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**Parliament of Australia
Joint Standing Committee on Foreign Affairs, Defence and Trade
Trade Sub-Committee**

Inquiry into Australia's Trade and Investment Relationship with the United Kingdom

Introduction

HSBC Australia welcomes the opportunity to provide a formal response to the Trade Sub-Committee's Inquiry. This paper explores the trade and investment landscape post-Brexit, and examines opportunities to increase bilateral investment and trade in goods and services, before presenting a list of the desirable characteristics of any potential agreement between Australia and the UK. It is intended as a high-level summary of areas of potential interest, and more detail can be provided on any of the below topics.

Founded in 1865 to finance trade between East and West, today HSBC is one of the world's largest banking and financial services organisations, serving more than 37 million customers worldwide across Commercial Banking, Global Banking and Markets, Private Banking and Retail Banking and Wealth Management. Headquartered in London, HSBC operates through an international network of around 4,000 offices in 70 countries and territories.

HSBC began operations in Australia in 1965 and was awarded a commercial banking license in 1986. Today, the Group offers an extensive range of financial services through a network of 37 branches and offices. These services include retail and commercial banking, financial planning, trade finance, treasury and financial markets, global liquidity and cash management and securities custody.

In the UK, HSBC serves approximately 17 million customers, including over 1 million businesses, and employs approximately 45,000 people. HSBC offers a complete range of personal, premier and private banking services including bank accounts and mortgages. It also provides commercial banking for small to medium businesses and a wide range of corporate and institutional banking services including advisory, financing, research and analysis, securities services, trading and sales and transaction banking.

The focus of our global strategy is to support growth in key areas of opportunity for our customers, including sustainable finance, infrastructure investment, technological innovation and the expanding middle classes. All of these trends are of particular importance in Asia, and the best possible trade and investment relationship between the UK and Australia would be one that supported economic growth in these key areas.

As the world's top trade bank¹, we offer our clients a global network covering 90 per cent of global trade and capital flows, facilitating more than USD500bn of documentary trade each year. Despite

¹ Trade and Forfeiting Review, August 2016



challenges including geopolitical uncertainty, subdued trade growth and a rise in protectionist sentiment, HSBC takes an optimistic view on the future of global trade. Trade boosts development, reduces poverty, enhances competitiveness, facilitates diversification, encourages innovation, opens up new markets, expands choice and lowers consumer prices, improves standards, broadens government procurement and strengthens ties between countries.

Australia and the UK share deep historical and cultural ties. The similarity of our legal systems and business customs make this corridor a natural choice for exploring deeper trade and investment links. Trade flows between Australia and the UK, while robust, are relatively small. A bilateral free trade agreement or other actions to reduce existing trade barriers, facilitate cross-border business and encourage convergence toward international standards or – where differences persist – mutual recognition of compatible national or regulatory standards, would be beneficial to both countries, enabling businesses to build on existing commercial relations.

1. The trade and investment landscape post-Brexit

With respect to Brexit, a key focus for HSBC is to support customers as they navigate the complexities of the economic transition. We will help them understand the impact on their business and ensure they continue to have access to the products and services they need. We will also help them explore the opportunities that Brexit may bring. Our subsidiary model and strong position as the largest European-headquartered bank will enable us to flex to serve the interests of our customers.

HSBC welcomes the recent clarification of the UK Government's position. In particular, the commitment to a phased process of implementation as being necessary for economic and financial stability. HSBC will look carefully at further details as they emerge.

HSBC acknowledges the UK Government's commitment to a comprehensive trade deal in goods and services with the EU as the foundation for its future growth. The UK has also confirmed its intention to pursue trade deals with other nations around the world. The UK's trade agenda following its exit from the EU will include establishing the UK as an independent member of the WTO, preferential accords with the EU and the EU's existing preferential trade partners, and establishing FTAs with new partners, including Australia.

According to HSBC's most recent Trade Forecast², the outcome of the EU referendum in the UK has dented the confidence of UK exporters and could dampen growth prospects in the next few years, particularly in terms of investment into the UK. In the long-term, however, the UK could benefit from greater non-EU trade, as it looks to reduce barriers bilaterally with trading nations beyond the EU such as Australia.

Negotiation of new trade and investment agreements can open the UK market to increased competition from abroad, while enabling the UK to capitalise internationally on its own strengths in areas such as services.

HSBC believes the UK, as an enthusiastic advocate for free trade and a service-driven economy that is now seeking to redefine its role in the global trading system, can work with like-minded countries including Australia as a leading voice for market openness, collaboration and trade facilitation.

