in light of their relatively strong performance during the last four years when tariff barriers declined. Signs of a more active approach are apparent in the Government's new industry policy, which appears to guide investment towards certain strategic sectors and industries and to counter the otherwise neutral policy goals of the reform programme.

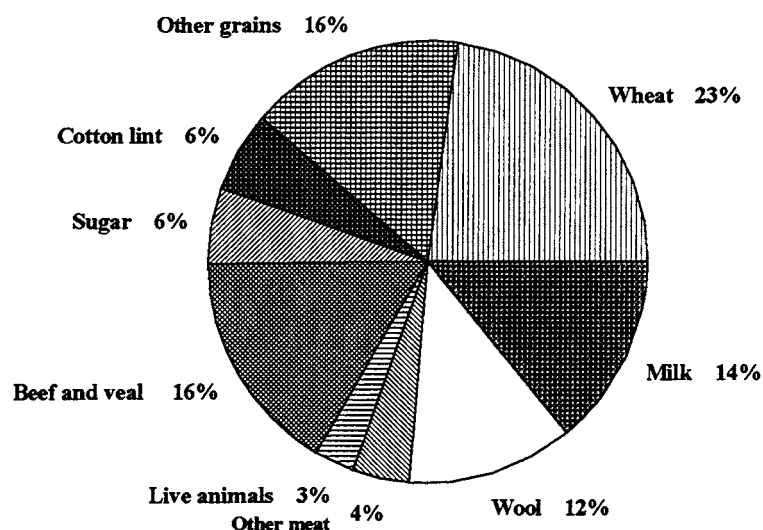
##### (2) Agriculture, Forestry and Fishing

###### (i) Overview

4. Agricultural production in Australia accounted for some 3.8% of total GDP in 1996/97. As a result of policy reforms implemented in the 1980s and early 1990s, there has been a decline in subsidies and price support programmes and a subsequent increase in average yields and productivity. There are approximately 120,000 individual enterprises currently involved in the sector and although their numbers have declined during the past decade, improved productivity has resulted in continued growth in output. The most important products include wheat (accounting for around 23% of total sectoral output), milk (14%), wool (12%), sugar and cotton (6% each). In addition, beef and veal account for around 16% of the value of agricultural production (Chart IV.1).

**Chart IV.I****Structure of agricultural production, 1996/97**

(Per cent)



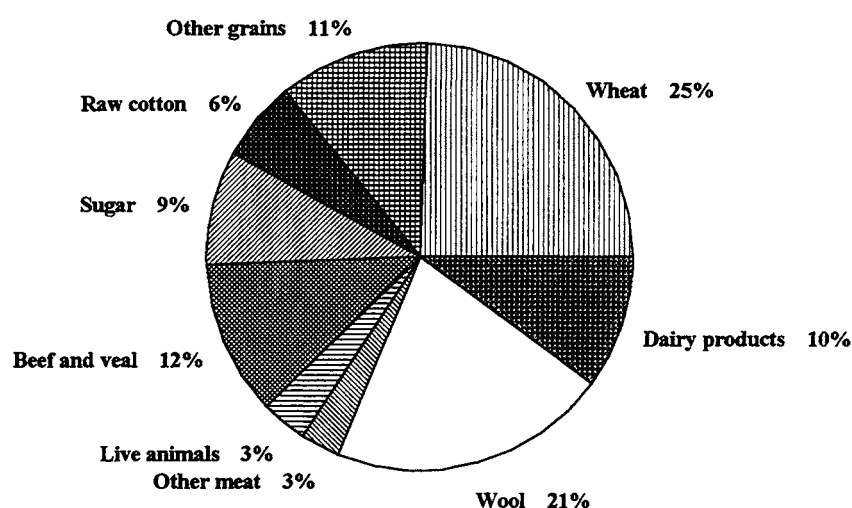
Total production: \$A20,675 million

Source: Data provided by the Australian Government.

5. Agricultural exports have increased in value from around \$A 12.6 billion in 1991/92 to approximately \$A 17.7 billion in 1996/97 (currently about 17% of total exports of goods and services) (Chart IV.2). The largest export market is Japan with a 18% share in 1996/97, followed by the United States, China and Indonesia. Imports of agricultural products were valued at \$A 5.0 billion in 1996/97.

6. Based on traditional measures of assistance such as tariff barriers, producer subsidy equivalents and effective rates of assistance, Australian agriculture is relatively unprotected. However, low tariff rates of 0.3% (ISIC 1) and low assistance rates to Australian producers do not necessarily mean that the market is relatively open to imports. The impact of Australian quarantine requirements are not included in measures of assistance (Box IV.1). It is therefore difficult to provide an accurate estimate of the real extent of import barriers in, and hence implicit support to, the Australian agricultural sector.

**Chart IV.2**  
**Structure of agricultural exports, 1996/97**  
(Per cent)



Total exports: SA17,722 million

Source: Data provided by the Australian Government.

7. Following the conclusion of the Uruguay Round, Australia is likely to make significant gains in agriculture. According to the authorities, exports by the sector face significant tariff and non-tariff barriers in major markets. The Australian Government's efforts have concentrated on reducing such barriers and improving market access for Australian exporters in the sector. Under a recent market access agreement, resulting from consultations with India in the WTO, India will remove import restrictions on 177 priority Australian products before April 2000, and an additional 208 products, including vegetables and fish products by 2002.<sup>1</sup>

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<sup>1</sup>Department of Industry, Science and Tourism (1998).

**Box IV.1: Effective rates of assistance (ERAs)**

The effective rate of assistance (ERA) as measured by the Industry Commission attempts to calculate the percentage increase in return to the value added of a particular activity, per unit of output, relative to the situation of no government assistance. The measures are production weighted, thereby allowing comparisons of the relative effects of assistance on different industries within a sector.

The estimates include assistance provided via tariffs and tariff preferences, quantitative import restrictions, local content schemes, certain export incentives and, for agricultural products, domestic pricing arrangements and income tax concessions. Certain State Government activities that have the effect of raising agricultural prices are also included in the measures. Other forms of assistance, notably assistance resulting from government procurement activities, the "factor f" scheme in pharmaceuticals and anti-dumping measures, are not included in the calculation of ERAs.

In the case of agriculture, fisheries, and food processing, quarantine measures, which are important barriers to imports, are not included in ERAs. The overall protection, as measured by the ERA, is therefore likely to be underestimated in these cases.

Source: Industry Commission (1996), Annual Report, 1995/96, Canberra.

**(ii) Assistance**

8. During the time of Australia's previous Trade Policy Review, government assistance to the agricultural sector was low compared to other OECD countries, with producer subsidy equivalents (PSEs) averaging just under 12% during the period 1979 to 1992. This average fell further to 10% in 1994 and 9% in 1996 (Table IV.1). Milk production continues to be the largest recipient of support, although PSEs in the sector declined from 40% during the previous Review to 21% in 1996.

9. Effective assistance, as measured by the Industry Commission increased slightly for the whole agricultural sector (including the dairy and livestock sectors) from 11% in 1993/94 to 12% in 1995/96, although this is not as high as the 1990/91 level of 15% (Table AIV.2). The intensive livestock sector and crops such as sugar, rice and cotton mainly account for the increase. Assistance levels are highly varied, with the most highly assisted products, as during the previous review, being milk production, especially market milk, and tobacco, although assistance to the latter is declining (product specific assistance and policies are provided in Table IV.2).

10. Total Commonwealth budgetary assistance to the sector has increased in nominal terms from an estimated \$A 1.61 billion in 1993/94 to \$A 1.95 billion budgeted for 1997/98. The increase is mainly attributable to relatively higher general levels of assistance to the sector, which is expected to account for 46.1% of overall Commonwealth assistance, compared with 42.7% in 1993/94 (Chart IV.3). However, product specific assistance as a share of the total is expected to decline slightly from 46.5% in 1993/94 to 46.2% budgeted for 1997/98.

Table IV.1  
Agricultural support in Australia, 1994-96  
(Per cent and \$A million)

	1994	1995 <sup>a</sup>	1996 <sup>b</sup>	Total 1996 (\$A million) <sup>b</sup>
	Percentage PSEs			
All products	10	9	9	1,521
Crops	7	7	7	452
Wheat	8	8	8	257
Maize	n.c.	n.c.	n.c.	n.c.
Other grains	6	5	6	65
Rice	10	6	7	17
Oilseeds	11	5	5	15
Sugar	7	9	9	98
Livestock products	11	11	10	1,069
Milk	28	24	21	587
Beef and veal	7	7	6	185
Pigmeat	7	5	5	32
Poultry	4	4	4	43
Sheepmeat	9	7	6	51
Wool	7	7	7	155
Eggs	6	8	8	15

a Provisional

b Estimate

n.c. Not calculated

Source: OECD (1997), *Agricultural policies, markets and trade*, Paris.

11. Assistance is also provided through the Rural Adjustment Scheme, the diesel fuel rebate scheme and funding for research and development, which together accounted for \$A 799 million in 1996/97. In May 1997, the Commonwealth Government announced its intention to replace the Rural Adjustment Scheme with a new programme, "Agriculture -Advancing Australia", which will help farmers with business management and provide adjustment assistance for those who wish to move into a non-agricultural sector. Another important component of general government expenditure on agriculture is AQIS' export inspection and quarantine services.<sup>2</sup>

12. In addition to assistance from the Commonwealth Government, Australian agriculture receives support from the statutory marketing authorities (Chapter III(3)(iv)(c) and section 2(iv)). Although not all the marketing authorities have sole control over the crops under their purview, their control over marketing and exports in many cases, is considerable. Marketing and pricing controls are also maintained and administered by the marketing authorities for several commodities (Table IV.2).

<sup>2</sup>Industry Commission (1997c).

Table IV.2  
Main policy changes in major agricultural products

Sector	Trade policies	Distribution and marketing	Assistance
<b>Cereals</b>			
Wheat	Single desk export monopoly by the Australian Wheat Board (AWB) to be maintained for 5 years to 2004, subject to outcome of Competition policy review in 1999/2000.	Export controls by the AWB. Around 30%-40% of domestic crop marketing by private sector. New wheat marketing policy announced in April 1997 (and reaffirmed in April 1998) includes replacement of the AWB by a grower owned and controlled company in July 1999, while retaining statutory export monopoly status. Review of export monopoly under competition policy laws expected in 1999/2000.	Assistance provided mainly through the rural adjustment scheme, tax concessions available to all primary producers, and the Government guarantee on AWB borrowings; the guarantee (reaffirmed in April 1998) will cease on 30 June 1999. Effective rates of assistance show an increase from 5% in 1993/94 to 9% in 1995/96.
<b>Other crops</b>			
Sugar	Removal of specific tariff rate of \$A 55 per tonne. MFN rate is 0% as of June 1997.  Sugar exporters were provided rebates to offset tariff component incorporated in domestic price of sugar. With the removal of the tariff, this rebate is no longer effective.	The Queensland Sugar Corporation (QSC) has single desk export monopoly; it also controls all raw sugar produced and marketed in Queensland (around 95% of the country's sugar). The QSC's export monopoly status was retained following a review in 1996 by the Sugar Industry Review Working Party.  Assignment system in Queensland, which defines area within which sugarcane can be grown. Cane grown in these areas must be delivered to designated mills.	QSC's marketing arrangements allowed domestic prices to be considerably higher than international market prices. As of 1 July 1997, raw sugar produced in Queensland is sold to domestic refiners and other users at export parity prices. Specific tariff rates until recently also provided assistance to local producers. Commonwealth and State Government assistance worth \$A 40 million made available for infrastructure development in Queensland and NSW between 1993/94 and 1998/99. Effective assistance rose from 12% to 15% between 1993/94 and 1995/96.
Tobacco	Specific rates of duty maintained before July 1995, since when applied MFN rate is 0%.  Local-leaf-content scheme which provided concessional tariff rate of imported leaf contingent on local content of at least 50% discontinued on 31 December 1994.	Administered prices for tobacco leaf based on marketing quotas for domestically produced tobacco leaves and local content plans, were abolished on 31 December 1994.	Tobacco Industry Stabilization Plan expired at the end of 1994. The industry has been deregulated.
Horticulture	MFN tariff rates range from 0% to 5% with a mixed <i>ad valorem</i> and specific duty rate for concentrated fruit juice imports.	Local-content-based sales tax differential for concentrated fruit juices, which was abolished in 1995.	Assistance provided mainly through tariffs. Adjustment assistance of \$A 8.4 million was provided over 5 years to the citrus industry in 1995 as a consequence of the abolition of the local-content-based sales tax differential for fruit juice. Average effective rates of assistance declined from 6% to 5% in 1995/96.

