



Response of the Committee for Sydney to the **Financial System Inquiry**

Murray Interim Report July 2014

Submitted 1st September 2014



1. Introduction

The Committee for Sydney is an independent think tank and champion for the whole of Sydney. We take a leading role in shaping public policy and promoting initiatives to ensure a sustainable and prosperous future for the whole of Sydney, beyond the electoral cycle.

Our aim is the enhancement of the economic, social, cultural and environmental conditions that make Sydney a competitive and creative global city. Our members represent a cross section of Sydney's leading organisations across the public, private sectors and not for profit sectors including global companies, financial institutions, SMEs, strategically minded local authorities and key arts, cultural and sporting bodies. Our policy and advocacy are shaped by this diverse group of significant members: we represent no single constituency or sector.

Our focus is on improving the prosperity and liveability of Sydney for all. As the national resources boom moderates, the importance of cities as generators of wealth and productivity can only grow. At the heart of Sydney's high labour-productivity and GDP is its financial sector.

Our diverse members are keen to work with government to support the growth of Sydney's financial sector as being in the interests of the wider community and indeed the nation. Our submission is made in this spirit and to promote an ambition which we would like to see the Panel reinforce in its final report: this is that public policy fully supports Sydney's role in the national financial services sector and enables that sector to greatly increase its presence in and exports to the wider region.

Our submission thus echoes the key recommendations of the earlier *Australia as a Financial Centre (the Johnson Report)* into financial services which sought to ensure our finance system competes effectively in the provision of finance and supporting professional and business services to global enterprise and investors. The Committee submission also supports the view taken in the NSW Government submission that the Panel should specifically explore the future development of Sydney as an internationally competitive financial centre.

2. The Importance of Sydney's Financial Services

With 44% of the nation's financial services capacity here, Sydney is Australia's pre-eminent financial centre with an industry capacity in asset management, investment and project finance, and a unique lifestyle, which attract global talent. As the hub also of Australia's ICT sector it is emerging as the nation's – and potentially the region's – centre for 'FinTech'.

Sydney's success in these sectors is critical to the national economy not least because of the multiplier effects it has, there being, as the Johnson Report on financial services says, 'a well established causal link from financial sector development to economic growth'.

Because of the centrality of financial services and the need constantly to understand the basis of their current success and the preconditions for further growth, the Committee for Sydney is currently undertaking a project in collaboration with NSW Trade and Investment on 'Sydney as a Financial Services Knowledge Hub'. The project involves a review of the existing capacity of Sydney and its eco-system for key sectors in financial services – and their prospects for development. Those sectors include:

- financial technology (FinTech);
- funds management;
- infrastructure and real estate funds;
- bond finance and index based products.

This work, which involves expert input from the Committee's members and stakeholders, informs this Committee submission. The Committee will share the outputs from the various sector studies underway with the Panel in due course.

Global Sydney's talent and assets

This project follows on from a successful and continuing collaboration with the NSW Government on 'Sydney as a Global Talent Hub' which has led to greatly improved understanding of what global talent looks for in a global city and how Sydney can improve its attractions to such a key cohort. The research showed inter alia that the global financial crisis (GFC) gave Sydney a great opportunity to access new global or ex-pat Australian talent – particularly with a financial or ICT background - from countries experiencing a significant and long term downturn:

The two strands – of Sydney as a Global Talent Hub and as a Financial Services Knowledge Hub - are intimately linked and reinforce Sydney's role as Australia's global city, with a specific ability to attract global talent. Indeed, newly published work on 'The Changing Face of the Global City' identifies Sydney as now in 8th position in a league table of global cities, equal to Beijing in the region¹.

This is because of its key 'global city' assets such the importance of its financial and professional services, attraction of foreign direct investment, presence of corporate HQs, technology and media capacity, diversity, talent and air connectivity. Similarly, the 2014 Global Financial Centres Index,

¹ *Size is not the Answer – The Changing Face of the Global City, Joel Kotkin (2014)*

while noting Sydney's competitiveness challenges around taxation and infrastructure, describes Sydney as 'now an Established Transnational Centre ...on the borderline of ...Global Leadership status'².

Sydney: a key engine of national growth

Sydney is both a key engine of Australia's economic performance and Australia's global gateway for business. At the heart of this success is Sydney's financial services sector and the impact it has on professional services and the growth of the nation's ICT sector which is increasingly clustering in Sydney (see **Figures 1 and 2** below).

