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Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Budget Estimates)

THURSDAY, 3 JUNE 2010

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BY AUTHORITY OF THE SENATE

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SENATE ECONOMICS
LEGISLATION COMMITTEE
Thursday, 3 June 2010

Members: Senator Hurley (*Chair*), Senator Eggleston (*Deputy Chair*), Senators Cameron, Joyce, Pratt and Xenophon

Participating members: Senators Abetz, Adams, Back, Barnett, Bernardi, Bilyk, Birmingham, Mark Bishop, Boswell, Boyce, Brandis, Bob Brown, Carol Brown, Bushby, Cash, Colbeck, Jacinta Collins, Coonan, Cormann, Crossin, Farrell, Feeney, Ferguson, Fielding, Fierravanti-Wells, Fifield, Fisher, Forshaw, Furner, Hanson-Young, Heffernan, Humphries, Hutchins, Johnston, Kroger, Ludlam, Lundy, Ian Macdonald, McEwen, McGauran, McLucas, Marshall, Mason, Milne, Minchin, Moore, Nash, O'Brien, Parry, Payne, Polley, Ronaldson, Ryan, Scullion, Siewert, Sterle, Troeth, Trood, Williams and Wortley

Senators in attendance: Senators Abetz, Bushby, Cameron, Eggleston, Heffernan, Humphries, Hurley, Joyce, Parry, Pratt, Sterle and Xenophon

Committee met at 9.02 am

TREASURY PORTFOLIO

Consideration resumed from 2 June 2010

In Attendance

Senator Sherry, Assistant Treasurer

Executive

Dr Ken Henry, Secretary

Outcome 1—Sound Macroeconomic Environment

Output Group 1.1 Macroeconomic Group

Dr David Gruen, Executive Director

Mr Tony McDonald, General Manager, Macroeconomic Policy Division

Dr Steve Morling, General Manager, Domestic Economy Division

Mr Adam McKissack, Principal Adviser, Forecasting, Domestic Economy Division

Mr Paul Flanagan, General Manager, International Finance Division

Mr Mike Kooymans, Senior Adviser, International Finance Division

Mr Bill Brummitt, General Manager, International and G20 Division

Mr Liangyue Cao, Senior Adviser, Macroeconomic Modelling Division

Outcome 2—Effective Government Spending Arrangements

Output Group 2.1 Fiscal Group

Mr Nigel Ray, Executive Director

Ms Peta Furnell, General Manager, Social Policy Division

Mr Peter Robinson, Principal Adviser, Social Policy Division

Mr Chris Foster, Principal Adviser, Social Policy Division

Mr Damien White, Manager, Social Policy Division

Mr Steve French, General Manager, Industry, Environment and Defence Division
Mr Russ Campbell, Principal Adviser, Industry, Environment and Defence Division
Ms Natalie Horvat, Manager, Industry, Environment and Defence Division
Ms Jan Harris, General Manager, Budget Policy Division
Ms Luise McCulloch, Principal Adviser, Budget Policy Division
Mr Jason Allford, Principal Adviser, Budget Policy Division
Ms Sue Vroombout, General Manager, Commonwealth-State Relations Division

Outcome 3—Effective taxation and retirement income arrangements

Output Group 3.1 Revenue Group

Mr David Parker, Executive Director
Mr Mike Rawstron, General Manager, International Tax and Treaties Division
Mr William Potts, Manager, International Tax and Treaties Division
Mr Greg Wood, Manager, International Tax and Treaties Division
Ms Brenda Berkeley, Secretary, Board of Taxation and General Manager, Indirect Tax Division
Ms Maryanne Mrakovcic, General Manager, Tax Analysis Division
Mr Phil Gallagher, Manager, Tax Analysis Division
Mr Colin Brown, Manager, Tax Analysis Division
Mr John Clark, Manager, Tax Analysis Division
Mr Anthony King, Tax Analysis Division
Mr Marty Robinson, Manager, Tax Analysis Division
Mr Paul McCullough, General Manager, Business Tax Division
Mr Michael Willcock, General Manager, Personal and Retirement Income Division
Mr Tony Coles, Manager, Personal and Retirement Income Division
Mr Trevor Thomas, Principal Adviser, Personal and Retirement Income Division
Mr Nigel Murray, Manager, Personal and Retirement Income Division
Ms Christine Barron, General Manager, Tax System Division
Mr Jason McDonald, Principal Adviser, Tax System Division
Ms Mary Balzary, Principal Communications Adviser, Tax System Division
Mr Brant Pridmore, Manager, Tax System Division

Outcome 4—Well Functioning Markets

Output Group 4.1 Markets Group

Mr Jim Murphy, Executive Director
Mr Richard Murray, Executive Director, Policy Coordination and Governance
Mr Geoff Miller, General Manager, Corporations and Financial Services Division
Ms Vicki Wilkinson, Principal Adviser, Corporations and Financial Services Division
Mr Mark Sewell, Manager, Corporations and Financial Services Division
Mr Daniel McAuliffe, Acting Manager, Corporations and Financial Services Division
Ms Marian Kljakovic, Manager, Corporations and Financial Services Division
Ms Alix Gallo, Manager, Corporations and Financial Services Division
Mr Timothy Beale, Manager, Corporations and Financial Services Division
Dr Richard Sandlant, Manager, Financial Services Taskforce
Ms Lorraine Allen, Senior Adviser, Australian Financial Centre Forum
Mr Patrick Colmer, General Manager, Foreign Investment and Trade Policy Division

Mr John Lonsdale, General Manager, Financial System Division
Ms Jacky Rowbotham, Manager, Financial System Division
Mr Justin Douglas, Manager, Financial System Division
Mr Roger Brake, Manager, Financial System Division
Dr Steven Kennedy, General Manager, Infrastructure, Competition and Consumer Division
Mr Brad Archer, Principal Adviser, Infrastructure, Infrastructure, Competition and Consumer Division
Mr Bruce Paine, Principal Adviser, Competition Infrastructure, Competition and Consumer Division
Mr Andrew Deitz, Manager, Infrastructure, Competition and Consumer Division
Mr Paul McBride, Principal Adviser, Cities and Housing, Infrastructure, Competition and Consumer Division
Mr Simon Writer, Manager, Infrastructure, Competition and Consumer Division
Mr Paul Madden, Program Director, Standard Business Reporting Management Group
Mr Greg Divall, Program Manager, Standard Business Reporting Management Group
Mr Peter Martin, General Manager, Australian Government Actuary

Australian Bureau of Statistics

Mr Brian Pink, Australian Statistician
Mr Trevor Sutton, Deputy Australian Statistician, Social Statistics Group
Ms Gillian Nicoll, Assistant Statistician, Office of the Statistician
Mr Paul Lowe, Assistant Statistician, Population Census Branch
Mr Michael Belcher, Chief Financial Officer
Mr Denis Farrell, Deputy Australian Statistician, Population, Labour, Industry and Environment Statistics Group
Mr Ian Ewing, Deputy Australian Statistician, Macroeconomics and Integration Division
Ms Sue Phillips, Acting Assistant Statistician, Corporate Services Division
Mr Peter Harper, Chief Operating Officer
Mr Vince Lazzaro, Assistant Statistician, Human Resources Branch
Mr Garth Bode, First Assistant Statistician, Social Statistics Group