Table IV.2 (cont'd)

Sector	Trade policies	Distribution and marketing	Assistance
<b>Livestock</b>			
Wool		Statutory marketing body, Australian Wool Corporation replaced by the Wool Realization Commission and subsequently by Wool International which was established in 1993 to manage the sale of the wool stockpile that had developed during the late 1980s. Wool International will be disbanded in 2000 following completion of stockpile disposal. The Australian Wool Research and Promotion Organization established to undertake promotion and R & D activities formerly carried out by the Australian Wool Corporation.	Average effective rates of assistance declined from the relatively high level of 14% in 1993/94 to 6% in 1995/96 reflecting declines in temporary adjustment support provided by the Commonwealth Government.
Meat	Regulatory restrictions based on Quarantine laws. Licensing by the Australian Meat and Livestock Corporation (replaced by the Australian Quarantine Inspection Service from 1 July 1998).  Trend towards supervised industry responsibility for ensuring quality for exports. Export quota agreements with trading partners.	Promotion and some market access issues responsibility of the Australian Meat and Livestock Corporation (AMLC), the statutory body, funded by a compulsory levy on the beef, sheep and goat industries. Main role is to market Australian meat domestically and internationally and to secure market access. To be replaced by a producer-owned and funded company, Meat and Livestock Australia, responsible for marketing and R & D activities for the red meat industry from 1 July 1998. The new company will be provided policy direction by the peak industry councils. Private sector processors/retailers responsible for distribution and marketing.	Average effective rates of assistance changed from 3% to 4% for beef; 4% to 3% for sheepmeat; 4% to 5% for pigmeat; and 7% to 10% for poultry between 1993/94 and 1995/96.
Dairy	Imports of cheese restricted by means of tariff quota of \$A 96 per tonne for 11,500 tonnes above which tariff increases to the bound rate of \$A 1,294 per tonne. Imports of cheeses from New Zealand and South Pacific Forum islands enter duty free.  Exports were subsidized through a levy on milk production; rebates specifically for exports discontinued in July 1995.  Export licensing for a number of products.	Although individual dairy farms conduct their own activities and there is no organization solely responsible for selling Australian dairy produce, the Australian Dairy Corporation, a statutory marketing body, operates and administers the domestic market support (DMS) scheme.  State Government intervention in the form of regulation of supply and pricing at the farm gate; deregulation beyond the farm gate complete in all States except New South Wales and Queensland, which will deregulate in July 1998 and December 1998, respectively. Farmgate arrangements are currently under review.	High rates of assistance, especially for liquid milk (over 200% in 1996/97). Commonwealth assistance provided for producers through the DMS scheme, which is due to expire in June 2000.

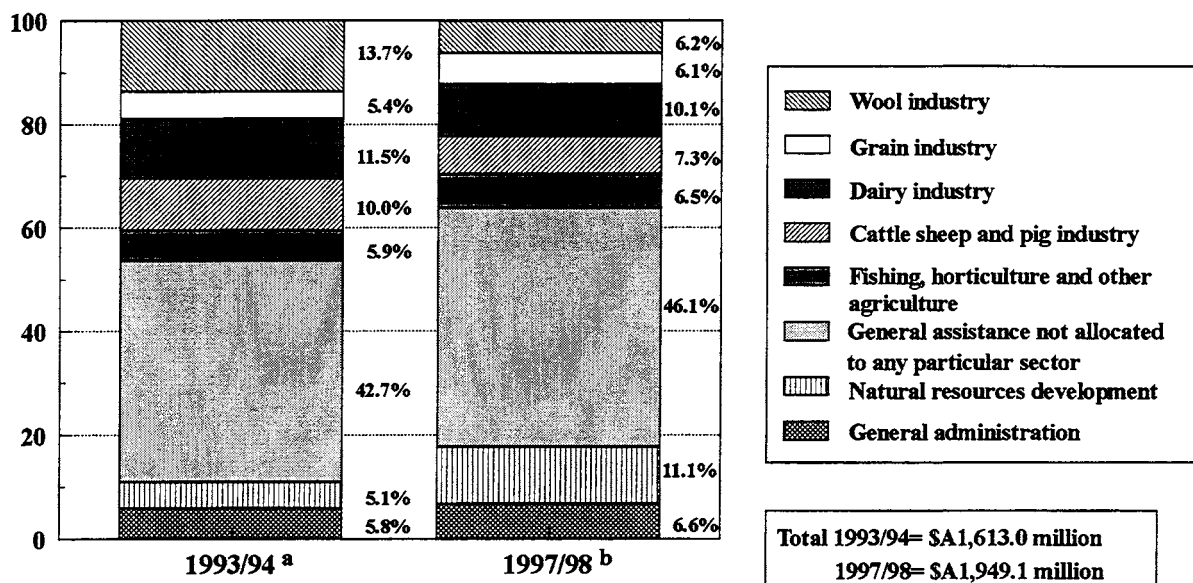
Source: Australian Government and Industry Commission (1997), *Trade and Assistance Review, 1996/97*, Canberra.



## Chart IV.3

## Commonwealth assistance to the agriculture, forestry and fishing sector, 1993/94 and 1997/98

(Per cent)



a Estimates.

b Budgeted.

Source: Government of Australia, *Budget Papers*.

13. Under the requirements of Australian competition policy, reviews of marketing and distribution arrangements for several products have been recently completed or are shortly to be carried out. The completed reviews in some cases, notably in the sugar industry, have recommended the dismantling of many of these controls and setting up supply and demand relationships based on market prices. In general, the Government has tended to follow the recommendations of these reviews and a number of changes in distribution controls and border taxes have been announced since the previous Review of Australia (Table IV.2). State and Commonwealth Governments have also agreed, under the new competition policy rules, to restructure the statutory marketing boards, including a separation of their regulatory and marketing-related functions. The Government has announced planned changes for a number of statutory marketing boards, including the Australian Wheat Board (AWB) which has an export monopoly in wheat, the Queensland Sugar Corporation (QSC), which has a monopoly over export supply of sugar, and the Australian Meat and Livestock Corporation (AMLC). Future arrangements for the boards will be considered in light of Australia's competition policy reviews on a sector-by-sector basis (Table IV.2).

14. Although tariffs and calculated effective rates of assistance are low for agriculture, Australia's quarantine laws restrict the entry of a wide range of agricultural products for health and scientific reasons. All plants, animals and associated products, including food products, are subject to quarantine restrictions. Thus, while the Australian agricultural sector is relatively unprotected in terms of border measures

and direct government assistance, the overall effect of quarantine measures in providing assistance to the agricultural sector is unclear.

(iii) WTO commitments

15. Australia's commitments under the WTO Agreement on Agriculture require it to reduce its product specific and non-product-specific domestic support if either of the two forms of support exceed 5% of total value of production of a specific product or as a whole during the base period of 1986-88.<sup>3</sup> Australia's aggregate measure of support (AMS) was estimated to be \$A 589.92 million during the base period with a commitment to reduce support to \$A 471.86 million by the year 2000. Australia has notified that its domestic support for fiscal year 1995/96 was \$A 151.717 million<sup>4</sup>, falling to \$A 144.19 million in 1996/97.<sup>5</sup>

16. Government assistance programmes for pears and dairy products were classified as export subsidies, and hence were required to be reduced under the commitment by industrialized countries to reduce export subsidies by 36% by value and 21% by volume. Australia has notified the WTO Secretariat that it did not provide export subsidies for pears in 1996<sup>6</sup>, and has not provided export subsidies for dairy products since 1 July 1995.<sup>7</sup>

(iv) Forestry and wood products

17. Australia harvests around 10 million cubic metres of pulplogs of which 60% is destined for export markets, primarily Japan, and 40% is consumed domestically, mainly in the form of paper and wood panels. The bulk of exports are made up of woodchips (46% by value in 1996/97) and packaging and industrial paper products (35% by value in 1996/97). Australia remains a net importer of forestry products, with its trade deficit in the sector valued at around \$A 1.50 billion in 1996/97; around 52% of all imports of forestry products consisted of paper, paperboard and paper products, with sawn timber making up a further 16%. Demand for Australian wood products by Japan has been declining over the last decade due to a number of factors including export licence agreements and Australia's long-term supply of woodchip.<sup>8</sup> According to the authorities, however, there have been signs of a recent recovery in demand for Australian forest and related products<sup>9</sup>; policy efforts are also being made to improve the supply of woodchips from Australia.

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<sup>3</sup>Article 6 of the Agreement on Agriculture.

<sup>4</sup>WTO document G/AG/N/AUS/7/Rev.1, 31 October 1997. The estimate excludes "Green Box" measures which include measures such as funding for R&D and drought climate research, allowed under the Agreement on Agriculture.

<sup>5</sup>WTO document G/AG/N/AUS/14, 31 October 1997.

<sup>6</sup>WTO document G/AG/N/AUS/8, 13 March 1997.

<sup>7</sup>WTO documents G/AG/N/AUS/6, 26 September 1996, and G/AG/N/AUS/10, 8 September 1997.

<sup>8</sup>Connell, Gilmour and Penm (1997).

<sup>9</sup>ABARE (1997).

18. The Government's policy on forestry products is implemented through Regional Forestry Agreements (RFAs) agreed between the Commonwealth and State Governments. The RFA process aims to develop sustainable, internationally competitive forest and wood products industries in Australia; State governments, which have constitutional responsibility over forests, will ensure sustainable forest use while the Commonwealth will ensure consistent application of the policy across the country and the removal of impediments to competitive development such as tax and export control measures. Commonwealth agencies involved in implementing the policy include the Department of Primary Industries and Energy, the Forest Taskforce of the Department of Prime Minister and Cabinet, and the Department of the Environment. In the States, implementation responsibilities lie with departments of land management and conservation, and national parks and wildlife services.

19. Commonwealth legislation imposes a levy on unprocessed wood produced in Australia and an equivalent charge on imports of unprocessed wood and certain primary, processed wood products.<sup>10</sup> The Commonwealth provides \$A 1 for every \$A 2 raised from the domestic industry, up to a maximum of 0.25% of the gross value of production of the forest and wood products industries. The legislation sets a maximum rate for a class of wood at 0.5% of its average value, to ensure that no one sector of the industry bears a significantly greater responsibility for industry contributions and that the industry overall is not levied excessively. Revenue raised is administered by the Forest and Wood Products Research and Development Corporation (FWPRDC), a statutory corporation established in 1994 under Commonwealth legislation, and is used for research and development in the industry. State and Territory Governments (except for Victoria, Tasmania and Queensland) do not recover revenues from forestry activities levied in addition to charges for access to the forestry resource.

20. Tariffs on imports are relatively low, although there is some escalation (0.5% for forestry and 4.1% for processed wood products (Table AIV.1)). Exports are constrained by a system of export restrictions on unprocessed wood and woodchips. However, as part of its efforts to increase sustainable use under the RFAs, and to ensure steady supply for its export markets, the Commonwealth has declared that it will progressively remove controls presently maintained on the export of hardwood chips sourced from native forests covered by the RFAs. Under regulations introduced in 1996, a transitional regime will apply, which places an aggregate annual export ceiling of 6.251 million tonnes, until the RFAs are finalized (31 December 1999). After that time, exports of hardwood chips will only be allowed from regions covered by the RFAs. Once an RFA is in force there will be no Commonwealth controls on exports of native woodchips and unprocessed wood from that region. For wood sourced from plantations, controls have already been lifted in Victoria, Tasmania, South Australia, Western Australia and New South Wales.