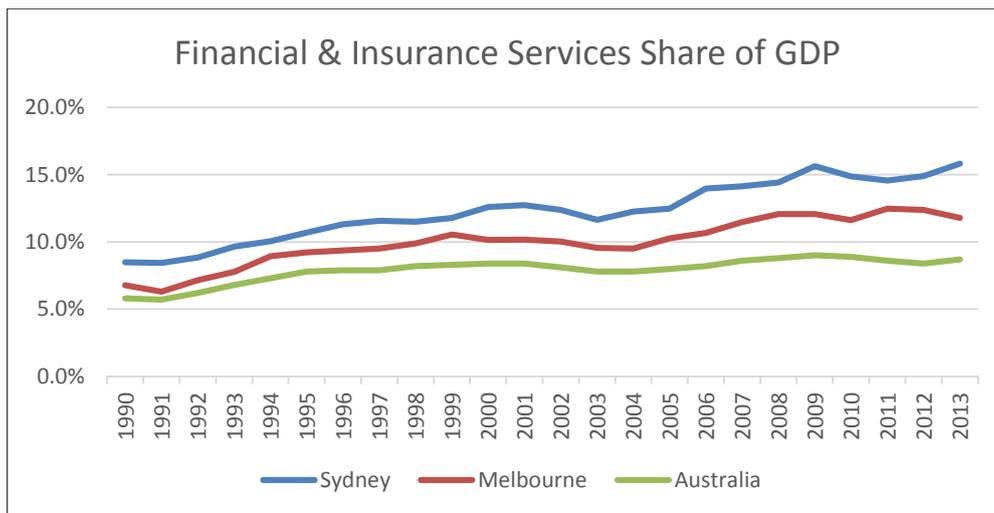


Figure 1 – Financial & Insurance services Share of GDP (courtesy of SGS Economics & Planning)

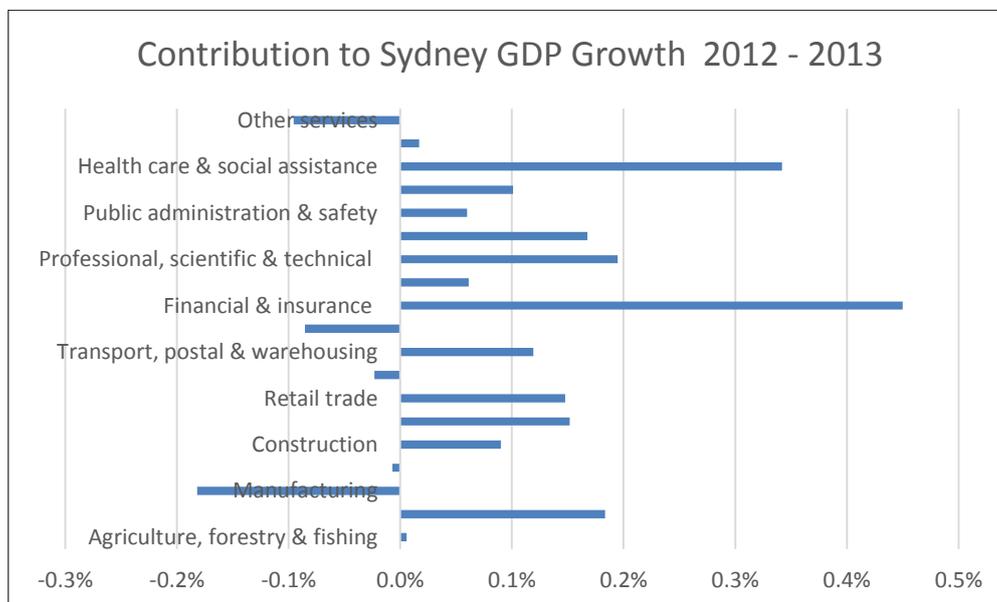


Figure 2 – Contribution to Sydney GDP Growth 2012-2013 (courtesy of SGS Economics & Planning)

² http://www.longfinance.net/images/GFCI15_15March2014.pdf

Sydney and the eco-system for its financial services matter to the nation. Greater Sydney now represents 22.1% of the Australian economy, and Sydney's CBD alone produces over 8 % of national GDP which more than matches the resources sector and exceeds it in terms of employment impact and the multiplier effect for the economy. Recent work by Enrico Moretti in the US indicates that a manufacturing or resources job leads to the creation of a further 1.5 jobs. For higher value and innovative knowledge economy jobs, the multiplier is over 4. This is the impact and importance to the economy of Sydney's financial services, especially as the national resources boom moderates.