Australian Competition and Consumer Commission

Mr Graeme Samuel AO, Chairman
Mr Brian Cassidy, Chief Executive Officer
Mr Marcus Bezzi, Executive General Manager, Enforcement and Compliance Division
Mr Tim Grimwade, Executive General Manager, Mergers and Acquisitions Group
Mr Mark Pearson, Executive General Manager, Regulatory Affairs Division
Mr Jo Schumann, Executive General Manager, Corporate Division
Ms Michelle Groves, Chief Executive Officer, Australian Energy Regulator
Mr Scott Gregson, Group General Manager, Enforcement Operations
Mr Nigel Ridgway, Group General Manager, Compliance, Research, Outreach and Product Safety
Mr Adrian Brocklehurst, Chief Finance Officer
Mr Richard Chadwick, General Manager, Adjudication Branch
Ms Gail Neumann, Acting General Manager, People Services and Management Branch

Mr Sebastian Roberts, General Manager, Water Branch

Mr Sean Riordan, General Manager, NBN Engagement and Industry Compliance Branch

Australian Office of Financial Management

Mr Neil Hyden, Chief Executive Officer

Mr Michael Bath, Director, Financial Risk

Mr Gerald Dodgson, Head of Treasury Services

Mr Andrew Johnson, Head of Compliance and Reporting

Mr Pat Raccosta, Chief Finance Officer

Australian Prudential Regulation Authority

Dr John Laker, Chairman

Mr John Trowbridge, Member

Mr Keith Chapman, Executive General Manager

Mr Senthamangalam Venkatramani, General Manager

Australian Taxation Office

Mr Michael D'Ascenzo, Commissioner of Taxation

Mr David Butler, Second Commissioner

Mr Bruce Quigley, Second Commissioner

Ms Jennie Granger, Second Commissioner

Mr Mark Konza, Deputy Commissioner, Small and Medium Enterprises

Ms Raelene Vivian, Chief Operating Officer

Mr Neil Olesen, Deputy Commissioner, Superannuation

Mr Robert Ravanello, Chief Finance Officer

Australian Securities and Investments Commission

Mr Tony D'Aloisio, Chairman

Ms Belinda Gibson, Deputy Commissioner

Mr Michael Dwyer, Commissioner

Mr Justin Owen, Manager, Government Relations

Mr Matthew Abbott, Senior Executive Leader, Corporate Affairs

Productivity Commission

Mr Gary Bank AO, Chairman

Dr Michael Kirby, Acting Head of Office

Ms Lisa Gropp, Principal Adviser, Research

Mr Terry O'Brien, First Assistant Commissioner

CHAIR (Senator Hurley)—I declare open this public hearing of the Senate Economics Legislation Committee. The Senate has referred to the committee the particulars of proposed expenditure for 2010-11 and related documents for the portfolios of Innovation, Industry, Science and Research; Resources, Energy and Tourism; and Treasury. The committee must report to the Senate on 22 June 2010 and it has set 30 July 2010 as the date by which answers to questions on notice are to be returned. Under standing order 26 the committee must take all evidence in public session. This includes answers to questions on notice. Officers and senators are familiar with the rules of the Senate governing estimates hearings. If you need assistance, the secretariat has copies of the rules. I particularly draw the attention of witnesses to an order of the Senate of 13 May 2009 specifying the process by which a claim of public interest immunity should be raised and which I now incorporate in *Hansard*.

The extract read as follows—

That the Senate—

- (a) notes that ministers and officers have continued to refuse to provide information to Senate committees without properly raising claims of public interest immunity as required by past resolutions of the Senate;
- (b) reaffirms the principles of past resolutions of the Senate by this order, to provide ministers and officers with guidance as to the proper process for raising public interest immunity claims and to consolidate those past resolutions of the Senate;
- (c) orders that the following operate as an order of continuing effect:
 - (1) If:
 - (a) a Senate committee, or a senator in the course of proceedings of a committee, requests information or a document from a Commonwealth department or agency; and
 - (b) an officer of the department or agency to whom the request is directed believes that it may not be in the public interest to disclose the information or document to the committee, the officer shall state to the committee the ground on which the officer believes that it may not be in the public interest to disclose the information or document to the committee, and specify the harm to the public interest that could result from the disclosure of the information or document.
 - (2) If, after receiving the officer's statement under paragraph (1), the committee or the senator requests the officer to refer the question of the disclosure of the information or document to a responsible minister, the officer shall refer that question to the minister.
 - (3) If a minister, on a reference by an officer under paragraph (2), concludes that it would not be in the public interest to disclose the information or document to the committee, the minister shall provide to the committee a statement of the ground for that conclusion, specifying the harm to the public interest that could result from the disclosure of the information or document.
 - (4) A minister, in a statement under paragraph (3), shall indicate whether the harm to the public interest that could result from the disclosure of the information or document to the committee could result only from the publication of the information or document by the committee, or could result, equally or in part, from the disclosure of the information or document to the committee as in camera evidence.
 - (5) If, after considering a statement by a minister provided under paragraph (3), the committee concludes that the statement does not sufficiently justify the withholding of the information or document from the committee, the committee shall report the matter to the Senate.
 - (6) A decision by a committee not to report a matter to the Senate under paragraph (5) does not prevent a senator from raising the matter in the Senate in accordance with other procedures of the Senate.
 - (7) A statement that information or a document is not published, or is confidential, or consists of advice to, or internal deliberations of, government, in the absence of specification of the harm to the public interest that could result from the disclosure of the information or document, is not a statement that meets the requirements of paragraph (1) or (4).
 - (8) If a minister concludes that a statement under paragraph (3) should more appropriately be made by the head of an agency, by reason of the independence of that agency from ministerial direction or control, the minister shall inform the committee of that conclusion and the reason for that conclusion, and shall refer the matter to the head of the agency, who shall then be required to provide a statement in accordance with paragraph (3).

(Extract, Senate Standing Orders, pp 124-125)

[9.03 am]

Australian Prudential Regulation Authority

CHAIR—I again welcome the Assistant Treasurer, Senator Sherry, and APRA officers. Minister or officers, would you like to make an opening statement?

Senator Sherry—I do not wish to make an opening statement.

Dr Laker—I will make a brief opening statement. At the time of our February appearance before this committee, the operating environment for Australian financial institutions was clearly on the improve. Recovery in the global economy, though uneven, was beginning to gain traction, the Australian economy had resumed its forward momentum after a mild downturn and conditions in global funding markets had become more settled. Nonetheless, we noted that uncertainties continued to cloud the global economic outlook and global financial markets remain vulnerable to aftershocks. For that reason, we advised the committee that APRA was not ready to dial down the level of its supervisory intensity. That caution on our part has been vindicated by recent events.

Since February, prospects for the global economy have continued to firm. The IMF is now forecasting global growth over the next couple of years to be a little above trend but with very different outcomes across regions. Recovery in Asia has been particularly robust and this is generating a significant terms of trade boost for Australia. As a consequence, forecasts for GDP growth in Australia are also being ratcheted up. These developments augur well for Australian financial institutions.