21. Support for the development of the sector is provided through a number of programmes such as the Farm Forestry Programme and Plantations for Australia: the 2020 Vision. The latter of these two programmes, which forms the Government's recent national plantation forestry strategy, was announced in 1997. It provides a framework for achieving a more commercially focused, internationally competitive plantation growing and processing industry. The strategy aims to develop a competitive forestry sector by expanding the area covered by plantations, presently around 1 million hectares, to 3 million hectares by 2020. A national plantations coordinator has been appointed to provide a national focus for achieving the strategy and will consult with key stakeholders to refine the

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<sup>10</sup>The levy applies to six classes of logs: hardwood sawlogs, softwood sawlogs, plywood and veneer logs, cypress sawlogs, wood panel pulplogs and export woodchips and hardwood pulplogs. The import charge applies to their imported equivalents.

implementation details. A plantations implementation committee, comprising Commonwealth, State and industry stakeholders has been established to oversee the work.

(v) Fisheries

22. The landed value of Australia's catch rose from \$A 1.68 billion in 1993/94 to \$A 1.76 billion in 1996/97.<sup>11</sup> Most of this output is destined for foreign markets. Australia currently exports around \$A 1.1 billion of fishery products (75% of total production in the sector), of which rock lobster and prawns are the main products, accounting for 34% of total exports in 1996/97. High value products such as abalone, prawns and lobsters make up more than 60% of output by value. The largest export market for Australia's fish exports is Japan, whose share fell from 42% in 1991/92 to 39% in 1996/97, followed by Hong Kong, China (22% in 1996/97), Chinese Taipei (20%) and the United States (5%).

23. Present government policy is based on a policy statement released in 1989 titled "New Directions for Commonwealth Fisheries Management in the 1990s". This document led to the creation of the Australian Fisheries Management Authority (AFMA) under the Fisheries Administration Act, 1991 and the Fisheries Research and Development Corporation. As with the general trend to reduce government involvement in the activities of individual producers, the new policy called for the creation of a statutory authority to manage the development of the sector independent of the government.<sup>12</sup> However, the Minister continues to oversee AFMA's activities through key accountability provisions of the Authority's governing legislation.

24. AFMA is responsible for the management of fisheries under Commonwealth jurisdiction, including within the Australian fishing zone (AFZ)<sup>13</sup> and, in some cases, by agreement with State and Territory Governments, from the low water mark. AFMA, jointly with the Queensland Fisheries Management Authority, manages Torres Strait fisheries under the Torres Strait Fisheries Act, 1984, with policy decisions being made by the Torres Strait Protected Zone Joint Authority. AFMA is partly funded by a management levy imposed on fishing operators, with approximately 54% of its total funding in 1995/96 coming from the industry (approximately \$A 9.7 billion), while the rest was provided by the Commonwealth Government.

25. The Fisheries Management Act, 1991, provides for three kinds of fishing rights: statutory fishing rights, fishing permits, and foreign fishing licences. Statutory fishing rights include units of fish quotas and other quotas that may limit, for example, the size of the boat or fishing gear. Statutory fishing rights are granted under statutory plans of management for fisheries. The quotas are freely transferable in most cases and their duration is defined by the management plan. Statutory fishing rights may be granted by auction, tender or ballot, or may be granted to persons who meet specific

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<sup>11</sup>The State of Western Australia accounts for around one third of this output.

<sup>12</sup>Other recommendations included increased involvement on the part of shareholders in the management of fisheries through management advisory committees, and the creation of a Fisheries Resources Research Fund (FRRF) to monitor the activities of the new statutory marketing body.

<sup>13</sup>In general, this covers waters between 3 and 200 nautical miles offshore; State Governments have responsibility for the management of coastal waters up to 3 nautical miles. There are several exceptions to this structure where agreements have been reached between State and Commonwealth Governments to jointly manage resources.

criteria set out in the plan of management. Fishing permits, on the other hand, do not require a plan of management, may be issued for up to five years, and may also be made freely transferable. Foreign fishing licences are issued under government-to-government arrangements between Australia and other countries to allow foreign fishing boats to fish in Australian waters.<sup>14</sup> The main reason for allowing foreign fishing boats to fish in Australian waters is to develop domestic fishing capabilities through training and the introduction of new fishing techniques and technology. If the licence is granted, foreign boats must adhere to a number of conditions, including following pre-determined shipping paths. No foreign fishing licences are currently in use.<sup>15</sup>

26. Under Australia's foreign investment policy, the fishing industry is not considered to be a sensitive industry.<sup>16</sup> Hence, a detailed government examination is only required for investment proposals in excess of \$A 50 million.<sup>17</sup> State Governments have the power to enact additional legislation regarding foreign investment in the sector; the authorities were unable to provide information on such additional legislation as this issue falls within the responsibilities of the State and Territory Governments.

27. Although Australia's tariff restrictions in the sector are low, strict application of quarantine laws restricts a number of imports. All imports must be inspected at the point of entry and must comply with the Australian Food Standards Code. Approval of the Minister is required in the case of fish landed outside the AFZ. A recently completed review of aquatic animal health and quarantine recommended a review of the structure of quarantine policies and improved infrastructure arrangements for aquatic animal health. The Government has largely adopted the recommendations, including a revised quarantine risk assessment procedure, a review of existing quarantine policies and further development of fish health infrastructure (Chapter III(4)(i)(b)).

28. As with the agricultural sector in general, Australian fish exporters face a number of tariff and non-tariff barriers in their main foreign markets<sup>18</sup>; successful negotiations were recently completed with India to eliminate import restrictions on a number of agricultural products, including fish, by the year 2002.<sup>19</sup>

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<sup>14</sup>Foreign participation in fishing in the AFZ can take place either through government-to-government contracts, in which case the contract sets out the terms and conditions for access; or in cases where foreigners are involved, in collaborative fishing projects with Australians. In addition, foreign boats chartered by Australian nationals are allowed to fish in Australian waters.

<sup>15</sup>Since 1979, Australia has had an annually negotiated bilateral fishing agreement with Japan. However, talks to renew Japan's annual quota for 1998 broke down recently, with the consequence that Japan no longer has the right to fish in the AFZ.

<sup>16</sup>ABARE (1993).

<sup>17</sup>It has been suggested that as there are very few fishing businesses with assets in excess of this amount, government approval for foreign investment in the sector will be required for a very small number of projects (ABARE, 1993).

<sup>18</sup>In most of Australia's major seafood export markets tariffs are relatively low; in some, however, tariffs range from 20 % to 60 %. Non-tariff barriers include quantitative restrictions such as quotas, non-tariff charges, subsidies, customs procedures and technical barriers to trade including SPS measures.

<sup>19</sup>Department of Industry, Science and Tourism (1998).

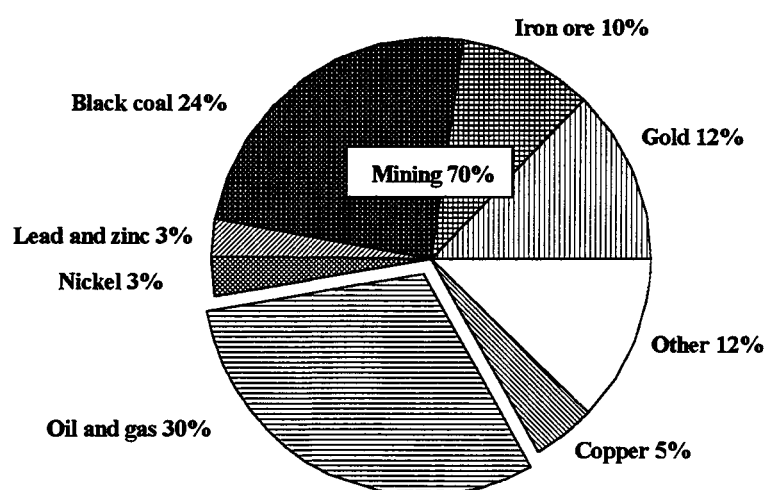
(3) Mining and Energy

29. Annual production by the mining, petroleum and gas sectors was valued at \$A 35.0 billion in 1996/97. Approximately 70% of this consists of mining, with coal (24%), gold (12%) and iron ore (10%) comprising the largest products (Chart IV.4). Australia produced around \$A 10.7 billion worth of crude petroleum in 1996/97 and is around 70% self-sufficient in liquid fuels.<sup>20</sup> The state of Western Australia, with approximately 73% of mining and energy output in 1996/97, is the largest contributor to the sector.

**Chart IV.4**

**Structure of mining production, 1996/97**

(Per cent of sectoral output)



Total production: \$A35,035 million

Source: Data provided by Australian Government.

30. The sector is the largest exporter in Australia, accounting for around 22% of exports of goods and services in 1996/97 (equivalent to around 29% of merchandise exports). Australia is presently the largest exporter of coal (32% of world trade), alumina (39%), and lead (19%); second largest for iron ore and uranium; and the third largest for gold and nickel. Its main export markets are Japan, whose share declined from 37% of total Australian mining and energy exports in 1993/94 to 28% in 1996/97, followed by the Republic of Korea (8% in 1996/97) and Chinese Taipei (5% in 1996/97).

<sup>20</sup>Department of Primary Industries and Energy (1998).

31. The resources sector is one of the most efficient and least protected in Australia. In 1998, MFN tariff rates for ferrous and non-ferrous mining averaged 0%.<sup>21</sup> In addition, there are no sector specific restrictions on foreign investment, however, proposals above \$A 50 million, must, as is the case with other sectors, be examined by the Foreign Investment Review Board (FIRB) and are subject to national interest considerations. In contrast to this relative openness, the authorities have identified a number of major markets where Australian exporters face tariff barriers and especially significant tariff escalation, for example in India, Indonesia, the Philippines, Chinese Taipei and Thailand.

32. Since the previous Review of Australia, a number of policy changes have been implemented in the mining and energy sectors, including the abolition of export controls on all minerals in March 1997 (except for uranium, whose export is still controlled due to nuclear safety considerations); abolition, in 1996, of the "3 mines" policy, which restricted uranium mining to 3 mines in Australia; introduction in December 1996, of a multiple land use policy, which allows mining exploration in protected forest areas, provided that it is compatible with environmental requirements and has the approval of the State Government concerned; establishment of the regional minerals programme, which provides \$A 1.2 million to encourage a coordinated regional approach to new mining projects and related infrastructure; retention of the Diesel Fuel Rebate for the mining industry, worth about \$A 800 million per year; and the introduction of legislation to simplify crude oil excise tax collections.<sup>22</sup> In addition, because virtually all mining takes place within the jurisdiction of the State and Territory Governments, considerable coordination between companies, State and Commonwealth Governments is required. To address this issue, a project facilitation division has been established in the Department of Primary Industries and Energy (DPIE), which will coordinate resources and energy projects and streamline the process of approval for projects in the sector. Issues concerning the mining and petroleum sector are addressed by the Australian and New Zealand Minerals and Energy Council (ANZMEC); the consultative forum, which includes representatives of the Commonwealth, State and Territory and New Zealand Governments, was set up to ensure coordination of policy, standards and regulatory requirements for the industry.

33. In parallel with the removal of remaining restrictions in the mining and petroleum sectors, related infrastructure and energy sectors have also been opened to international competition as required by Australia's new competition laws. In November 1997, the Council of Australian Governments (COAG) signed a national Natural Gas Pipelines Access Agreement, which develops uniform national arrangements on access to gas pipelines. Infrastructure reforms, including shipping and waterfront reforms would also reduce the cost of transportation and further increase the efficiency of the sector.

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<sup>21</sup>The authorities estimate that effective rates of assistance to the sector have been negative since the early 1990s and are likely to remain so until the turn of the century.

<sup>22</sup>This includes monthly collection of excise rather than three times a month; the ability to remove crude oil production regions from the excise regime when production falls below the excise liability level; and a removal of LPG excise from the excise legislation, which clarifies the excise-exempt status of this fuel.

(4) Manufacturing

34. After more than a decade of internal microeconomic and trade reforms, Australia's manufacturing sector is now benefiting from efficiency and productivity improvements.<sup>23</sup> The sector, which was traditionally the most protected, has seen border restrictions decline from an average MFN rate of 11.1% in 1993 to 6.0% in 1998. The standard deviation, which measures tariff dispersion, has also declined from around 12% in 1993 to 8.2% in 1998 (Table AIV.1).