The Committee has researched the labour productivity of Sydney in comparison with other Australian cities (see **Figure 3** below). It is significantly higher than all other capital cities at a time when Sydney's overall momentum has taken it from being Australia's worst performing capital in the first decade of the century to currently its best. At the heart of Sydney's productivity dividend for the nation are its financial services.

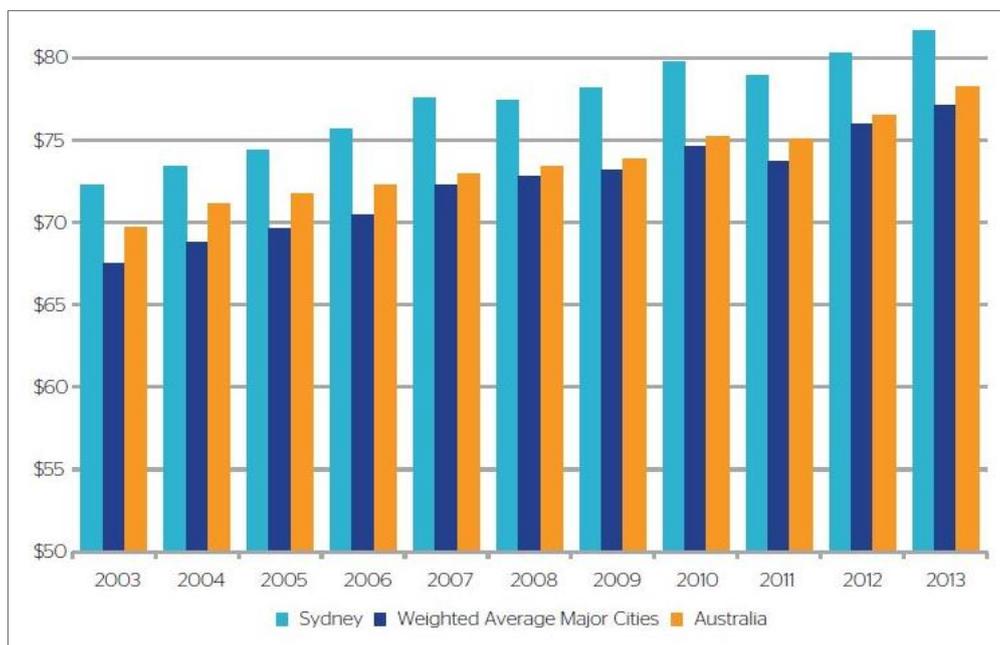


Figure 3 – Sydney's Labour Productivity³

Sydney's contribution to the Federal exchequer is consequently significant. Sydney generated \$90 billion in taxation revenue in 2011-12, 82% of which was collected by the Commonwealth, much of it used to subsidise other states.

Sydney's role as Australia's global city and the global connections and finance flows that this role brings are allowing it to tap into a global recovery while other parts of the Australia seek to manage the slow-down in mining investment and the continued reduction in large scale manufacturing. Furthermore recent research shows that Sydney's business cycle, because of its global connections, is leading to Australia's economy itself being more and more in synch with the recovering US economy (see **Figure 4** below).

³ Committee for Sydney Issues Paper 4 – Adding to the Dividend, Ending the Divide: An Update (2014)