Over recent weeks, however, this positive global growth story has been obscured by the financial ash cloud over Europe. Concerns about the public finances of Greece and other European countries, about the exposures of European banks and about Europe becoming a dragging anchor on global recovery have led to a renewed bout of turbulence in global financial markets particularly foreign exchange and equity markets. Australian banks have only very small exposures to countries in the euro area and, although spreads have been widening, global funding markets, to date at least, have been much more discerning about the fundamental strength of our banks. In contrast, the committee will recall that investor retreat from risk in October 2008 was so rapid and pervasive that all internationally active banks were, so to speak, ‘tarred with the same brush’.

We are continuing to liaise closely with Australian banks that tap offshore wholesale markets, and we are satisfied that these banks are much better placed than they were in October 2008 to deal with potential disruptions to these markets. We are also monitoring the impacts of recent global and domestic equity market volatility on the life insurance and superannuation industries. These impacts are being well managed.

At the same time, APRA remains fully engaged in G20 global reform initiatives designed to promote a more resilient global banking system and strengthen prudential and regulatory oversight of that system. For us, the main aspects of the reforms are the level and quality of capital held by banking institutions, the management of liquidity risk and remuneration incentives.

As I mentioned in February, the Basel Committee on Banking Supervision, the global standard-setting body for banking institutions, has released proposals to strengthen global capital and liquidity regulations. The objective is to improve the banking system's ability to act as a shock absorber rather than, as we saw in the global financial crisis, as a transmitter of shocks to the real economy. The proposals are wide ranging, and a global quantitative impact study is being undertaken to assess their impact and to ensure that they are calibrated appropriately. APRA has been an active participant in this study and has collected data from a number of authorised deposit-taking institutions. The results from the study are now being analysed by the Basel committee ahead of what will be critical deliberations at its next meeting in July, at which APRA and the Reserve Bank of Australia will be present. The Basel committee has also been consulting with interested parties and has received submissions from some Australian banks and from the Australian Bankers Association.

The final shape of this reform package will be clearer at our next appearance. The Basel committee's intention is to develop a fully-calibrated set of standards by the end of 2010 to be phased in as global economic recovery becomes more assured by the end of 2012, with appropriate phase-in and grandfathering arrangements. As I have said before, APRA will not implement the reforms in Australia without extensive consultation.

APRA's work on remuneration incentives is much further advanced. Prudential requirements on remuneration for authorised deposit-taking institutions and general and life insurance companies came into effect on 1 April this year. They were implemented through our existing prudential standards on governance. We see remuneration incentives as an important issue of risk management that boards must own, consistent with their responsibilities for good stewardship.

Before our prudential requirements came into effect, we asked a number of our largest regulated institutions to prepare self-assessments of their current remuneration practices against these requirements. Some institutions are well advanced in adopting risk-adjusted remuneration practices, while others have some way to go. Our current supervisory focus is, firstly, ensuring that institutions have appropriate governance structures to deal with remuneration and, secondly, undertaking our own initial assessments of remuneration structures so that we in APRA have a good understanding of how institutions incorporate an adjustment for risk in their performance based compensation schemes.

In March this year, the Financial Stability Board undertook its own peer review on progress in applying its *Principles for sound compensation practices* and its *Implementation standards*. Australia was one of 24 countries covered by the review and was identified as having made significant progress in this area. APRA has eschewed some of the more prescriptive limits and caps that have been recommended by the Financial Stability Board, but we are confident that our principles based approach will achieve the substantive outcomes sought by this global reform initiative.

In addition to its international engagement, APRA has been active on other prudential policy fronts that are more home grown in origin. Since February we have released enhancements to the prudential framework for life insurers, dealing with governance, audit and actuarial matters; a comprehensive set of proposals for supervising conglomerate groups aimed at ensuring that such groups hold adequate capital to protect APRA regulated entities

from potential contagion and other risks within the group—APRA is at the forefront of global policy developments in this area; and a set of proposals to update our capital requirements for general insurers and life insurers, aimed at making these requirements more risk-sensitive and improving the alignment of our capital standards across regulated industries. Naturally, as an integrated regulator, we have a strong commitment to harmonisation where it is appropriate. The proposed changes to capital requirements are more fundamental for life insurers than general insurers.

The various policy initiatives I have just described—global and home-grown—are intended to improve the regulation of financial systems. Focusing attention on regulation alone, however, downplays another key issue to emerge from the global financial crisis, namely, the quality of prudential supervision. By supervision, I mean the direct oversight of financial institutions to ensure that they are operating soundly and prudently, not just complying with the regulations. This is APRA's bread-and-butter activity.

As many now acknowledge, some advanced countries with similar financial systems operating more or less under the same set of global regulations were less affected than others in the crisis. Australia is one such country. While there may be a number of reasons for this, the International Monetary Fund has recently highlighted one explanation that supervision in some countries had not proved to be as effective as it should have. I would commend to this committee the IMF's paper *The Making of Good Supervision: Learning to Say No*. The IMF identifies the key elements of good supervision as being 'intensive, sceptical, proactive, comprehensive, adaptive and conclusive'. The IMF goes on to say:

To achieve these elements, the "ability" to supervise, which requires appropriate resources, authority, organisation and constructive working relationships with other agencies must be complemented by the "will" to act.

We in APRA, not surprisingly, are in broad agreement with the themes of the IMF paper. Certainly, the key elements of good supervision espoused by the IMF have been fundamental to our approach to supervision before and during the crisis, and will continue to shape our approach when the dust from the crisis finally settles. We are now happy to take the committee's questions.

CHAIR—It sounds to me like the IMF's recipe for good supervision sounds a lot like good parenting.

Dr Laker—There are very strong parallels. I could leave you all a copy of the paper. It is a good read.

Senator CAMERON—Kids do not have the same motivation that these bankers do.

Senator Sherry—They grow up, though.

CHAIR—You were speaking about the global efforts around regulation of remuneration. In Australia, remuneration, particularly in the financial sector, has been frequently linked to United States salaries rather than European salaries. I was wondering whether you could give us an update of what is happening in the United States. I understand a bit of work is occurring in Europe. The press reports we hear seem to indicate that is not happening quite as much in the United States.

Dr Laker—We are not privy to all of the behind-the-scenes activity that is going on in the US on this matter, but all countries are committed to the FSB's *Principles and Implementation standards* and I know that certainly the Fed Reserve board and other regulators are looking at the application of these *Principles* in the US. Notwithstanding that, there are still some very high-profile salaries being bandied about. As we have always said to this committee, it is not the level that is relevant, it is the structure of these remuneration packages and what risks they are meant to address. So it is hard for us to go beyond some of the coverage in the media to understand more fully what these large packages are containing. But I do know that there is a global consensus about the importance of getting a robust set of remuneration incentives into the banking system. It is work in progress.