35. While tariff reform has brought average tariffs down significantly, microeconomic reforms have tried to address problems relating to over-regulation in the economy, cooperation between State and Commonwealth Governments, flexibility and skills of the workforce which have been addressed through labour market reforms, and competition through a new competition policy agreement signed with the States in 1995.

36. As a result of the reform programme the level of overall average effective assistance to the manufacturing sector was 6% in 1996/97, declining from 11% at the time of the previous Review (Table AIV.3). However, the non-inclusion of protection extended to the food and beverages sector by quarantine laws, may underestimate overall effective assistance to the sector. The pre-programmed phase-down of assistance will ensure that the overall effective rate of assistance for the sector will decline to 5% by the year 2000; however, support for individual industries continues to vary greatly. Textiles, clothing and footwear, and passenger motor vehicles currently receive average effective rates of assistance of 25%, 52% and 28%, respectively, compared to, for example, 2% and 3%, respectively, for paper products and chemical, petroleum and coal products. Textiles, clothing and footwear, and passenger motor vehicles are thus the main areas of concern, by virtue of continuing considerably higher rates of assistance than all other industries. In particular, the tariff pause announced by the Government in 1997 for these industries, will have implications for the pace of reforms and adjustment in the sector.

(i) Food and beverages

37. The food and beverages industry remains one of the least assisted (according to tariff and effective assistance measures) and fastest growing industries in Australia, although Australia's quarantine laws effectively restrict imports of all food products. Assistance levels have been around 3% in the period under review and are scheduled to decline to 2% by the year 2000 (Table AIV.3).<sup>24</sup> The industry is also relatively open to international trade, with MFN tariffs declining from 3.3% in 1993 to 1.6% in 1998 for food products, and from 8.2% to 4.0% during the same period for beverages (Table AIV.1). Imports of some kinds of cheese are restricted by means of a tariff quota rate of \$A 96 per tonne up to 11,500 tonnes, increasing to \$A 1,294 per tonne above this amount.

38. Imports of all food products are subject to restrictions under Australia's strict quarantine laws, which are reviewed on a case-by-case and country-by-country basis, making the process of gaining access to the Australian market extremely long and uncertain. Recent decisions to lift bans on cooked

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<sup>23</sup>According to the OECD, Australia's total factor productivity in the business sector has increased from an average annual growth rate of around 0.75% (1.2% weighted average for the OECD) during the period 1970-90, to around 1.5% (0.5% weighted average for the OECD) during 1990-96 (OECD, 1997a).

<sup>24</sup>As is the case with the agricultural sector, the Industry Commission's measures of effective assistance do not include protection extended through quarantine restrictions on imports.



poultry imports from the United States, Denmark and Thailand, and of pigmeat from Canada and Denmark were based on submissions made over a decade ago (Chapter III(4)(i)(b)). Australia's quarantine regime has been criticized by its major trading partners as providing high levels of protection to industries such as food processing.<sup>25</sup> In addition to quarantine and other measures that affect the price of imports, the industry's relatively high use of anti-dumping measures may restrict competition and provide assistance for local producers, which is not reflected in the effective rates of assistance provided by the Industry Commission.<sup>26</sup> According to the authorities, anti-dumping measures are taken only in response to the dumping of products and therefore do not constitute assistance.

39. The traditional emphasis of the industry on domestic sales has also changed in recent years with significant increases in exports of processed foods and beverages (which grew by 8.6% between 1986/87 and 1996/97). Minimally processed products such as fresh, chilled and frozen beef and sheepmeat, and sugar still dominate Australian exports. However, significant contributors to the growth in exports include the dairy and wine industries, both of which have seen significant export-oriented investment. The industry's leading export markets in 1996/97 were Japan, New Zealand, the United Kingdom and the Philippines. Although the industry is expanding at a rapid rate, according to the authorities and to industry, export growth would be faster if tariff and non-tariff barriers faced by Australian exporters in their major markets were to decline.<sup>27</sup>

40. To address market access issues faced by the industry, the Government recently appointed a Processed Food and Beverages Market Access Facilitator in the Department of Foreign Affairs and Trade. The Facilitator's main task is to identify market access problems faced by companies, which can then be addressed through bilateral, regional and multilateral trade negotiations; to develop a strategy for further trade liberalization by trading partners; and to improve communication between the Government and industry on market access issues. In 1996, the Government established a Supermarkets to Asia Council, which addresses issues affecting the competitiveness of agri-food producers in Australia (e.g. by developing a Quality Food Australia programme), and export impediments (e.g. by developing a single electronic document covering both customs and quarantine); and seeks to develop an export culture (including through regional export forums). Funding of \$A 1.4 million per year has been allocated for the programme to the Department of Industry, Science and Tourism and the Department of Primary Industries and Energy.<sup>28</sup>

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<sup>25</sup>USTR (1997).

<sup>26</sup>See Industry Commission (1997c). The industry has had the fourth highest incidence of anti-dumping cases in force since 1991 (Chapter III(2)(v)(c)).

<sup>27</sup>Commonwealth of Australia (1997g).

<sup>28</sup>Other funding for the programme includes \$A 2 million per year for AQIS' Technical Market Access Programme; \$A 1 million for the Delicatessen Programme; and an average \$A 800,000 a year for Air and Sea Freight Export Councils.

(ii) Textiles, clothing and footwear

41. Value added in 1994/95 at factor cost by the textiles, clothing and footwear (TCF) industries was 4.9% of the total for the manufacturing sector; the industries employed 103,500 persons in 1997, accounting for around 1.2% of total employment (around 8.5% of employment in manufacturing).<sup>29</sup> Production is concentrated in Melbourne, Sydney and the States of New South Wales and Tasmania.

42. The TCF industries have traditionally been the recipients of high rates of government assistance. In 1987, with the implementation of the Button Plan, the Government began to gradually phase out assistance to the sector. As a result, effective rates of assistance have declined from 65% for clothing and footwear in 1993/94 (37% for textiles) to 52% in 1996/97 (25% for textiles) (Table AIV.3). These rates are expected to decline to 34% for clothing, 24% for footwear and 17% for textiles by 2000.

43. Under a previously programmed phase-out, tariff rates for these industries had, in most instances, been gradually reduced by 2-3 percentage points annually and were expected to continue to do so until 2000. The highest rate, that on clothing and finished textiles, for example, declined by 3 percentage points annually from 43% in 1994 to 31% in 1998, and this was expected to fall by a further 3 percentage points in 1999 before reaching 25% in 2000 (Table IV.3).

Table IV.3  
Tariff phase-out for textiles, clothing and footwear, 1994 to 2005

	1994	1995	1996	1997	1998	1999	2000	2002	2004	2005 <sup>a</sup>
Clothing and finished textiles	43	40	37	34	31	28	25	25	25	17.5
Cotton sheeting and fabrics	31	28	25	22	19	17	15	15	15	10
Sleeping bags, table linen	19	17	15	13	12	11	10	10	10	7.5
Carpets	27	25	23	21	19	17	15	15	15	10
Footwear	33	30	27	24	21	18	15	15	15	10
Footwear parts	27	24	20	17	14	12	10	10	10	7.5
Other (eg. yarns, leather)	15	12	10	5	5	5	5	5	5	5
General manufacturing	10	8-7	5	5	5	5	5	5	5	5

a Legislation to introduce tariff changes in 2005 to be introduced in Parliament (Press Release, September 1997; <http://www.dist.gov.au/media/>).

Source: Industry Commission (1997), The Textiles, Clothing and Footwear Industries, Vol. 1, June; and Government of Australia.

44. Despite this reduction, the average tariff rate in the sector, at 15.9% for textiles, 24.9% for clothing and 14.6% for footwear, remains considerably higher than the overall average for the manufacturing sector (6.0%) (Table AIV.1). Rates, moreover, tend to escalate, with more processed items attracting considerably higher rates of duty than raw materials or primary inputs. A number

<sup>29</sup>Industry Commission (1997d).

of by-laws which allow products such as fabrics into Australia at zero or low rates of duty<sup>30</sup>, as well as the Tariff Concession Orders (TCO) system<sup>31</sup>, cause further distortions by increasing tariff escalation in the sector. The by-law and TCO systems have also resulted in a number of anomalies, allowing the import of very similar products at diverging rates of tariff protection.<sup>32</sup>

45. In addition to tariff barriers, a number of trade-related concessions are granted to the sector. The import credit scheme (ICS), which allows exporters to earn credits on import duties, results in around \$A 110 million in duty forgone per year. Under the scheme import credits are earned as a percentage of the Australian value-added content of eligible products.<sup>33</sup> The value of the multiple declined from 0.30 in 1994 to 0.25 in 1997 and is scheduled to fall further to 0.15 in 2000. The main user of the scheme is the clothing industry, with approximately 77% of ICS credits between 1991/92 and 1995/96.<sup>34</sup> Exports to New Zealand are excluded from the scheme, although this is not the case with other preferential agreements such as SPARTECA. In addition to the ICS, the overseas assembly production (OAP) programme, which allows concessional entry of re-imported goods, was established in March 1993 and has recently been extended to 2000. The programme, which allows firms to assemble clothing overseas from fabric made in Australia and then to re-import the finished product free of duty on the Australian content<sup>35</sup>, cost around \$A 8.9 million in duty forgone in 1995/96.<sup>36</sup> Four countries, China, Philippines, Viet Nam and Indonesia have accounted for all of Australia's OAP imports since the programme was established.

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<sup>30</sup>The Industry Commission estimates that over 60% of all fabrics entered Australia duty free under the system of by-laws in 1995/96 (Industry Commission, 1997d).

<sup>31</sup>In 1995/96 around \$A 450 million of textiles, clothing and footwear products entered under the TCO system (around 10% of total imports by the sector), increasing from \$A 230 million in 1994/95 (Industry Commission, 1997d).

<sup>32</sup>For example, while leather sandals face an import duty rate of 24%, leather sandals with a strap over the big toe face zero rates of duty; similarly, while bed linen, curtains and drapes enter at 34%, table linen and blinds face an import duty rate of 13%.

<sup>33</sup>The ICS, which is scheduled to terminate on 30 June 2000, provides companies with import credits based on the value-added component of their exports. The Australian Customs Service applies a set of standard rates of value added to calculate credit entitlements; the values range from 20% (f.o.b.) of the export value for low value-added products to 90% for high value-added products. Estimates of value added are calculated with reference to actual industry performance levels based on the value added to imported products. Credits under the ICS are tradeable. Eligibility for the scheme is restricted to medium- and highly processed goods; goods in early stages of processing such as scoured wool, wool tops and "wet blue" hide exports are excluded. Eligibility is also restricted to firms that export at least \$A 100,000 worth of products over a consecutive two-year period.

<sup>34</sup>The Industry Commission also notes that because there is no specific legislation for the scheme, which is implemented through administrative guidelines published by the Customs Service, a relatively high degree of administrative discretion and a lack of extensive monitoring may exist. (Industry Commission, 1997d).

<sup>35</sup>In order to qualify for the scheme, at least 85% of the fabric used in the production of the finished garment must be made in Australia.

<sup>36</sup>To be eligible, clothing firms have to demonstrate "long term strategic significance to the local Australian TCF industries". The final decision on eligibility is made by the Minister upon recommendations by the Department of Industry, Science and Tourism, and Australian content is calculated as the sum of a number of items, including the cost of fabric produced in Australia, the cost of imported fabric up to a maximum of 15% of the Australian fabric, and the cost of transportation from Australia to the overseas factory.

46. Along with high border measures, the sector receives Commonwealth assistance through a number of other means. While the three bounty schemes in the sector, for bedsheeting, textile yarns and printed fabrics, were discontinued in 1995, assistance is currently provided primarily through the TCF 2000 Development Strategy and the Import Credit Scheme. Another programme, the Industries Development Strategy (IDS), was abolished in 1996. The TCF 2000 Development Strategy was established in 1995 and expects to spend around \$A 17.2 million by the year 2000. Total Commonwealth spending for TCF up to the year 2000 is expected to be around \$A 350 million (Table IV.4).