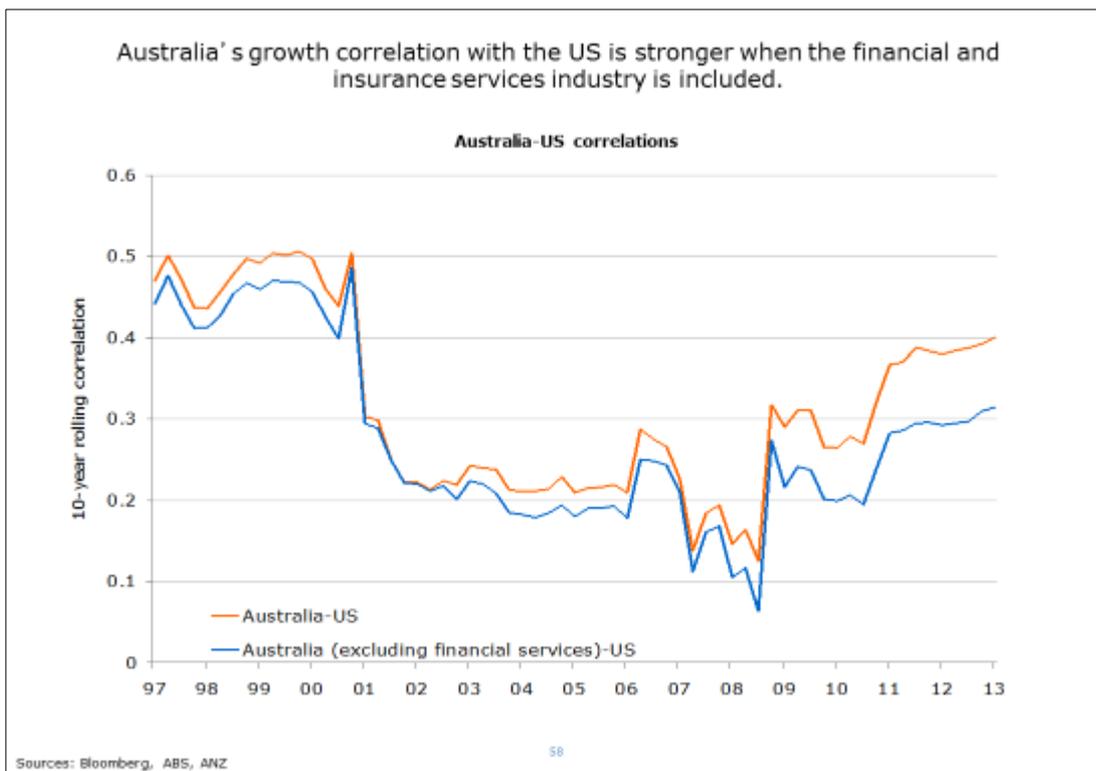


Figure 4 – Australia's Growth Correlation with the US (courtesy of ANZ)

Because of Sydney's role as an engine of national growth and its leadership in key forward looking sectors, the Committee has argued that public policy and investment need to be targeted at Sydney so that it can continue to play its essential role for the nation. Simply put, a 'Sydney First' approach results in a bigger bang for the public buck than investing in alternatives.

Sydney as the nation's financial services hub

In this context we urge the Panel to consider in your deliberations and final report Sydney's vital contribution now to Australia's financial services and national economy and what further role it can play, with the right policy settings in exporting services and expertise to the region and Asia more broadly.

We make this statement with confidence: Sydney is already punching above its weight in this crucial sector. We can be as successful internationally as we have been domestically, if we adopt the right strategy and approach, regulatory, commercially and culturally, to the opportunity presented by the continuing explosion of potential consumers of our services in the businesses and cities in our region.

Sydney in the 'Asian Century': beyond rhetoric to exploiting the shift eastward in global wealth and population

While it is conventional to talk of the 'Asian Century' and Australia's opportunity, the Committee stresses that much of the opportunity of the explosion of a middle class urban population in China – looking for a safe business environment for their savings and investment and the skills and structures required to grow their capital with confidence – can and must be grasped by Sydney's financial and business services.

The unprecedented movement of a half a billion people in Asia into the middle-class and changing economic model in China make it ever more important that Australia is competitive and relevant in key