As I said in my opening remarks, we are well advanced in that process. We were, in part, the architects of the FSB's *Principles and implementation standards*. We already have a framework in our governance requirements which enabled us to introduce them quite efficiently. So for us it is now becoming part of our ongoing supervisory activities. But I think you need to watch this space, because the work is going on behind the scenes in all countries. The feedback we get is that there is a generational change beginning to take place in the approach of boards to remuneration incentives for their senior executives but, as I say, it is a generational change and it will take some time to be established.

Senator EGGLESTON—You have mentioned the Basel committee and the proposals to increase banking regulations.

Dr Laker—Improve banking regulations, I would like to think.

Senator EGGLESTON—Improve them, yes, a very important difference. Some people, such as the Chairman of the Reserve Bank, have criticised your proposals as being too strong. Would you make a comment on that?

Dr Laker—Sorry, the Chairman of the Fed—

Senator EGGLESTON—To what extent will Australia adopt the Basel committee's recommendations, do we think?

Dr Laker—The Basel committee is responding to the G20 reform mandate. Part of that reform mandate made it very clear that there was a need to improve the quality and level of capital in the global banking system and to introduce a leverage ratio as a backstop measure. That is the mandate of G20. That is what the Basel committee is responding to. I am not aware of any particular public comments that our proposals are too strong, because we have not issued any specific proposals. We have discussed the Basel committee's proposals amongst our regulated institutions. But they are at this point proposals. There is considerable work under way to address that question that you have raised about whether they are too strong a set of proposals.

In APRA we are only one of 27 members of the committee but we are active in two of the key work streams. One of our executive general managers is heavily involved in what is called a 'top-down calibration group' which is to make sure that when all these measures are added up they make sense and they are appropriately calibrated. That work will culminate in that meeting in July when we will, in a sense, confront the principles with the likely impact. There is very strong G20 commitment to the principles. There is a challenge in that for some

countries implementing them immediately would be very, very difficult because their banking systems are still in a fragile state and their economies, likewise, are not performing strongly. So how they are ultimately phased in will become a very important question.

Senator EGGLESTON—What I was referring to was an article in the *Financial Review* from 12 February where Mr Tom Quarmby from Macquarie Securities expressed some concern about what might happen in Australia, and he stressed that his estimates were based only on informal proposals. But he said that ‘surprisingly, the APRA proposals are far more onerous than those drafted by the Basel committee’. Obviously your proposals are not really out there but there is some discussion about what you might do.

Dr Laker—I would need to go back to that particular article. We have a set of proposals out there on liquidity but not on capital. On capital, the Basel committee is taking the lead. On liquidity, we have said that we will hold back going further with our own approach until the Basel framework is clarified. There is a lot of work going on to look at the impact. There is work being done by the banks themselves through their own associations both in Australia and globally. There is work being done by the prudential authorities and central banks. There is a considerable dialogue between both sides on this issue. Nobody wants to get the calibration wrong, but equally I think it is important to emphasise that there is a very strong will to strengthen the foundations of the global banking system because if there was any obvious lesson from the global financial crisis, it was that those foundations were not as strong as they should have been.

The other element that I would emphasise, which also goes to one of your other questions, is that there is a strong global commitment to a level playing field, which means that our starting point would be if there is a consensus on the global framework that would be the framework that we would want to introduce in Australia. I have said to this committee before that analysts, markets and others would hold Australian institutions to a global standard in any event.

Senator EGGLESTON—There is another article I refer you to from the *Financial Review* on 19 April by Geoff Winestock. It is headed ‘Local banks protest at unfair Basel liquidity rules’. It begins by saying:

Australian banks could come under pressure to securitise their mortgage loan books or else face tough limits on their short-term borrowing under controversial new global liquidity rules.

It goes on to say something you have mentioned already:

One key part of the rules requires banks to keep sufficient assets in a saleable liquid form to meet withdrawals during a 30-day panic on markets.

Australian regulators have complained because under the Basel proposal, only government bonds would qualify as liquid assets.

This poses a problem for Australia because there are far less government bonds on issue than in other countries and certainly not enough for banks to meet the Basel requirements.

Would you like to comment on that?

Dr Laker—One aim of the liquidity proposals from the Basel committee is to require globally active banks to take out more self-insurance in managing liquidity. By that the

committee means that banks should hold high-quality liquid assets that are not exposed to bank risk. This is the important distinction—high-quality liquid assets that they would be able to readily realise to address a stress period of 30 days. That is one element. The second element is to reduce the reliance on very short-term funding to fund assets which are much longer in duration. The third higher level principle is that there is a lot of moral hazard currently in the global banking system because of the view that, if all goes tough, a bank can go straight to the central bank and find liquidity support from central banks. The proposals are really designed to put that moral hazard genie back into the bottle by having greater reliance on banks' own ability to manage their own liquidity without going to the central bank at the first sign of pressure. That is what the purpose of these global liquidity reforms are. That is what they are intended to cover.

We have said all along that we support the principle that banks should hold high-quality liquid assets on their books to enable them to meet stress. In principle, those assets should be free of risk to other banks, because that is what you want in a crisis. In a banking crisis you want paper that can be sold that is not touched by having a bank exposure. They are important principles and we support them, but we have also said, quite candidly, 'We can do mathematics,' or in the American sense, 'I can do the math,' without the 's', but we know what the sum total of government securities is in Australia. It is far too low to meet those narrow definitions that the Basel committee has proposed. The committee has also put out a broader definition, and we could not meet that either because the assets that they would add in are not assets that are actively traded in Australia.

We know that Australia has a particular set of issues with those proposals and that is what we are working through with the committee. We cannot meet them, for the most virtuous of reasons—that we have had very frugal governments over a long period of time. We are not the only country in that position and so the current deliberations of the Basel committee are about trying to work out how countries like Australia can meet the principles and about trying to address moral hazard, but without some mechanical rule which we just cannot technically meet. But I am optimistic that we will have a sensible outcome that reflects Australia's unique and quite propitious circumstances.

Senator EGGLESTON—I have another question. It is with respect to superannuation, which I believe you are going to become involved in. Is that not the case?

Dr Laker—Until you tell me the question, Senator, I do not know whether we are going to be involved or not. You are teasing me here!

Senator EGGLESTON—You are going to have an increased role. You are already involved.

Dr Laker—Yes.

Senator EGGLESTON—This is about superannuation fraud and police investigation of a scam using superannuation fraud and transferring funds, using a false identity, to other accounts. This has been under investigation in New South Wales. I understand the minister, in 2009, put a public watch out for superannuation scams which, of course, would concern everybody. It has been said the real problem is that the police are frustrated because private and self-managed funds refuse to provide details of their accounts, on the grounds of privacy.

The question has been put to me to ask whether or not a different body should be administering private and self-managed insurance funds, because there appears to be a degree of fraud in that area. Do you have any comment on that, Minister?

Senator Sherry—The self-managed super funds sector is overseen by the ATO, so issues in respect of the self-managed super funds sector would not come to APRA. The only issue, and there might be some comment about this, is that I am aware there have been actual cases of fraud involving false self-managed super funds established in order to access funds from prudentially regulated funds, which would fall into APRA's area. One of the officers might like to make some comment about that aspect, but the oversight of SMSFs is for the ATO.