Table IV.4  
Commonwealth assistance to the textiles, clothing and footwear industries, 1994-98

Programme	Purpose	Value (\$A million)
Industries Development Strategy	Abolished in 1996.	0
TCF 2000 Development Strategy	To facilitate industry restructuring so as to meet the challenges of reduced barrier assistance.	17
Import Credit Scheme <sup>a</sup>	To facilitate increased internationalization of Australia's domestically orientated TCF manufacturing enterprises.	310
Overseas Assembly Provisions <sup>b</sup>	To improve the ability of local suppliers to utilize international supply networks.	25
Bounties	Abolished in 1995.	0
Total		352

a 1991/92-1995/96

b 1992/93-1995/96

Source: Government of Australia.

47. Implementation of the Button Plan has resulted in several changes in the TCF industries. As protection at the border through tariffs declined, imports grew from around \$A 3.5 billion in value in 1990/91 to almost \$A 5.3 billion by 1996/97. Adjustment by the industry to increased competition, however, resulted in exports growing at twice the import growth rate (from \$A 1.4 billion to \$A 2.7 billion) (Chart IV.5).

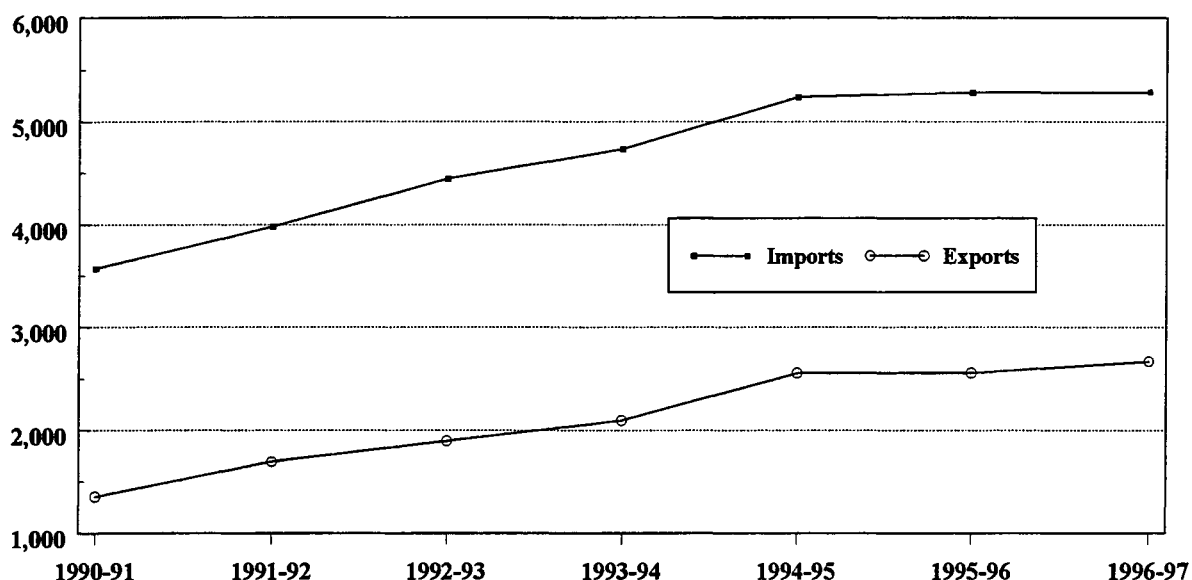
48. In general, as protection declined, labour productivity increased substantially; according to the Industry Commission, gross output per hour of labour input in the TCF industries grew by 26.4% between 1984/85 and 1994/95. However, individual industries in the TCF sector, notably leather, have demonstrated declining trends in productivity, and productivity growth in clothing and footwear was less than that of the sector overall.

49. While productivity has improved as a result of increased exposure to competition, hourly wage costs in the sector remain higher than for most textile and clothing producers in the region and also when compared to other industrialized countries, notably the United States. A combination of improved productivity rates, lower outputs, higher imports, attempts to reduce production costs, and a move to higher value-added production, has resulted in a steady decline in employment in the sector, which has fallen by about 11.5% since 1985.

### Chart IV.5

#### Exports and imports of textiles, clothing, footwear and leather, 1990-97

\$A million (current prices)



**Source:** Data provided by the Australian authorities.

50. Given the productivity gains made both by the economy as a whole and by the TCF industries as a result of reduced assistance, the Industry Commission recommended continued reduction in effective assistance to the sector, and in particular, reduction in tariffs and the removal of distortionary programmes such as the by-law and TCO systems. In September 1997, however, the Government announced that rather than continuing the progressive tariff reduction beyond the year 2000, there would be a tariff pause between 2000 and 2005 (prior to reducing rates to a maximum of 17.5%), thereby effectively increasing the adjustment time for the sector<sup>37</sup>. During the pause, by-laws and tariff concessions will continue to be granted, thereby enabling duty-free entry of a wide range of inputs.<sup>38</sup> To further facilitate restructuring, the Government announced a \$A 10 million TCF Technology Development Fund and an additional \$A 10 million to establish a national centre of excellence for TCF training. For adjustment after the pause, the Government has declared that it will introduce legislation to reduce tariffs to 17.5% from 1 January 2005 (Table IV.3); post 2005 tariff reductions will be

<sup>37</sup>The rationale used frequently for continuing protection in this industry has been the development of industry and through this the protection of jobs, an important concern in Australia especially during the current period of relatively high unemployment. However, the Industry Commission in its report on the textiles, clothing and footwear industries has documented that rising levels of assistance in the 1970s and 1980s were unable to prevent job losses, which have been occurring steadily in this sector since the late 1960s.

<sup>38</sup>The Government also announced, that while assistance would continue through the By-Law and TCO schemes, an examination to remove the anomalies in these schemes would take place.

reviewed in 2005.<sup>39</sup> Whether the tariff pause retards the adjustment process and thereby reduces the productivity gains and export growth previously achieved, remains to be seen. It also remains to be seen whether, after the pause, the Government will reduce tariff rates in 2005 to the levels originally envisaged under the phase-out. In the case of clothing and finished textiles, for example, the tariff rate was scheduled to reach 17.5%, entailing a drop of 7.5 percentage points from the rate of 25% now fixed for 2004. The tariff pause followed by such a drop is in contrast to the gradual, and arguably more predictable, reductions in tariff rates implemented since 1994.

(iii) Pharmaceuticals

51. The Australian pharmaceutical industry comprises around 120 companies, many of which are subsidiaries of multinational companies. The industry contributed around 2% of value added in the manufacturing sector and employed almost 12,000 people (around 1.3% of total employment in the manufacturing sector) in 1992/93. Sales in 1994 were around \$A 3.8 billion, of which prescription drugs accounted for around 64%. Australia exports around \$A 980 million of pharmaceutical products, its largest market being New Zealand which accounts for approximately 24% of export earnings by the sector. Other major markets include the United Kingdom (11%) and Hong Kong, China (5%). The value of imports in the sector is roughly double that of exports. The industry is relatively open to international competition, with MFN tariff rates averaging 0.1% in 1998 (Table AIV.1). Except for health and safety considerations, there are no additional border restrictions on imports.

(a) Regulation

52. Government support to the pharmaceutical sector is provided through the National Medicinal Drug Policy (NMDP) which is overseen by the Australian Pharmaceutical Advisory Council, established in 1991. The main features of the NMDP include the timely, reliable and affordable access to medicines by the community through the pharmaceutical benefits scheme (PBS); the maintenance of a viable pharmaceutical industry through the "factor f" scheme administered by the Department of Industry, Science and Tourism (DIST); and the maintenance of high quality and safety, overseen by the Pharmaceutical Health and Rational Use of Medicines Committee (PHARM) and the activities of the Therapeutic Goods Administration and the Australian Drug Evaluation Committee.

53. All therapeutic goods entering Australia must be registered or listed in the Australian Register of Therapeutic Goods (ARTG).<sup>40</sup> Manufacturers of drugs in Australia must be licensed and are subject to an examination by the TGA to ensure that appropriate safety, quality and efficacy are maintained.<sup>41</sup> In addition, wholesalers and retailers of drugs are subject to State based licensing and regulation.

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<sup>39</sup>The industries expect that Commonwealth funding during the period from 1997 to 2005 will rise by \$A 400 million as a result of this decision.

<sup>40</sup>Products are registered or listed depending upon the degree of risk they pose to consumers. High-risk products are registered after a thorough assessment by the Drug Safety and Evaluation Branch (DSB) of the Therapeutic Goods Association, whereas listed goods require less thorough screening.

<sup>41</sup>Overseas producers of drugs are required to adhere to similar or equivalent standards and must be subject to similar licensing arrangements in their country or to periodic evaluations by the TGA.

## (b) Price controls and assistance

54. The pharmaceutical benefits scheme, which controls the cost of certain drugs to consumers, was introduced in 1950 and provides universal coverage for all Australians. The PBS schedule lists all drugs for which a government subsidy is provided.<sup>42</sup> The amount of the subsidy varies with the price of the drug. Where the price is less than \$A 20, however, and the drug is dispensed to a general patient, the pharmacist can charge the patient the stated Commonwealth price. It is administered by the Commonwealth Department of Health and Family Services (DHFS). Around 55 % of all drug sales are covered under the PBS (Box IV.2).

55. Prices for the PBS are reviewed annually or on an ad hoc basis by the Pharmaceutical Benefits Pricing Authority (PBPA), which recommends prices for pharmaceutical products to the DHFS.<sup>43</sup> Prices determined by the PBPA fall into three broad categories:

- For therapeutically interchangeable pharmaceuticals, the PBPA recommends prices for the PBS based on the lowest priced brand. This minimum pricing policy is applicable currently to around 318 items (of which 202 have brand premiums) out of a total of 1,985 on the PBS.
- For around 40 % of items on the PBS, for which alternative items are available in the same chemical group, benchmark pricing is used.
- Pricing for pharmaceuticals for which there are no directly comparable products is based on the cost of production plus a margin negotiated between the pharmaceutical company and the Government.

56. The Government's concern about the rising cost of health care in Australia<sup>44</sup> has prompted a number of recent reforms such as the introduction of the minimum pricing policy, holding down of prices paid to manufacturers, and changes in the co-payments system (Box IV.2).<sup>45</sup> In addition,

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<sup>42</sup>Around 1,985 products and 550 pharmaceutical substances were listed on the PBS schedule in February 1998.

<sup>43</sup>In making its recommendations, the PBPA takes into account the PBACs comments on clinical and cost-effectiveness aspects; the prices of alternative brands of drugs; comparative prices for drugs in the same therapeutic group; cost information provided by the supplier or estimated by the PBPA; prescription volumes, economies of scale and other factors such as expiry dating, storage requirements, product stability and special manufacturing requirements; the level of activity being undertaken by the company in Australia, including new investment, production, and research and development; prices of drugs in reasonably comparable overseas countries; other relevant factors which the applicant company may wish the PBPA to consider; and other directions advised by the Minister (Industry Commission, 1996d).

<sup>44</sup>Australia spent around \$A 3.3 billion in 1992/93 on the pharmaceutical sector, which accounts for around 10 % of total health care costs. It has been estimated, that overall government outlays on health services rose from just under \$A 15 billion in 1990/91 to over \$A 20 billion by 1997/98 (Industry Commission (1996d).

<sup>45</sup>Comparisons of average prices paid to pharmaceutical companies as part of the PBA, show a steady increase from 55 % of average prices in the European Union in 1990, to 85 % and 92 %, respectively of OECD and UK prices in 1996.

a 1994 amendment to the National Health Act, 1953, allows pharmacists to substitute generic for brand drugs without reference back to the prescriber, thereby increasing access to lower priced drugs.<sup>46</sup>

57. The "factor f" scheme was introduced in 1987 to compensate firms for revenues lost as a result of price controls administered under the PBS. It was introduced mainly in response to the fear that companies would not invest and conduct R&D in Australia because of the PBS. The first phase (1987-1995) was followed by a review carried out by the Bureau of Industry Economics (BIE) to examine the effectiveness of the scheme. The BIE recommended that, *inter alia*, consideration be given to reducing the effective rate of compensation to companies; "factor f" price increases should be actual rather than nominal<sup>47</sup>, prices should be raised so that their upper limit is the average price of drugs in the European Union; and a 10% cap on annual price increases be removed. Some of the BIEs recommendations were taken into consideration in designing phase II of the scheme, including price capping according to the average price of the product in the European Union; and a removal of the price cap of 10% on annual price increases.