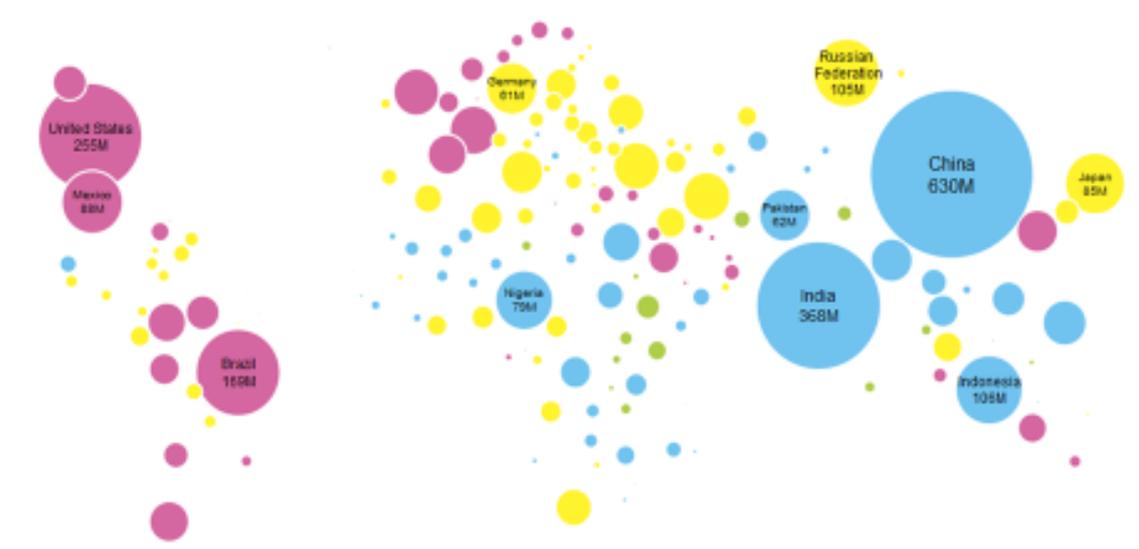
services sectors. The Financial Services sector in Sydney already represents one of the major drivers of Australia's economic and employment growth. The decisions made in the next few years will determine whether it will continue to be so and whether the potential for a much greater international contribution is realised.

While we don't underestimate the continuing challenges to develop the skills, aptitude and education to realise our opportunities in Asia, the scale of the export opportunity is significant as indicated by the following compelling charts on the long term and decisive eastward direction of travel of the world's centre of gravity for wealth (as identified by McKinsey & Company in **Figure 5** below) and the fact that by 2050 almost half the world's population will be in Asia with its dynamic and increasingly prosperous cities – and the appetite for our business services can only grow accordingly (see **Figure 6** below).



Figure 5 – Centre of Gravity of the World's Wealth (courtesy of McKinsey & Company)

2010 metropolitan population:



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2050 metropolitan population:



© The Business of Cities Ltd 2014



Figure 6 – Growth of World Metropolitan Population 2010 – 2050 (courtesy of Greg Clark, *The Business of Cities*)

3. Committee Response

The Committee welcomes the Panel's interim report. The Committee feels however that more weight should be given in the final report to:

- Enhancing the participation of Australian institutions in global markets
- Facilitating the export of financial services from Australia.
- Fostering innovation in financial services and FinTech
- Fostering the development of local talent and the attraction of global talent
- Recognising the role of Sydney as a financial services hub for Australia, promoting the ecosystem and infrastructure which underpin its success and ensuring we attract – and do not lose – global talent, whether ex-pat or international
- Adopting key outstanding recommendations of the Johnson Report

The core of our response

The core of our response is that, as Mark Johnson has noted: 'our financial sector ranks highly in international surveys...yet our exports and imports of financial services are low by international standards'. Our financial services exports are a small proportion of the entire sector compared with London, Singapore and Hong Kong. We must focus more on the export opportunity and break down any policy, tax, visa or regulatory barriers inhibiting our performance.

We must also recognise that in the current globalised economy, it is cities – not countries – that are competing with one another for scarce talent and investment in financial services. Hence the need to ensure Sydney has the tools and support it needs to flourish in this global cities competition, for the benefit of Australia.

Clearly, rapid Asian growth is real but more than the rhetoric of the 'Asian Century' will be required for Australia to take advantage, for example, of the enormous opportunity for growth in offshore sourced funds under management in Australia. We have to have the will and the means to achieve the maximum results.

That will require policy innovation and leadership that on the one hand promotes an understanding internationally of the strengths and opportunities of Australian financial services but also actively reduces barriers to foreign companies listing on the Australian stock exchange, exploiting financial opportunities in Australia or investing in agriculture, infrastructure and property.

Deepen international integration and create more globally recognised structures/instruments

The implication of the importance of Asian growth is to significantly improve and deepen the international integration of our economies and in particular our finance system, products and services. But barriers remain including the idiosyncratic structure of certain Australian regulations and financial products/trusts and critically, tax. We need fewer uniquely Australian products and more globally recognised collective instrument structures most notably a local version of the European Undertaking in Collective Investments in Transferable Securities (UCITS).

It is widely understood that such innovations have to be introduced and impediments have to be removed for Australia to fully exploit the opportunities in the region. Adopting such structures will help Australia to compete for fund related business from foreign investors and the Panel should simply and

unequivocally support this move.