Mr Venkatramani—We have been working very closely, apart from with the industry, with the ATO in terms of transfers between other funds and their funds, as well as with the Federal Police with reference to general criminal activity in terms of identity theft et cetera. Following on from that we have recently issued guidance to our own entity trustees, giving clear guidance as to what other things they should be looking for and what proactive steps they can take to minimise fraud. In doing this, obviously we feel one aspect of the operational risk management of trustees will require a proper risk management framework and controls, and we also need to be mindful of doing it in such a fashion to balance it so that legitimate requests for transfers are not stymied. So it is something that we are working on constantly with the industry, making presentations, and we have even suggested to the industry that where fraud occurs, or attempted fraud occurs, the industry would be better off sharing that information to form defences against fraudsters.

Senator EGGLESTON—That sounds like a very sensible idea. I am advised the Federal Police have not taken action on these matters for over 12 months, in spite of warnings given to them. It was suggested that there should be amendments to strengthen proof of identity and security of transfer provisions. What is the scale of this problem of removal of funds from superannuation funds through fraud? Is that a question for this group?

Senator Sherry—I do know that the ATO, who are responsible for the self-managed super funds sector, would have some further information they could provide. It is not my direct ministerial remit, but I am aware that the ATO has been issuing warnings and actually giving some examples of the way in which the SMSF is used illegally as a vehicle to access funds from superannuation via transfer from an APRA-regulated fund. As I have indicated, that aspect of this matter, and it is the SMSF that is used as the vehicle for illegal access and fraud, is a matter for the ATO. I will take your question on notice, because I am confident the ATO could provide some more detailed information on this, and we will provide that to you.

Senator EGGLESTON—I will have a discussion with you after and advise you who the questions came from. Then you might like to deal with that individual fairly directly.

Senator BUSHBY—What is the view of APRA on the use of members' funds by a superannuation fund to advertise?

Mr Venkatramani—APRA quite some time ago identified the use of funds for advertising as an issue for clarification. Basically what we have said to the trustees is that the link between advertising and securing members' interests in terms of the required sole purpose is

pretty tenuous and therefore if members' funds were to be used for advertising that would be inappropriate. However, it is different if trustees, out of fees which have already been properly disclosed and charged, decide to use trustee money for marketing the funds under that trusteeship without directly affecting member balances. That is a matter for the trustees. Effectively, we have made a distinction between dipping into members' money and using trustee money. We have also issued a warning that an anti-avoidance mechanism, by simply bumping up trustees' fees in preparation for a certain expense, is not acceptable either. I think this has been widely communicated and disseminated through the industry.

Senator Sherry—There is a policy issue here, and I do know it is one of the matters being examined because it goes to the operation of the superannuation system. The policy issue itself is a matter that is before the Cooper review. Obviously I cannot pre-empt what Cooper may recommend on this matter, or any other matter that is before his consideration. The review is scheduled to be completed by the end of June. He may or may not make some policy recommendation.

Senator BUSHBY—But it is one of the matters being considered by the Cooper review?

Senator Sherry—Yes—it is part of the general operation of the superannuation system and there is no doubt that that is a matter that is part of the examination of the operation of the superannuation system.

Senator BUSHBY—The reason I am asking will probably be fairly obvious at this point in time. On 27 May 2010, the *Sydney Morning Herald* had a page 1 article on the RSPT which amongst other things reported:

A senior government source said the government would not mind if the super industry started running ads to counter the mining campaign.

“It would be wrong to say we have leant on them. Equally it would be incorrect to say we are not discouraging them,” he said.

A super industry source said an ad campaign was not in the pipeline yet.

“We’re certainly considering what steps we can take,” he said.

How can it be said that a political campaign paid for out of super funds' moneys such as the one which the government is encouraging is in accordance with the statute which you would administer? Have you written to the funds advising them that this would be in breach of the SI(S) Act? Have you advised the senior government source that a campaign funded by the funds which are owned by super fund members would be in breach of the SIS Act?

Senator CAMERON—Mitch Hooke might have something to say about that.

Senator BUSHBY—Senator Cameron, I think you had dinner with him last night, not me.

Senator CAMERON—I was at the dinner.

Senator BUSHBY—I wasn't.

Senator Sherry—It is very interesting to know who was at what dinner, but all I know is I was here for hours and hours like you, Senator Bushby. I was not at any dinner. It may surprise you that I did not think that was the issue you were going to. I thought you may be

going to the issue of the advertising by some funds, comparing the pair, and the sponsorship issues around football teams.

Senator BUSHBY—I think that is more general and that has been canvassed to some extent previously.

Senator Sherry—Yes, although it became somewhat controversial in the case of the Storm team recently. That was the area I thought you were going to.

Senator BUSHBY—No, I could still go there.

Senator Sherry—The issue of advertising and the current requirements are well regulated by APRA, but the issues of policy are before the Cooper review. I have to say they were before Cooper well before any issues around RSPT were raised.

Senator BUSHBY—I understand that, but Cooper is looking at what policy changes may be implemented which may well have an impact on future regulation and legislation. We currently have before us the rules that need to be applied. I am interested in knowing whether, if APRA were to consider such a campaign, that would be in breach of the SI(S).

Mr Chapman—I guess the question is rhetorical because nobody has proposed such a campaign. The sole purpose test really says that anything that comes out of the fund must be used for the benefit of members. That is always going to be a qualitative judgment. All sorts of advertising can be done if it is in the interests of members. Funds promote themselves, they run seminars and all of that is quite appropriate.

Senator BUSHBY—Provided it comes out of their funds.

Mr Chapman—We have not seen somebody advocating that superannuation funds should not invest in cigarette companies. It would be hard to conclude that some sort of generic campaign would fit within the sole purpose of an individual fund. That is the best I can say.

Senator BUSHBY—If you had a sniff that they were going to do an advertising campaign of some sort, whether on this or some other sort of generic campaign, would you feel that you had a responsibility to advise them in advance of your thoughts on such a thing?

Mr Chapman—We do not always find these things out in advance, but if we saw a campaign start—like the industry fund campaign they run all the time on TV with the diamond—we would look at that for the purpose of deciding whether it was an appropriate use of members' money. As Ramani said earlier, one of the issues there is always where the money comes from: is it coming directly from the fund or is it coming from another source? Those are all issues we look at as a matter of course when we are looking at how the fund is being used because the sole purpose test is a fundamental cornerstone of the whole superannuation system.

Senator BUSHBY—I will move on from there. In general, once again talking about the superannuation industry, what have been the major lessons for super fund trustees arising out of the GFC? What practical things that would improve the prudential management of superannuation funds—such as the advantages on unit pricing on a daily basis, care with exposure to liquid assets, runs to switch from more risky to less risky assets or pressures on call centres—have you learnt from the global financial crisis?

Mr Venkatramani—Several issues were picked up—and to the credit of the industry, by the industry itself—as we experienced the GFC. A key message was that in selecting and offering investment menu options under the choice regime, which is now firmly embedded in the system, trustees need to be mindful of stresses which investment markets go through and their ability to comply with the disclosed asset allocations and, if they diverge significantly, what implications there might be for members and for trustees as well. So we have said that in effect some investment strategy is not appropriate under any circumstances but particularly in volatile circumstances. That was one message.