58. Despite the large sums of money spent on the "factor f" scheme, the Industry Commission has noted that very few companies have participated in the scheme (only 17 out of 120 companies whose products are on the PBS list), appearing to suggest that the tradeoff between higher prices in return for a commitment to increase R&D and Australian value added is not that attractive to companies.<sup>48</sup> The Commission also found that the aims of the scheme appear to reflect industry development objectives rather than a restoration of efficiency in the industry. The review was completed in September 1996. Its main recommendations included a change in the "factor f" scheme to make it more efficient and a review to reform the PBS listing process. The Government's response has been a decision not to review the PBS, but instead to establish a new programme to replace the "factor f" scheme which is due to expire in 1999 (Box IV.2).

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<sup>46</sup>Before the amendment pharmacists were required to dispense the brand name prescribed unless permission was granted by the prescriber to use a generic substitute. According to Government estimates, this policy amendment has increased the use of generic drugs from around 8.3% of all drugs prescribed in September 1994 to 10.3% in June 1995.

<sup>47</sup>The nominal price is that agreed with and paid directly to the manufacturer as a lump-sum, in contrast with the actual price listed in the schedule of benefits, which is inflated by wholesalers' and pharmacists' markup.

<sup>48</sup>One of the criticisms of the scheme in a survey of industry was that it was not an appropriate long-term measure to offset distortions caused by the PBS (Industry Commission, 1996d).



**Box IV.2: The pharmaceutical benefits and "factor f" schemes**

The PBS was established in 1950 and provides access by consumers to necessary, cost effective medicine at the lowest possible cost to the Government and consumers. The supply of prescription drugs by hospitals and pharmacies are refunded in part by the Commonwealth Government and partly through patient co-payments introduced in 1960. There are two categories of patient co-payments:

- general users, for whom co-payment increased from \$A 0.50 in 1960 to \$A 16.80 in 1995; it is now indexed to the consumer price index;
- concessional user category, introduced in 1983 for low income groups, the unemployed and health care card holders. Current payments are indexed. Pensioners, who previously paid no co-payments, joined this category in 1990.

Once the sum of co-payments in a calendar year reaches \$A 600 (\$A 140.40 for concessional payers), co-payments drop to \$A 2.60 (zero for the concessional category).

The Government, by virtue of being a monopsonist, establishes appropriate prices for products listed on the PBS. Pharmaceutical prices are negotiated with suppliers by the Pharmaceutical Benefits Pricing Authority (PBPA), which takes into account related factors such as brand prices, prescription volumes and prices in comparable countries. If suppliers cannot agree with the PBPA on the appropriate price, they have the option of pricing at the market rate although the monopsony position of the Government implies that it is not generally possible to supply PBS drugs at market rates.

A minimum pricing policy, introduced in 1990, ensures that the Government subsidizes a pharmaceutical product up to the level of the lowest priced brand. Multi-brand suppliers can set different prices for different brands provided that at least one brand is supplied at prices agreed with the PBPA.

The "factor f" scheme sets performance requirements for firms to qualify for higher notional prices. The performance requirements include increases in research and development expenditure, and domestic manufacturing and export activity in Australia. The scheme was established in 1987 to compensate for the distortions caused by the PBS.

Under the scheme, approved companies receive payments from the Government to increase returns for certain products listed on the PBS.

Under Phase I of the scheme (1987-95), the Commonwealth Government spent around \$A 158 million; payments were allocated to ten companies eligible for the scheme. Seven out of these ten were subsidiaries of multinational companies and received \$A 124 (79% of the total amount).

The second phase of the scheme was due to expire in 1999. Following a review by the Industry Commission, in 1997 the Government announced a new scheme (to be called the Pharmaceutical Industry Investment Programme (PIIP)), to follow from the factor (f) scheme. The scheme will commence in July 1999 and end in June 2004. A review of the new scheme will take place in 2003. Funding of \$A 300 million has been allocated over the five years.

Source: Industry Commission (1996), *The Pharmaceutical Industry*, Vol. 1, Report no. 51, May.

(iv) Automotive sector

59. Together with the textiles, clothing and footwear industries, the passenger motor vehicles (PMV) industry is one of the most highly assisted and protected in the economy. The industry accounted for around 7% of total manufacturing value added in 1995/96 and employed around 0.5% of Australia's total workforce (4% of total employment in manufacturing) in 1996/97. The industry comprises four assemblers of passenger motor vehicles, Ford, Holden, Mitsubishi and Toyota, all of which are foreign owned, and around 200 component suppliers. The industry is concentrated in the States of Victoria and South Australia.

60. Automotive production has grown steadily from a low of around 277,000 vehicles in 1992, when Nissan ceased producing vehicles in Australia, to around 325,000 vehicles in 1996. Australia's automotive exports have grown from just under \$A 1.5 billion in 1993 to around \$A 2.2 billion in 1996 (around 22% and 29% respectively of total sectoral output). Of this, the two major segments are components (58% by value in 1996) and completely built up (CBU) passenger motor vehicles (around 39% in 1996). The major export destinations for CBUs were New Zealand, the United States and the Middle Eastern countries. Major component export destinations were the United States, Japan, South Korea and New Zealand. Import growth has been much more rapid than export growth, rising in value from \$A 7.63 billion in 1993 to \$A 9.16 billion in 1996. Imports from Japan made up 49% of the 1996 total. The United States, Germany, the Republic of Korea and the United Kingdom are also significant sources of automotive imports, 32% of which are CBU PMVs.

61. Despite phased reductions, current tariff levels are high compared to the general manufacturing average of 6%. The maximum tariff on PMVs and original equipment (OE) is presently 20%. However, that rate is expected to gradually decline to 15% by the year 2000 and will be further reduced to 10% in 2005 (Table IV.5). In 2005 there will be a review to make the Australian position compatible with its APEC commitment of zero tariffs by 2010.<sup>49</sup> The tariff on "replacement" components for passenger motor vehicles is presently 15% and will remain at this level until the end of 2004, falling to 10% in 2005, thereby bringing it into line with the rate on PMVs and original equipment. Light commercial vehicles and their components currently face import duties of 5%. Imports of second-hand vehicles are subject to *ad valorem* tariff rates of 5% and 20%, with an additional flat rate of \$A 12,000 charged per vehicle in the case of high volume imports (over 25 cars per licensee or compliance plate holder). The additional flat rate has had a prohibitive impact on high-volume imports of second-hand vehicles.<sup>50</sup>

62. In addition to tariffs, new vehicles (including imports and domestically produced vehicles) are subject to a Commonwealth wholesale sales tax, raised from 16% to 22% in 1995.<sup>51</sup> State Governments also charge stamp duty, which varies from 2% to 4%. Commonwealth and State taxes are levied on the tariff-inclusive price of automobiles.

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<sup>49</sup>Joint statement by the Right Hon. John Howard, Prime Minister, the Hon. Peter Costello, Treasurer and the Hon. John Moore, Minister for Industry, Science and Tourism, 5 June 1997.

<sup>50</sup>Used car sales account for around 1.7% of total annual car sales in Australia, compared to around 67% in the liberalized New Zealand market (Australian Financial Review, November 17 1997). New Zealand, moreover, announced in December 1997 that it was planning to remove all tariffs on cars by the end of 2000 (Reuters Press, 18 December 1997).

<sup>51</sup>For luxury cars, a 22% tax is applied for the first \$A 36,995 of the wholesale price and 45% on the balance.

Table IV.5  
Tariff reductions for passenger motor vehicles, 1994 to 2005  
(Per cent)

	1994	1995	1996	1997	1998	1999	2000	2005
Tariff	30.0	27.5	25.0	22.5	20.0	17.5	15.0	10.0

Source: Department of Industry, Science and Tourism (1996), *State of the Australian Automotive Industry, 1995*, Canberra, July; and Joint statement by the Right Hon. John Howard, Prime Minister, The Hon. Peter Costello, Treasurer and The Hon. John Moore, Minister for Industry, Science and Tourism, 5 June 1997.

63. The sector, thus, is one of the highest recipients of assistance. In addition to high import duties on final products, manufacturers in the sector can import a number of components free of duty under the duty-free import allowance. The scheme allows passenger motor vehicle producers to import up to 15% of their PMV value of production in any calendar year duty free (Table IV.6). Duty forgone as a result of the scheme was \$A 289 million in 1993, rising to \$A 292.7 million in 1995, and falling to \$A 266.7 million in 1996.

64. Assistance is also provided through the Export Facilitation Scheme (EFS), under which manufacturers of PMVs and OE components can import some automotive products duty free. Since the scheme is linked to the level of tariffs for the industry, there has been a general decline in the level of assistance in line with the decline in tariffs. Import duty forgone under the EFS declined from \$A 275 million in 1993 to around \$A 220 million in 1997. The EFS will be replaced in 2000.

65. On 22 April 1998 a new initiative to replace the EFS was announced. The Automotive Competitiveness and Investment Scheme (ACIS) will commence on 1 January 2001 and run for five years. The scheme will provide assistance according to expenditure on new investment and technology development for component producers; and for expenditure in new investment for PMV manufacturers. It will also extend the duty-free allowance that presently applies at 15% of the value of production. The ACIS will be consistent with WTO rules.

66. Other assistance programmes from which the sector benefits include a 125% R&D tax concession generally available to Australian industry.<sup>52</sup> Effective assistance to the sector is expected to decline from 38% in 1993/94 to 19% by 2000/01 according to Industry Commission estimates. However, mainly as a result of continued high tariffs, it will remain almost four times higher than the manufacturing average (5% in 2000/01).

<sup>52</sup>Automotive imports are generally excluded under the tariff concession scheme because of the 15% duty-free entitlement. However, non-automotive imports used in the production of vehicles are eligible.

Table IV.6  
Levels of assistance in the passenger motor vehicles sector, 1993 and 1997

	1993	1997
<b>Trade measures</b>		
Tariffs	PMVs 32.5% (15.0% for LCVs). An additional \$A 12,000 per unit levied on high-volume imports of second-hand vehicles.	PMVs 22.5%. The additional \$A 12,000 per unit continues to be levied on high-volume imports of second-hand vehicles.
Duty-free import entitlement/ Minimum volume requirement	15% of production value, subject to a minimum production volume of 30,000 units per year. Below that level, eligibility falls progressively to zero (20,000 units and less). Imports from New Zealand and the South Pacific Forum island countries viewed as local content.	Unchanged
Export facilitation scheme	Duty-free import entitlement of 32.5% of the exported automotive value added. For car manufacturers, this is additional to the duty-free entitlement. Not applicable to exports to New Zealand since 1 January 1993.	Duty-free import entitlement because it is related to the tariff level, is now down to 22.5% of exported automotive value added.
<b>Internal policies</b>		
Sales tax	Base rate of 16% applying to the first \$A 32,486 of the vehicle's wholesale value. Luxury tax of 45% on the balance over this amount.	Base rate of 22% applying to the first \$A 36,995 of the vehicles's wholesale value, with a luxury tax of 45% on the balance of the wholesale value over this amount.
Labour adjustment and training	\$A 40 million adjustment support for retrenched employees over 1991-2000.	No additional funding provided.

Source: GATT (1994), Trade Policy Review of Australia, and Government of Australia.

67. In a recent report, the Industry Commission recommended a continuation of tariff reductions of 2.5% a year given that levels of 15% in 2000 may not be compatible with the APEC goal of zero tariffs by the year 2010.<sup>53</sup> Lower tariffs would also hasten the process of reform in the Australian motor vehicle industry and would reduce the gap between the performance of the Australian and international automobile industries.<sup>54</sup> The Government decided in 1997 that, instead of reducing tariffs in the gradual and predictable manner recommended by the Industry Commission, there would be a pause in tariff reductions until 1 January 2005, at which time tariffs for the sector would decline sharply from, 15% to 10%. In 2005 there will be a review to make the Australian position compatible with its APEC commitments.<sup>55</sup> With a continued commitment to maintaining other assistance programmes such as the EFS beyond 2000, it appears likely that effective assistance in the sector will remain considerably higher than the manufacturing average for several years.