² HSBC Trade Forecast (Dec 2016): Australia Trade Report



2. Bilateral investment now and opportunities in the future

The historic relationship between Britain and Australia is today reflected most strongly in terms of investment flows between the two countries. The UK remains the second biggest foreign investor in Australia, with a total stock of nearly A\$500bn³, and it is the largest foreign investor in agricultural land in Australia⁴. Similarly, as at the end of 2015, total Australian investment in the UK was A\$353.2bn, making the UK Australia's second most important foreign investment destination⁵.

Some of Australia's largest companies, in sectors as diverse as mining, industrial services and media, proudly retain a strong Anglo-Australian identity. According to the Department of Foreign Affairs and Trade, approximately a third of all international businesses using Australia for regional headquarter operations are European, of which almost half are British.

Investment in the UK

Approximately 1,500 Australian companies are active in the UK, many using the country as a base for Europe. We believe the UK will continue to be an attractive destination for Australian investment and will continue to hold many advantages as a location for European regional headquarters, even after Brexit takes effect. London will remain a global financial centre and will continue to be an attractive base for Australian companies for reasons including language, time zone, legal and education systems.

There is further potential for increased investment by Australian companies as the UK Government intensifies its focus and creates opportunities in areas including infrastructure, the green economy and regional development, including the Northern Powerhouse and Midlands Engine. This investment, and closer collaboration between British and Australian companies, can then facilitate partnerships elsewhere – as set out below in the section covering trade in services.

Accessing the Asian growth story

One significant opportunity that Australia can offer the UK is the potential for British investors to invest in Australia as a way of capturing growth in Asia. Australia's participation in the Regional Comprehensive Economic Partnership (RCEP) places it strategically in the emerging Asian regional trade architecture, just as agreements such as TTIP and TPP in certain other regions appear to be stalling.

UK businesses can take advantage of Australia's familiar legal, business and social systems to establish offices from which they can tap into China and ASEAN consumer markets. Even in advance of the RCEP accord, there are opportunities available via the three North Asian FTAs that Australia has signed with China, Japan and South Korea.

Second, British investors whose policies restrict them from investing in non-OECD countries across Asia can access Asian growth indirectly by investing in Australian assets with a high degree of exposure to Asian trade, for example ports and airports, agricultural producers, tourism providers and commodities firms.

As previously mentioned, the UK is already the second largest source of foreign direct investment (FDI) in Australia, and further incentives such as corporate tax changes could make the country even more attractive as a destination for foreign investment.

³ ABS catalogue 5352.0 (May 2016)

⁴ Australian Tax Office, Farm Register (Sep 2016)

⁵ Australian Department of Foreign Affairs and Trade, United Kingdom country brief



3. Bilateral goods trade now and opportunities in the future

Australia's current goods trade relationship with the UK is limited, with geographic distance and the close proximity of larger trade partners remaining the biggest obstacles. The distance between the two countries is one of the few aspects of the trading relationship that will not be affected by Brexit, although the value of proximity may change if tariffs or other barriers are erected between the UK and the rest of Europe.

The UK is Australia's eighth largest export partner for merchandise, with gold, lead, alcohol and pearls and gems comprising the four largest export categories. Conversely, Australia is only the UK's 20th largest export destination for goods, largely based on motor vehicles, medicaments, alcohol and printed matter⁶.

We see considerable opportunities for growth in goods trade between the two markets. For example, the UK's exit from the EU may open new agricultural export opportunities for Australian suppliers.⁷ For British exporters, there could be the potential for Australia to become a stronger part of the UK's route into Asia.

Agriculture

According to DFAT, Australia is already the top supplier of wine sold in the UK, accounting for one in five imported bottles of wine consumed in the country despite EU suppliers benefiting from easier market access and no tariffs.

The UK produces just 54 per cent of the food it consumes, with the EU currently supplying 27 per cent and Australasia around one per cent⁸. The possibility of a level playing field, or even advantageous terms, could allow Australia to extend its leadership in wine and broaden this out to other segments which would complement existing British production in areas including beef and other meats, grains, fruit and vegetables, dairy and high-end consumables.

Integration within global supply chains

The nature of trade and investment flows around the world has become increasingly complex and interconnected, shaped more by international production networks than by country lines. Today, running international production lines is cheaper, faster and generally safer than ever before, leading to sprawling supply chains. At the same time, in some cases, this has gone hand-in-hand with increased localisation and customisation of some aspects of production, a trend we expect to continue.⁹

Such developments provide multiple opportunities for Australian and UK firms to benefit, whether they are central to a supply chain or provide more peripheral or niche products or services. Complex supply chains increasingly include a combination of goods and services, with intermediate inputs that often cross borders multiple times.