The second important issue, which really hit the industry like a bucket of cold water, was the presumed, if you like, exemption from proper liquidity management in the industry because of the relentless cash flow coming through the SG and other voluntary contribution mechanisms. The GFC showed that superannuation funds also need to manage liquidity robustly, to stress test them, and to be prepared to keep continually looking at how liquid that portfolio is and who will be the default liquidity provider if it is a very large fund, say, the DB section or the default section. So I think that liquidity management for the industry and the market has grown very mature and we have learned some very severe lessons, and these are embedded in the psychology of the industry.

The third one is valuation of unlisted assets in volatile markets and the lag between unlisted assets and listed assets. As a result of all of that, I think the industry itself has learned some sobering lessons and we are seeing that day to day. The challenge is to make sure that those lessons are not forgotten in the aftermath of the GFC.

Senator BUSHBY—Thank you very much. That is a good comprehensive analysis, and some of the things that I mentioned in my examples you mentioned as well. Have there been any instances where funds actually experienced some of those issues that you say we have learned some lessons from? Were they practical problems that were faced that have led you to draw those conclusions?

Mr Venkatramani—Yes. On the liquidity side there is an ability for funds to approach us in terms of the portability requirement. The rules say that unless something is declared as illiquid and member consent is obtained, portability must occur within 30 days. But fund trustees have an ability to come to us because of market factors and gain an exemption, and during the GFC we were very active with the industry in providing those exemptions principally because some of the underlying investments were frozen. That is not directly the fault of the trustee, but the trustee had invested in other investments which could not be liquefied within the term required. So we worked with industry and we have provided not only specific exemption from time to time but also general guidance on how best this could be managed.

Senator BUSHBY—I imagine that to a very significant extent most of the problems experienced by super funds were not their fault but were caused by extraneous external circumstances. But I guess the particular way they manage their funds may have had different consequences when those effects were applied to them. I guess that is what you are talking about: how they actually managed funds in these different areas that you raised. But the bottom line is that there were instances where some of these funds experienced some of these problems. I do not want specifics of funds and the problems they faced, but I am interested in

the types of issues that they faced and how widespread they were. You mentioned examples there, but how widespread were these problems within the industry?

Mr Venkatramani—Those funds which offered reasonably diversified investment strategies experienced less difficulty compared to others which offered concentrated options. Something which I forgot to mention in my earlier comment was that, even as we picked industry wide issues and worked with the industry and provided specific dispensations, as a by-product or corollary of that process, we provided input to front-line supervisors saying, ‘Your funds investment management requires improvement; please take that on board and in the normal supervision emphasise that message, identify it as a deficiency and ask for remediation within set time frames.’ So you work on the industry level but, simultaneously, we also work on individual funds and trustees. That by-product has been working very well.

Senator BUSHBY—In respect of the issues that you raised on the valuation of unlisted assets and the lag between valuations of unlisted assets, what sorts of problems did that present during the GFC that led you to make your comment?

Mr Venkatramani—The general perception there was, because of this perceived lag between listed and unlisted, those funds which had significant exposure to the unlisted sector were apparently receiving a perceived benefit because they were not being buffeted to the same extent as the listed market was. Our concern was the issue of equity between people who remain in the fund, who enter into the fund run and who leave the fund. So we did a number of things. You might have seen guidance which we issued for trustees as to the necessity for having robust management processes more frequently. Simultaneously we met with the professions—auditors, accountants and actuaries—to explain our perspective and require greater oversight on their part. Finally, we also met with some significant investment advisers, particularly those who are pushing additional investment in these sectors, to make clear that, in the ultimate analysis, member interests come first and, therefore, as a result of the GFC these need to be reviewed. So we have been again working with the industry, working with individual entities, working with the professions and working with other advisers as consultants. That has been our process. It has been a sobering experience; I do not think the industry will ever forget this.

Senator BUSHBY—I am sure they will not. Mr Venkatramani, we have discussed unit pricing before. I recall that you are usually the person who I interact with on that. I have raised before the equity issue of the lag between valuations and where you have significant events happening where prices are volatile. That can lead to people either benefiting greatly if they are retiring within a certain period or conversely suffering as a result when they retire when things have been revalued down and some of the value has been taken out by members who left prior to the valuation being revised downwards.

You have made comments about unit pricing in the past. You told me just then that you are working towards a greater ability to understand the true value of the assets that superannuation funds are managing—is that what you are saying?—so you can actually average out those equity issues or have a better understanding of the true value of the assets that have been held at any point in time? Is that what you are working towards as part of those negotiations that you are involved in?

Mr Venkatramani—It is not clear to me whether you are phrasing your question as an issue in respect of unit pricing or in respect of all the funds.

Senator BUSHBY—All the funds. I think unit pricing solves a lot of those issues—if you are daily unit pricing, probably more to the point, or very frequently, then you have a better understanding of the true value. If the market is volatile, you have a better understanding of the true value of the funds that you are managing and, consequently, what that might mean for the individual member who is coming in or out of the fund. But the question I am asking is in the greater sense—being able to understand at a more macro level what the true value of the fund is and what individual member's value is in terms of their part of that fund.

Mr Venkatramani—There we have issued advice on fund unit prices and crediting rates. The trustees need to be mindful of the level of movement within the fund and the assets. If, for example, there is frequent movement in terms of entry and exit and rollovers, then the frequency with which they set either crediting rates or unit prices must reflect that.

Equally then, we have said that, say, to go for an expensive unit pricing in a small corporate fund where there is not very much movement simply to keep up with the market might actually be against member interests. So we have said very clearly, 'You need to be careful about the equity issues which the mismatch between member movements on the one hand and asset price movements on the other can lead to. You need to manage that in a proper way, looking at the costs of the operations.'

Senator BUSHBY—Appropriate balance, yes—I understand. In a general sense, has APRA written any papers for super funds on the lessons which have been learned from the subprime financial crisis?

Dr Laker—I was about to give you that answer before you posed the question. To follow up what Ramani said, we have a publication called *Insight*, which comes out two or three times a year. The edition that we are planning to publish in the next few weeks has two articles on superannuation, and I would commend them to you. The first one is what we do on a reasonably regular basis, an industry overview, and it will look at the performance of the industry and some of the prudential issues that we have been dealing with.

The second article is a summary of a liquidity questionnaire that we put out to superannuation funds, and it is quite a detailed explanation of the sort of responses we got on different questions on liquidity and, importantly, what APRA expects in these various areas. That is really written for trustees to get feedback from what we learned from the liquidity questionnaire, but it also has a more general value because it does show you the kind of work that we were doing through the crisis and what the funds themselves were doing to respond to what Ramani said was quite a new experience, because in that time it was not just all money coming in. They are a couple of examples of where you would get some general feedback on that.

Senator BUSHBY—I look forward to reading those when it comes out.

Dr Laker—Ramani, I do not know whether you have got anything else?

Mr Venkatramani—No.

Senator BUSHBY—In terms of the top quartile performance of large or large-ish funds, has there been any major movement in their ranking because they have had to bring to book major losses in their unlisted assets in particular?