<sup>53</sup>Industry Commission (1997e). The report also found that the variety of cars available to consumers increased substantially from 69 models in 1988, when import quotas were lifted, to 101 models in 1995. Tariff reform, the report argued, would provide further benefits to consumers.

<sup>54</sup>Industry Commission (1997e). The report, commissioned by the Commonwealth Government, recommends a steady reduction in tariffs until 2004, when automotive tariffs would have a general rate of 5%. Component tariffs moreover, should be reduced at a faster rate.

<sup>55</sup>Joint Statement by the Right Hon. John Howard, Prime Minister, The Hon. Peter Costello, Treasurer and the Hon. John Moore, Minister for Industry, Science and Tourism, 5 June 1997.

68. In keeping with the recent emphasis on external market access, the Government has announced an automotive trade strategy, which includes the appointment of a special automotive envoy to consult with industry and represent it in key markets; the appointment of an Automotive Sectoral Trade Negotiator in the Department of Foreign Affairs and Trade to co-ordinate and pursue bilateral, regional and multilateral access negotiations; and the creation of an Automotive Market Development Fund to finance the Automotive Market Development Programme (AMDP) which will be administered by AUSTRADE for four years. The overall administration of the automotive trade strategy will be carried out by the Department of Industry, Science and Tourism with Commonwealth funding of \$A 20 million for the whole period.<sup>56</sup>

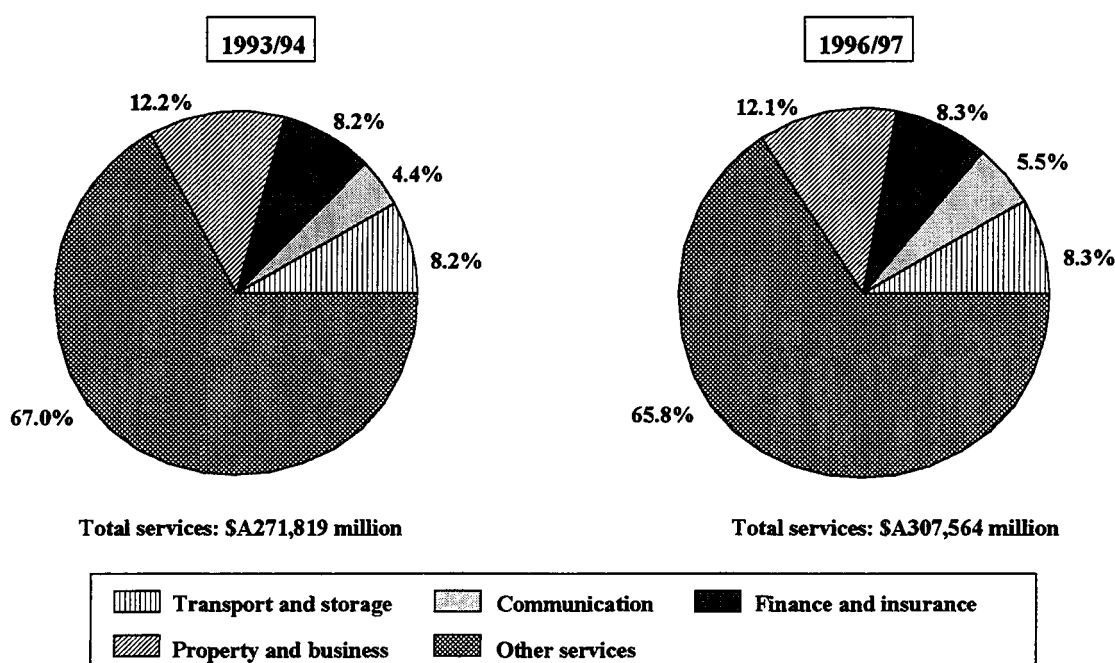
(5) Services

(i) Overview

69. The services sector dominates the Australian economy, accounting for around 70% of GDP and approximately 73 % of the total labour force (over 80 % of total employment) in 1996/97. Growth in the sector has averaged around 4 % since 1990/91. One of the fastest growing industries has been communication services, whose share in real GDP grew from around 2.5 % in 1990/91 to almost 4 % by 1996/97 (Chart IV.6). Another fast growing industry has been regular public transport civil aviation services which, in terms of passenger numbers, grew by an average annual rate of 8.6 % over 1990/91 to 1996/97.

**Chart IV.6**

**Structure of the services sector, 1993/94 and 1996/97**

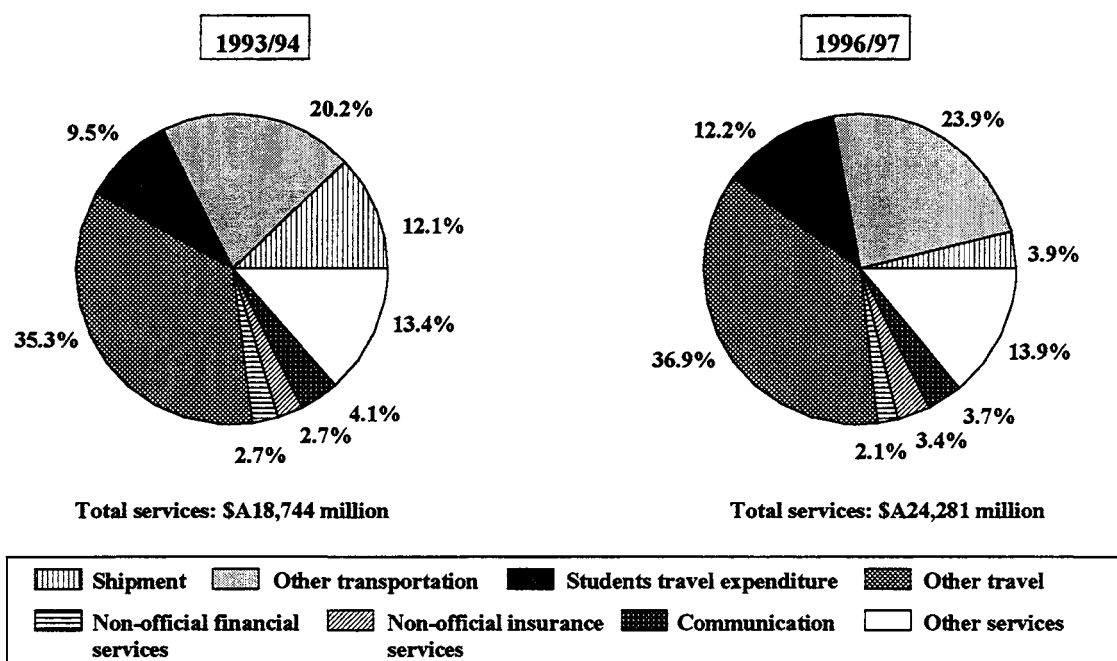


**Source:** Data provided by Australian Government.

<sup>56</sup>Commonwealth of Australia (1998a).

70. The sector is also a net exporter, contributing around 23% of Australia's exports of goods and services in 1996/97; tourism-related travel and transportation (other than shipping) formed the two largest industries in the sector (Chart IV.7). Exports from the sector have increased at a rate of around 11% since 1990/91.

**Chart IV.7**  
**Structure of services exports, 1993/94 and 1996/97**



Source: Data provided by Australian Government.

71. The role played by services as essential inputs for manufacturing and agricultural activities, has highlighted the fact that past lack of competition in the sector has impaired Australia's general economic competitiveness. Almost a third of services consumption takes place through infrastructure and intermediate use.<sup>57</sup> Thus, sectors providing vital services such as transport, telecommunications and finance have come under increasing scrutiny and substantial reform. Reforms have been implemented in all important services areas, including telecommunications, financial services, air transport and the utilities; however port and maritime services have not yet been reformed. Australia's new competition policy is applicable to activities in goods and services sectors, including government business enterprises, whose activities in services are substantial. The reforms are therefore likely to make a major contribution to the competitiveness of services in Australia.

<sup>57</sup>Industry Commission (1996a).

(ii) Commitments under the General Agreement on Trade in Services (GATS)

72. During the GATS negotiations, Australia made commitments under 90 sectors and sub-sectors.<sup>58</sup> Under its horizontal commitments, Australia restricts foreign investment, subject to national interest considerations under the Foreign Acquisitions and Takeovers Act, 1975. Limitations on national treatment with regard to commercial presence require that at least two of the directors of a public company ordinarily be resident in Australia (Table AIV.4).

73. MFN exemptions were maintained in the financial services sector until 1997. In the audio-visual services sector, Australia has made no scheduling commitments to provide improved market access or national treatment under the GATS. National treatment is granted to those works covered by these arrangements (including eligibility to apply for Commonwealth funding and satisfying the Australian content standard for commercial television standards). Constraints on the entry of foreign nationals to work in Australia, imposed by the Migration Act 1958 and the Migration Regulations 1994, do not apply to personnel entering to work on official co-productions. At present, Australia has treaty arrangements for co-production programmes with Italy, the United Kingdom, Canada and Israel; less than treaty arrangements have been signed with France and New Zealand. The intention of the programme is to foster cultural and industry development and cultural exchange through the production of film and television programmes in which creative and financial inputs are shared. Local-content and value-adding requirements, which discriminate in favour of Australian programmes, are also applicable to the broadcasting services sector (Chapter III(2)(v)(d)).

74. In the financial services sector, Australia had one MFN exemption by which it allowed foreign access to its stock exchange on a reciprocal basis, on terms and conditions considered to be reasonable and not more restrictive than those applied to the members of the Australian Stock Exchange. In its final offer during negotiations for the WTO Agreement on Financial Services in December 1997, this MFN exemption was revoked. National treatment restrictions, however, apply to Commonwealth, State and Territory guarantees for the liabilities of government-owned financial institutions.<sup>59</sup>

75. Australia also participated in WTO negotiations on a telecommunications services agreement, which came into effect in February 1998. Its final offer allowed unrestricted competition in basic telecommunications services as of July 1997; ended limits on the number of satellite service providers and primary suppliers of public mobile cellular telephony (currently set at 2 and 3, respectively) by July 1997; and lifted a previous restriction on foreign equity in the second basic service provider, Optus. Foreign equity restrictions in the partly government-owned carrier, Telstra, is restricted to 11.7%, while majority Australian ownership was required of the mobile carrier Vodafone.<sup>60</sup> Australia also committed itself to the Reference Paper on regulatory principles.

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<sup>58</sup>As defined by the United Nations' Central Product Classification.

<sup>59</sup>Under the Competitive Principles Agreement of the national competition policy, however, Commonwealth, State and Territory Governments are required to provide competitive neutrality to government business enterprises; implementation of competitive neutrality would therefore ensure that no financial service supplier enjoys any net competitive advantage due to its form of ownership.

<sup>60</sup>WTO document GATS/SC/6/Suppl.3, 11 April 1997. Rules for foreign investment in Telstra are expected to change with the full privatization of Telstra announced by the Government in March 1998. Among the changes is removal of the requirement for majority Australian ownership in Vodafone.

(iii) Agreement with New Zealand

76. The Protocol on Trade in Services, signed as part of the Australia New Zealand Closer Economic Relations Agreement in 1988, entered into force on 1 January 1989. The negative "inscription list" which was initially provided by both parties has been shortened over the years. Australia has now removed telecommunications services from the list; amendments have also been made to air services, as part of the Australia-New Zealand Single Aviation Market signed in 1996, and to postal services, reflecting liberalization of domestic and international postal services. Coastal shipping, television and broadcasting, basic health, third-party insurance and workers' compensation insurance currently remain on the Australian "inscription list". However, shipping reforms announced by the Australian Government in December 1997, aim to liberalize Australia's coastal trade.