Reductions in trade barriers can result in greater clearance speed, increased efficiency and reduced cost. Trade liberalisation permits high-productivity firms to enter new export markets and thrive. This in turn fuels further productivity-enhancing investment, benefitting the larger economy.¹⁰

⁶ Australian Department of Foreign Affairs and Trade, UK Fact Sheet (Dec 2016)

⁷ HSBC, Brexit and agro-food trade: Who will reap the UK trade harvest?, 13 March 2017

⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/526395/foodpocketbook-2015update-26may16.pdf

⁹ HSBC (2015), *Trade Winds*, https://globalconnections.hsbc.com/grid/uploads/trade_wind_tait.pdf.

¹⁰ Melitz, M. and S. Redding (2015), Heterogeneous firms and trade, *Handbook of International Economics*.



By way of example, Australia's logistics industry could benefit from increased exposure to the UK. The Australian Logistic Council estimates that the logistics industry accounts for 8.6 per cent of Australian GDP¹¹, when supply chains supporting other sectors are taken into account. New trends including 3D printing, automation and wireless sensor tags are disrupting transport and logistics industries around the world, and Australian innovators in this field stand to benefit from exporting their expertise and innovation to other markets.

Trade liberalisation efforts can be further reinforced and complemented by steps toward harmonisation or mutual recognition of standards and by establishment of on-going consultations between the UK and Australia on regulatory developments bilaterally and in the context of the multilateral trading system. Such systems could help to enable greater innovation and bilateral trade, including as part of supply chains that stretch far beyond the two countries.

4. Bilateral services trade now and opportunities in the future

The services export relationship between the two countries is stronger than that for goods, and could have the most potential for future growth. The UK is Australia's third largest export market for services, while Australia ranks tenth for UK services exports, with much of the bilateral trade in services focused on travel and tourism, business services and financial services.

The services sector is a major part of both the Australian and British economies, contributing 70 per cent and nearly 80 per cent to each country's GDP, respectively. Services also play an increasingly important role in both countries' exports, both in their own right and also through value-add within traded goods (for example, shipping and logistical services, legal services and financial services). Services trade is an important component of economic growth, as it has proven less sensitive than manufacturing to the economic cycle.

Services exports between Australia and the UK could benefit considerably from trade liberalisation, as implied barriers to trade are two to three times higher for services than for goods¹².

Education and research

Education has become an important export sector for both countries. While attracting international students from the UK to Australia and vice versa could be a source of growth, regions including Asia and the Middle-East will likely boost growth in the sector more broadly. Beyond attracting international students, there is room for deeper collaboration between Australia and the UK in areas of expertise including genetics, biotechnology and alternative energy. Following departure from the European Union, research institutions and funders in the UK will have greater freedom to seek out partners worldwide, and it is clear that Australia has many natural advantages in this area.

Australia could look to attract more British investment to better commercialise its public sector research. Taking the health sector as an example, Australia is well regarded for leading-edge medical research, producing world leaders such as Ramsay, Sonic Healthcare and Cochlear. However Australia's small domestic population and limited local funding for research and development hamper its ability to commercialise these ideas. According to a recent PwC study, greater commercialisation of public-sector medical research could add A\$1 billion to the Australian economy.

¹¹ Australian Logistics Council & ACIL Allen Consulting (2014): 'The Economic Significance of the Australian Logistics Industry'

¹² Miroudot, Sauvage and Shepherd (2013): 'Measuring the cost of international trade in services', World Trade Review



Tourism

According to the OECD, the travel industry contributes to over half of Australia's services exports to the UK and 30 per cent of the UK's services exports to Australia. Qantas Airlines will shortly commence the first ever direct commercial service between Australia (Perth) and the UK. Stronger trade and investment ties could be expected to have positive follow-on benefits in increasing tourism between the two countries.

Financial services and business services

The UK's strength is driven in large part by financial services and business services. Opportunities and challenges to be addressed by financial services are increasingly international in nature, from investment in infrastructure to responses to climate change. Collaboration, both between the public and private sectors and across borders, will be vital to mobilising the enormous amounts of finance required. The power of financial, legal and business services expertise is multiplied by the clustering of firms that can be found in the UK – as in Australia. To make the most of this combined financial and human capital requires the greatest possible degree of regulatory convergence.

This is another area where a formal, bilateral free trade agreement is not the only way to increase trade and investment: greater standardisation or mutual recognition of equivalence in regulation and consultation on future regulatory developments also have a role to play. For both the UK and Australia, any free trade agreement that did not contain specific provisions for financial services would seem to be missing a major opportunity.

Role of technology and innovation

The services sector is one of those where the geographic distance between the UK and Australia is more easily bridged through technology and innovation. The internet of things and free movement of data will underpin trade in the twenty-first century, and technology will be particularly relevant to the growth of trade in services and the reconfiguration of global supply chains.