Mr Chapman—We would have to take that on notice to give you a detailed answer.

Senator BUSHBY—I am really interested in what impact the last 18 months has had on the—

Mr Chapman—As a general comment, and Ramani touched on this before, unlisted asset valuations tend to lag the changes. During the crisis we saw the funds with a larger proportion of unlisted assets apparently outperform. As a general comment I would say that after that, as the valuation of the unlisted assets has caught up, they probably underperformed. But that does not answer—

Senator BUSHBY—That is basically the question; because of the timing there actually has been an artificial representation, both positive and negative, of performance of some funds.

Mr Chapman—Yes. Also, just to come back to one of your comments earlier, one of the issues with unlisted assets—indeed, any assets; it does not matter what they are—is the conundrum between daily unit pricing, which everybody now expects, and the fact that super is a long-term investment. In many ways the issue of equity only arises when somebody leaves a fund, not when they retire. I am not picking on what you said, but you said ‘retire’. If you are in the same fund in retirement then over the lifetime of your membership of that fund you get the swings and the roundabouts and it is okay.

That is the real dilemma with all unit pricing and all valuations in super: the long-term versus the short-term unit pricing and members going out. That is why Ramani made the comment about it really depending on member volatility.

Senator BUSHBY—Yes, I acknowledge that volatility aspect of it, and the need—particularly with smaller funds—to balance the cost of doing these things against the benefits members are going to receive. But, nonetheless, in other circumstances the cost may be justified.

Mr Chapman—Yes.

Senator BUSHBY—Has there been any tensions on any trustee boards caused by sudden shifts in the position of the fund returns and/or the need to restructure assets and administration arrangements—tensions to a sufficient extent that they have come to your notice?

Mr Chapman—There are lots of tensions on lots of trustee boards about lots of things.

Senator BUSHBY—Exactly, but—

Senator Sherry—There should be!

Senator BUSHBY—Yes, but to the extent that it is actually of concern to APRA?

Mr Chapman—I cannot answer for specific funds, but to answer in the general sense I think a lot of trustee boards have learned a lot of things about investments that arguably they should have known five years ago, and which now have been more highlighted. So as the

Australian dollar moved there were tensions on trustee boards which had significant overseas investments which were hedged.

Senator CAMERON—If the US Treasury did not understand these issues, how can trustees understand them? It is a serious question.

Mr Chapman—This particular one is another good example, though. I think they should have understood more than they did about what the risk was.

Senator CAMERON—Does that go for the US Treasury as well?

Mr Chapman—It is a balance issue, to use Senator Bushby's comment: you do not expect everyone on a trustee board to be a super-duper investment analyst and to be able to understand all the intricate issues that go on, but—

Senator CAMERON—As a former trustee, I must say that I thought that was a bit of a flippant approach, given the complexity and the problems that fund trustees faced in the global market. It is a bit flippant.

Mr Chapman—Apologies if I have offended you, but it was intended to be comment more about this: if you look at nothing else out of the GFC, everybody in every sector—be it the banks over the fact that markets can close down overseas in terms of funding or be it the trustees in terms of how investments are rebalanced—there are a number of funds, as in this particular example, that had significant hedges in place for the right reasons. I do not think that the trustees of those funds had actually understood what the risk would be if things closed down. Nobody else understood what the risks were when things closed down, so it is just a learning exercise in expanding the risk horizon—

Senator BUSHBY—Do you think they did not understand it or that they did not pay particular heed to that risk because things had been so good for so long?

Senator CAMERON—Alan Greenspan did not understand it.

Mr Chapman—The point I am trying to make is that nobody recognised a lot of the risks in all sorts of sectors. One of the learnings for those trustees is that they need to think more about what the downside is. A hedge is not a hedge unless it actually achieves what you want it to and you can understand what problems could be created as things move. These hedges might have been perfectly valid if they had managed to run for a period of time. If they had to be renewed in the middle of the downturn, when investments had dropped, then it would cost a lot of money. Those issues had not been thought through, because nobody had envisaged what might happen. That is the same issue as with illiquid investments. We had a 10 per cent portfolio of illiquids but, as our liquid investment share market investments dropped from 90 to 70 per cent, our illiquids were then 10 on 80 as opposed to 10 on 100. How could they rebalance the fund? The fact that there have been a lot of lessons out of the crisis and lessons out of what has happened will, I think, start focusing trustees much more on what the first standard deviation risks might be.

Senator BUSHBY—Which has to be a good thing. Coming back, though, to my original question about the tensions—and I will phrase it slightly differently: have any tensions been sufficiently worrying to APRA that you have had to step in and play a role in helping to resolve them?

Mr Chapman—I am not aware of any individual cases. Helping them solve them is different to talking to them about what the issues are and whether there are other things they can consider. We have not been actively directing trustees to do certain things.

Senator BUSHBY—Have you had to contact super funds about tensions or concerns between trustees with a view to ensuring that members' funds are adequately protected?

Mr Venkatramani—It happens at a slightly more subtle level. When I go to a fund with my team to look at their investment processes, one of the things we are doing post-GFC is actually quizzing the trustees on the various layers through which they invest. They might invest through a fund manager who in turn might invest through a number of jurisdictions and who might invest in different asset classes. This layer effect, in good times, is very benign. Everything is going well and you do not really want to look into it; it might be considered a waste of time. But in times of stress, one of the things that is not working—or the opacity attached to it—could come home to haunt the trustee and the members. So one of the things we are doing, without actually directing them what to do, is running hypothetical scenarios. For example, we might say: 'Let's say the market drops tomorrow by 500 points and somebody in the Cayman Islands says that their fund is frozen or that no valuations can be obtained. Can you walk me through what you would do? How would you notify your members, how would you come to us and how would you manage your cash flow?' That is not directing but that is pretty close to directing in the sense that it creates a concern or a fear in the mind of the trustee: 'How will we deal with this?' So we do not direct but we run through scenarios.

Senator BUSHBY—That is normal prudential oversight: making sure that they have the appropriate prudential arrangements in place as opposed to stepping in when you see problems that may impact on members' funds. If a fund were experiencing major administration and governance issues, would APRA intervene at Fair Work Australia and recommend that fund lose its default fund status, particularly if it were a monopoly fund?

Mr Chapman—We have never done that in the past. I am not sure we actually have a legislative remit to do so.

Mr Venkatramani—Our hope would be that before it gets to that, the ongoing information flow and our prudential supervision would identify it so that they can get there before it gets to that level of seriousness, and then actually require remediation steps in terms of changing administrators, administration systems or revisiting asset valuation processes or investment strategies. One dilemma for a prudential supervisor, and no answers have been found, is that we need to be careful that we do not jump in too early and we do not leave it too late. It is question of professional judgment for our teams which in APRA we apply through an escalation process. Things get escalated through hierarchies of the organisation and risk experts.

Senator Sherry—There are very rare occasions when APRA has removed trustees. I can think of at least two, and you might think about whether you want to go to those with witnesses. I can recall a case in Queensland involving the motel industry—and I am trying to think of the name of the fund—

Mr Chapman—EPAS.