Tax: a key barrier

Tax is another barrier. As one Committee member puts it : ‘our uncompetitive tax regime (in terms of foreign investment and the taxing of non-residents) is a real handbrake on truly opening up free trade and investment from the region and the Northern Hemisphere and in enabling Sydney’s managed funds to compete with Hong Kong and Singapore’.

Taxation reform is so central that though all agree that the emerging Asia Region Funds Passport is significant, it needs to be introduced in parallel with reform to tax impediments, otherwise Australian fund managers are likely to remain at a disadvantage when marketing their funds offshore.

It cannot be over-stressed that the Australian tax regime for foreign investors in Australian funds or who place their funds with Australian fund or investment managers does not compare favourably with other countries. So, offshore investors who wish to place their money with Australian investment managers risk creating a permanent establishment in Australia, with the result that the income on their investments may be taxed in Australia. Also, Australian fund managers must withhold tax on distributions payable to offshore investors in Australian funds, which is not the case were they to invest in Hong Kong or Singapore-based funds.

As investors focus on after-tax returns, the imposition (or risk of imposition) of these taxes puts Australian fund and investment managers at a competitive disadvantage. Action must be taken.

The Panel interim report has identified these (and other) tax-related impediments, but it proposes simply to refer them to the proposed tax White Paper. At the very least it would be helpful for the Financial System Inquiry to express a clear view to frame discussion and give impetus to efforts to change the system. We ask that this be done in the Panel’s final report.

Advocacy for the sector – and for Sydney

Finally, a note on advocacy for the financial sector. The Committee strongly supports Mark Johnson’s view that as there remains something of a lack of awareness and understanding in many overseas countries of the strengths of Australia’s financial sector that there need to be some key initiatives around advocacy, marketing and cross government/private sector coordination supporting financial services.

We note that in most other countries such efforts at promotion have a strong identification with their key city for financial services, with the roles played by the Greater London Mayor, the Mayor of London’s financial services district, the Minister for Trade, the Treasurer and the Prime Minister in promoting London’s financial services being exemplary.

The Johnson Report talked of the need for both national and state politicians and government agencies to promote Australia as a financial centre. It recommended greater ministerial and agency involvement and engagement in tailored financial services missions to selected economies, so as to:

- promote understanding of the emerging Australian policy changes which will help the finance sector;
- encourage more two way investment in financial services with a view to expanding economic linkages and opportunities; and
- deepen understanding of Australian regulatory and prudential policies and strengths.

We agree strongly with this approach whilst stressing the need to replicate the UK’s emphasis on London as core to Britain’s financial services offer by focusing on Sydney’s role and prospects.

We also support his initiative of creating a dedicated financial services taskforce to support implementation of reforms and advocate for further changes – and agree that this will have to have a secretariat supported by both the public and private sectors so that it is not seen as an industry lobby group.

Indeed, the Committee's involvement in the emerging project with the NSW Government on 'Sydney as a financial services knowledge hub' is an example of the kind of public-private collaboration required to promote this key sector, and share best practice across the industry. Its focus on Sydney is also indicative not of some local patriotism but of the pre-eminence of Sydney in the nation's financial services economy. Something of this kind should be supported by the Panel in its final report.

4. Conclusion

We welcome the opportunity to respond to the Panel's interim report and have drawn attention both to the importance of Sydney's financial services sector and the need to invest in its future by a variety of means including regulatory, tax and visa reforms to ensure we continue to attract global talent and investment. Also crucial is investment in Sydney's infrastructure to ensure its ecosystem for enterprises and its transport are competitive and support Sydney's high productivity sectors.

The key message of the Panel's interim report is around how the nation's existing financial system can continue to serve consumers and businesses across Australia efficiently within a regulatory framework which maintains and indeed builds on Australia's reputation for high regulatory and probity standards. We endorse its contents on these matters.

Where we would like to see more emphasis placed is on the future of financial services and the capacity to export our services and skills within regional and global markets: that is, on the challenges and opportunities in key markets and sectors and the policies, incentives and regulatory approaches required to exploit them. With the right policy setting and ambition to be a regional player, Sydney's current contribution to and dividend for the nation can only increase.

Crucial to this agenda is that the Panel use its final report to boldly advocate the key tax and regulatory changes required to make a reality of our massive potential for export of finance services and skills – and not wait for the Taxation White Paper. The need is to help shape the agenda now so that the White Paper builds on the tax reform thrust initiated by the Panel report. The opportunity should not be missed to frame the national debate now in this way.