The move towards 'paperless trade' will make trade easier, cheaper and safer. Technology is changing business models. And the emergence of agile micro-multinationals is testament to how technology has given smaller and medium-sized firms the ability to enter new markets and connect to new customers without needing the scale of larger multinationals.

If digitisation is the great enabler of global trade, then common standards will be the great enabler of digitisation. Countries such as the UK and Australia, with a notably open and liberal attitude towards business and regulation, should promote appropriate conditions for doing business in the evolving trade environment.

The UK and Australia both place highly in the World Bank Doing Business rankings, but in both cases there are areas for improvement (e.g., concerning trade-related compliance costs).¹³ As noted above, this also means turning attention toward greater mutual regulatory coherence and transparency, along with enabling support for businesses.

Maximising opportunities directly in Asia

As well as bilateral investment within the Service sector, there is the potential for British and Australian firms to work together to maximise opportunities directly in Asia. To take one major example, China's Belt and Road Initiative is an ambitious, multi-faceted, multi-decade strategy aimed at boosting the flow of trade, capital and services between China and more than 60 other countries to

¹³ See the World Bank's Doing Business trade indicators here:
<http://www.doingbusiness.org/data/exploretopics/trading-across-borders> .



its West and South. Attracting the right international expertise and investment will be critical for the success of the Belt and Road Initiative, as delivering projects that offer long-term value for partners will require that they meet global standards for governance, planning and execution.

This is where UK and Australian firms can make a real difference. Engineering firms, designers, construction companies, law firms, financial services companies and others offer a broad range of world-class expertise. Many British and Australian firms in these areas benefit from decades of experience in international and cross-border infrastructure projects. These firms, often working together, can advise on what is required to make a specific project – whether it is a road in Malaysia, an airport in India or a railway in Central Asia – investable, deliverable, legal and sustainable.

5. Desirable characteristics of a UK-Australia agreement

As noted above, a bilateral free trade agreement between Australia and the UK is one option to encourage greater bilateral trade and investment, especially when complemented by supportive action in other areas such as regulation.

Set out below are a number of characteristics that would be welcome in any agreement between the two countries¹⁴:

- **Non-tariff barriers:** Provisions for improved transparency in requirements, alignment with international standards, and consultation or coordination in establishing new regulations. The Australia-New Zealand FTA, which covers business law coordination, mutual recognition of goods and occupations classification, and food standards, could provide a good basis.
- **Trade facilitation:** Reducing the complexity and cost of trade processes at the border, aided by the WTO's Trade Facilitation Agreement which came into force this year.
- **Trade in services:** Trade liberalisation for services exports has lagged that of goods. There is potential to open up sectors to ensure there is no discrimination against foreign partner firms, and also address temporary movement of service providers, for example by examining controls over movement of people between the two countries. This also includes provisions to ensure appropriate protection for intellectual property rights (trade of which is considered services trade).
- **Government procurement:** Liberalisation of government procurement in the UK and Australia could represent a significant opportunity. Accords could offer 'national treatment' for foreign firms in specified areas, complementing efforts by the WTO under the Agreement on Government Procurement.
- **Trade-related investment:** An investment chapter could go beyond WTO provisions to improve access to markets or investors protection in the event a party does not meet its commitment (investor state dispute settlement).
- **Special provisions for SMEs:** Assisting small to medium-sized enterprises to negotiate trade between the two markets, for example by providing easy online access to relevant information and contact points.
- **Labour rights and social concerns:** Aiming to ensure respect for internationally-recognised international labour standards, gender challenges and other concerns.
- **Environmental protection:** Levelling the playing field so that businesses in both the UK and Australia do not gain unfair advantage through abuse of the environment. An example from the now-suspended Trans-Pacific Partnership agreement included commitments for each country to enforce its environmental laws and abide by international commitments.
- **Specific sectors:** Addressing the challenges faced in specific sectors, where liberalisation is complex or difficult. Sectors requiring attention could include electronics, financial services, telecommunications and others. This could also include digital trade or e-commerce, where issues such as data localisation and privacy requirements could be addressed.

¹⁴ HSBC (6 May 2017) Trading Up: Moving ahead via regional and bilateral trade accords



Conclusion

In both Australia and the UK, HSBC is partnering with Government departments such as Austrade and the UK Department for International Trade and bodies such as the Export Council of Australia and the Australia-British Chamber of Commerce. In doing so, we work to deepen the business community's understanding of international markets and to connect our customers to opportunities around the world, as well as to present to Government the issues faced by our customers.

We would be very pleased to discuss any of the points raised above in greater detail in order to maximise the benefits for business and the economy of future Government-to-Government trade and investment discussions.

HSBC Australia