(iv) Financial services

77. Australia's financial services sector consists of three main institutional groups: banks, non-bank financial intermediaries (NBFIs), and insurance companies and management funds. The largest of these in terms of the share of total assets, is the banking sector, which currently represents around 45% of total assets. Of the largest financial institutions in 1995/96, 12 were banks.<sup>61</sup> Since the late 1980s, the fastest growing sector has been the life offices and managed funds sector, whose expansion has come at the expense of the NBFIs (Table IV.7). The growth of the life offices and managed funds sector has been largely due to strong growth of the superannuation savings pool.<sup>62</sup>

Table IV.7  
Assets of financial institutions in Australia, 1990/91 and 1996/97  
(\$A billion)

	1990/91	1996/97
Total assets	799.2	1,239.1
Banking sector	353.7	548.9
Domestic banks	310.4	459.6
Foreign banks	43.3	89.3
Non-bank financial intermediaries	132.9	148.0
Life offices and managed funds	225.3	426.3
Life offices	92.7	145.7
Superannuation	86.0	189.4
Other financial institutions	87.3	115.9
General insurance	36.0	65.0
Securitization vehicles	8.2	20.9

a: Including two subsidiaries (ANZ Grindlays bank and Commonwealth Development bank) and a branch of Bank of New Zealand, a subsidiary of National Australia Bank.

Source: Reserve Bank of Australia Bulletin.

<sup>61</sup>Bora and Lewis (1997).

<sup>62</sup>Financial System Inquiry, 1997. Superannuation funds are expected to grow to \$A 500 billion in real terms by the year 2005.



78. Deregulation in the financial services sector has played a major part in changing its structure. Regulatory reform in the services sector largely began in the late 1970s with, *inter alia*, the removal of nearly all interest rate controls on banks' deposit-taking and lending, the removal of all maturity structure controls on banks' borrowings and liberalization, and commencing in the mid-1980s, of entry by foreign institutions into the banking sector. Many of these reforms arose out of the recommendations of the Campbell Committee of Inquiry into the Australian Financial System in 1981, which were endorsed by the Australian Financial Review Group in 1983. At the same time prudential measures were strengthened to preserve stability in the system.

79. The current regulatory structure consists of four bodies, the Australian Financial Institutions Commission (AFIC), the Insurance and Superannuation Commission (ISC), the Australian Securities Commission (ASC) and the Reserve Bank of Australia (RBA) (Box IV.3). All four are represented in the Council of Financial Supervisors, formed in 1992. The Council meets two to three times a year.<sup>63</sup> Prudential responsibilities are institutionally divided, with the RBA overseeing banks and payments settlements; the ISC for life and general insurance and superannuation; the ASC for securities exchanges, securities and futures dealers; and the State-based Financial Institutions Scheme, incorporating AFIC and associated State Supervisory Authorities (SSAs), credit unions, and business and friendly societies.

80. In September 1997, the Treasurer announced a reform package for the financial sector, based on the recommendations of the Financial System Inquiry (Wallis Report), which was launched in response to the changing structure of the financial services sector.<sup>64</sup> The new framework places regulatory authority of the sector in the hands of three institutions, defined by function rather than, as previously, by institutional coverage: the RBA, the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) (Box IV.3). The three institutions are expected to work closely and exchange information on a regular basis. The existing Council of Financial Supervisors will be replaced by a Council of Financial Regulators, enabling closer and regular interaction between the four institutions. The new regulatory system is expected to come into being at the Commonwealth level on 1 July 1998 or as soon as possible thereafter (subject to the passage of legislation). Negotiations with the States and Territories are taking place on a proposal to transfer the regulation of building societies, credit unions and friendly societies to the Commonwealth as soon as possible.

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<sup>63</sup>The main objectives of the Council are to enable exchange of information on the efficiency of the financial system, increase awareness and understanding of other parts of the financial system, identify trends and issues important to the financial system and ensure that unintended gaps and inconsistencies in regulation are removed (Financial System Inquiry, 1997).

<sup>64</sup>Treasurer (1997).

**Box IV.3: Regulatory changes in the financial sector, 1997**

The current roles of the four financial regulators is defined according to sub-sector:

- the Insurance and Superannuation Commission (ISC), which is responsible for prudential supervision of the insurance and superannuation sectors;
- the Australian Securities Commission (ASC), which provides prudential regulation for securities exchanges, securities and futures dealers;
- the Reserve Bank of Australia (RBA), which oversees banks, payments settlement and ensures overall systemic stability; and
- the State-based financial institutions scheme, which incorporates the Australian Financial Institutions Commission (AFIC) and associated State Supervisory Authorities (SSAs) for credit unions and buildings societies.

Following an inquiry in 1996/97, the Government announced a change in the regulatory structure of the financial sector in September 1997.

The previous role performed by four regulators will be replaced by three regulatory bodies, which transcend the previous sub-sectoral divisions.

**The Reserve Bank of Australia (RBA)** will continue to be responsible for monetary policy, the stability of the financial system, and regulations concerning the payments system for which a new Payments System Board (PSB) replaces the existing Australian Payments System Council (APSC).

**The Australian Prudential Regulation Authority (APRA)** will be established as a statutory body to prudentially regulate deposit-taking institutions, insurance companies and superannuation funds (other than excluded funds). Building societies, credit unions and friendly societies are also expected to be included in the Commonwealth regulatory system, subject to agreements with the States and Territories.

**The Australian Corporations and Investments Commission (ASIC)**, to be based on the existing Australian Securities Commission (ASC), will be established with comprehensive responsibilities for market integrity and consumer protection functions across the financial system. The regulator will also take over the current responsibilities of corporate regulation, securities, and futures markets of the ASC. The ASIC will also be given enforcement powers to fulfil its task.

Source: Treasurer (1997), *Reform of the Australian Financial System, Details of Measures*, Press Release No. 102, 2 September.

(a) Banking

81. There were a total of 50 banks operating around 6,121 branches and 6,992 agencies in Australia at the end of June 1997.<sup>65</sup> The assets of these banks accounted for around 45 % of total financial assets in 1997 (excluding assets held by the Reserve Bank of Australia); around 63 % are held by the four

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<sup>65</sup>Of these 50, 18 are domestic banks, 12 are subsidiaries of foreign banks and 20 are branches of foreign banks.

largest domestic banks (Table IV.7).<sup>66</sup> Of the 50 banks, over half are foreign owned, representing around 16% of total banking sector assets.

82. The Reserve Bank of Australia oversees the banking sector and the foreign exchange market, including the licensing of foreign exchange dealers. The Australian Financial Institutions Commission (AFIC), formed in 1992, oversees the regulation (including prudential supervision) of building societies, credit unions and friendly societies. At the State level, supervision according to AFIC standards is delegated to the State Supervisory Authorities (SSAs). Merchant banks and finance companies are supervised by the Australian Securities Commission (ASC). To maintain banking independence, the Banks (Shareholdings) Act 1972 places a limit of 10% on individual shareholdings; however, the Treasurer can grant shareholding limits up to 15% and the Governor-General above 15%.<sup>67</sup> As part of the financial system reforms, however, the Banks (Shareholdings) Act 1972 will be replaced with the proposed Financial Sector (Shareholdings) Bill 1998 (currently before Parliament), which subjects all prudentially regulated financial sector companies to a 15% shareholding limit by any one person or such higher percentage as the Treasurer may determine as being in the national interest.

83. The "six pillars" policy, which prohibited mergers among the four largest banks and the two largest life insurance companies, was reformed in April 1997. As of that date, the ban has been lifted, although mergers between the four banks would not be permitted immediately.<sup>68</sup>

84. Locally incorporated entities and foreign banks wishing to set up locally incorporated banking subsidiaries or branches in Australia must obtain permission from the Governor-General on recommendation of the Treasurer.<sup>69</sup> The approval is subject to prudential regulations laid down by the Reserve Bank of Australia.<sup>70</sup> Applicants must also provide information on how their contributions would enhance competition in Australia and provide economic benefits to the Australian community.<sup>71</sup> Minimum criteria that must be met before any application is considered include, *inter alia*:

- a minimum capital requirement, currently \$A 50 million, which may be changed periodically by the RBA;

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<sup>66</sup>The four largest banks are the Commonwealth Bank of Australia, ANZ Banking Group, National Australia Bank and the Westpac Banking Corporation and their main savings bank subsidiaries (Financial System Inquiry, 1997).

<sup>67</sup>Financial System Inquiry (1997).

<sup>68</sup>The Government decided that mergers between the four major banks would be reviewed when it was satisfied that competition from new and established participants in the industry, especially small business lending, had increased sufficiently.

<sup>69</sup>Because the Reserve Bank of Australia cannot exert the same degree of influence over branches as it can over locally incorporated subsidiaries, foreign bank branches must confine their deposit-taking activities to wholesale markets (i.e. amounts greater than \$A 250,000). Moreover, they are not subject to the deposition protection provisions of the Banking Act and are required to disclose this fact to all potential depositors.

<sup>70</sup>Reserve Bank of Australia.

<sup>71</sup>According to the authorities, this provision is usually satisfied by the applicant demonstrating what benefit their presence would bring (i.e. increased flow of trade in goods and services between countries).

- adherence to capital and liquidity ratios (including Prime Assets Requirement - which was recently reduced from 6 % to 3 % as part of the refocusing of the RBA's supervision of liquidity) and other prudential requirements;
- lodging non-callable deposits with the RBA (currently 1 % of liabilities), although this requirement will be abolished as part of the financial system reforms programme;
- a wide spread of shareholdings;
- demonstration of substantial shareholdings (in terms of the Banks (Shareholding) Act 1972) that are well established<sup>72</sup>;
- a firm commitment from substantial shareholders that their investment is of a long-term and sound nature<sup>73</sup>; and
- a majority of the board composed of non-executive directors<sup>74</sup>;

Foreign banks are also required to submit details of supervisory arrangements in their country of origin.

85. Regulations on foreign investment in the banking sector are contained in the Banking Act, 1959, the Banks (Shareholdings) Act 1972, and prudential requirements. Any acquisition of substantial interest (above 15 %) in an Australian institution also requires approval by the Treasurer under the Foreign Acquisitions and Takeovers Act, 1975. Foreign investment has been allowed in the banking sector since 1985 with the amendment of the Banks (Shareholdings) Act 1972, followed by further liberalization in 1992.<sup>75</sup> These reforms resulted in an increase in the number of authorized foreign banks operating in Australia from 18 in 1986 to 30 by 1996. The foreign acquisition or takeover of any of the four major banks was prohibited until April 1997. Although the Government has now removed this restriction, any proposed investment has to be reviewed by the Government, as provided for under the Government's foreign investment guidelines, and national interest provisions apply.<sup>76</sup>

86. Despite the reforms, there are indications that competition in the Australian banking sector could be improved further. Between January 1993 and March 1998, banks' interest rate spreads - the difference between the interest rate received and the interest rate paid - appears to have widened substantially.<sup>77</sup> The recently completed Financial System Inquiry made a number of recommendations to streamline the system of regulation and increase competition in the Australian financial services

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<sup>72</sup>For foreign banks this applies to the bank (or its ultimate parent) as well as to substantial shareholders in the bank (or its ultimate parent).

<sup>73</sup>Soundness in this case relates to the operational arrangements for the proposed bank, in particular with a view to ensuring satisfactory protection of depositors and compliance with prudential policies.

<sup>74</sup>Reserve Bank of Australia. For foreign banks at least two directors should be independent of management in the bank or its associates.

<sup>75</sup>In 1992 the Government removed the limitation on the number of foreign banks that could operate in Australia; allowed foreign banks to undertake wholesale banking activities through an authorized branch of a foreign bank; and removed the previous restrictions precluding foreign banks from bidding for the smaller Australian banks.

<sup>76</sup>The Government has stated that, in making assessments of foreign investment in the four largest banks, it would apply the principle that any large-scale transfer of the financial system to foreign hands would be regarded as being contrary to the national interest (Industry Commission, 1997c).

<sup>77</sup>For example, the spread between the lending rate on banks' large variable business loans and deposit rates paid on transactions and investment accounts worth \$A 10,000 and over, increased from 6.1 to 7.35 percentage points.