Senator Sherry—Yes, EPAS. The trustees were removed and there was remedial action. It was a default fund, to the best of my knowledge. I think the Senate Select Committee on Superannuation looked at this issue. It is at least 12 or 13 years ago now. In that case it was a default fund. In that case my recollection is that it was ultimately removed as a default fund from the industrial instrument in Queensland.

Senator BUSHBY—Who would have taken the initiative to have it removed?

Senator Sherry—I was just going to say, I do not believe to the best of my recollection that APRA had any role in that area. To the best of my recollection, the employer party had it removed and a subsequent clause. Beyond that detail—

Senator BUSHBY—Quite clearly, my concern is that if you have a default fund which by their very nature has funds going in from members who have not taken a great degree of interest in it, they probably need a greater degree of protection to some extent.

Senator CAMERON—You hate those funds, don't you, because there are union trustees on them? We know where you are coming from. We know what this is all about.

CHAIR—Thank you, Senator Cameron.

Senator CAMERON—It is this now some; it is Work Choices next. You are still the same old rabble.

Senator BUSHBY—I am concerned about the protection of those members and their funds in circumstances where there may well be systemic management or trustee issues, which certainly does happen. If they are a default fund, what role does APRA see they could play in ensuring that members are not protected and that future funds that are being directed into those default funds are not directed in a way that is not in the interest of the members?

Mr Chapman—The first half of your question is what we do on a day-to-day basis, and that was Mr Venkatramani's answer. Our job is to ensure that members are protected member within the confines of SI(S). There is no direct link, as the minister said, between APRA, Fair Work Australia or the Industrial Relations Commission, or whomever it might have been in the past, about awards. I am not convinced there should be because a lot of the issues that we see, whether they be weaknesses, administration problems, trustee arguments or investments et cetera, are really hard to tie to the fact that this fund should now be removed as a default in any other process. I think that the broader question is perhaps one that should be pursued with somebody other than APRA. I know where the split is between APRA forming a view. If we form an extreme view, as the minister said, we will replace the trustee.

Senator BUSHBY—I understand that there is a bigger issue which goes beyond the remit of APRA but, given that you have a responsibility for the prudential management of these funds and the protection of the members' funds, I was interested in whether there was any potential role you thought you could play. I think you have answered that. I think Mr Venkatramani was saying that you want to get it right in the first place so that you do not actually have those systemic or trustee issues.

Mr Trowbridge—What you have been hearing in the answers is that we run this supervisory process, which John mentioned earlier in his opening remarks. The whole purpose of it is to hold accountable the trustees, in the case of super funds, and the boards, in

the case of banks and insurance companies; you are hearing examples of how we do that. If you want to delve into the specifics, you are really talking about what our teams do on a day-to-day basis. Within our power we do our best to hold them accountable to good behaviour and good governance, and that is the best kind of general statement that can be made on this.

Senator BUSHBY—I understand that; that makes sense.

Senator Sherry—The extent to which you raise the issue is, again, a matter for the Cooper review. The Cooper panel is looking at what a default fund is and how it is registered. There are some regulatory issues as well, but the basis of a default fund is an issue before the Cooper review.

Senator BUSHBY—It will be very interesting to see what Cooper does come up with on a number of matters. We are all looking forward to that, I am sure. At the last estimates hearings, APRA suggested that daily crediting rates are in fact very similar to daily unit prices. In recent times some clients have announced that they are moving from one to the other—for example, Legalsuper reported in the *InvestorDaily* on 19 May 2010 that it was moving from one to the other. Why would they be announcing such a move if they are basically the same thing? Can you explain to me the two approaches and give reasons why some funds would announce such a move and what reasons trustees would have for making a decision to go from one to the other?

Mr Chapman—I suspect the answer simply is that the majority of people around the country are now used to unit pricing. Correct me if I am wrong, but I would be very surprised if anybody was going from unit pricing to crediting rates. From our point of view, we are agnostic between the two, and I think we touched on this earlier, provided they are both done properly.

Senator BUSHBY—For the record, what are the differences?

Mr Chapman—The differences are obviously that crediting rating you tend to do on a much less frequent basis. It is a bank account style of approach—for example, I have \$1,000 and I get credited with two per cent for the last three months and in three months time I get four per cent for the last three months, and so on. Back in 1993, when SIS was introduced, I think that, almost without exception, people would have been on crediting rates; that is what the general population understood in terms of returns because they were used to bank accounts. In 2010, people are used to unit pricing and that is how they have done it. As far as I am aware there is no underlying reason; it is just more likely to be aligned with what is common usage in the industry.

Senator BUSHBY—So you are saying that it is basically public demand, essentially?

Mr Chapman—Yes.

Mr Trowbridge—If the super funds invest in unit trusts, the unit trust investments themselves are all clearly on a unit-pricing basis, so it is a more discrete way of adding up the changes in values of individual assets; it tends to be easier to deal with individual assets that way.

Mr Chapman—I missed the name of the publication you mentioned but my guess would be that the tables of comparative performance they had were all unit price based tables, so anybody who has a crediting rate is probably not in the comparative table.

Senator BUSHBY—The publication was the *InvestorDaily*.

Senator CAMERON—Dr Laker, I want to go briefly to the issues that Senator Hurley raised earlier on executive salaries. Your response was that there would be some generational change. How should a fund manager or a trustee of a superannuation fund look at a company that is waiting for generational change to do the right thing by shareholders and the Australian public? Is that an appropriate response?

Dr Laker—Our remit is really only the salaries that are set within APRA-regulated institutions. You are asking me a broader question about change in the listed sector overall in any country.

Senator CAMERON—Let us stick with Australia.

Dr Laker—Our remit, as I say, is to ensure that there are remuneration structures within our regulated institutions—and our governance requirements apply only to the deposit-taking and insurance sectors—to ensure that the structure of remuneration for people who are taking major risk decisions appropriately rewards prudent risk management and does not reward aggressive risk management. My comment about generational change is a comment we have heard in other markets where salary levels in banking were a focus of considerable public attention and where the regulators were really working within the Financial Stability Board framework to rein in those kinds of excessive salary structures.

We are at the early stages of working our requirements through the industry. As I said, they came into effect only on 1 April. They were telegraphed pretty widely so we got our major institutions to start focusing on that beforehand and to see how they lined up with what we require. Some are already lining up and they are now all required to line up. We are working with them. This is not an area we have been actively involved in until 12 months ago. This has not been a major focus of prudential supervision.

We are working with the industry. John and his team have been working particularly with boards, because this is really an issue for boards to own. John can answer for himself, but I think we are finding a much greater willingness of boards to address the question of how they reward their executives.

Senator CAMERON—What is the proof of that?

Dr Laker—Just in the way in which their own policies are being shaped and the way they are seeking to get a good handle on the risks and how they can be incorporated. There is not a formulaic approach in this area.

Senator CAMERON—Sure. I am not asking for a formulaic approach; I am asking what is happening. Executive salaries in the regulated financial sector are driven to a great extent from the unregulated sector; isn't that correct? There is a fair bit of comparative wage justice. There are remuneration consultants giving advice to both the regulated and the unregulated financial sectors. That is why the financial sector looks more like the American, the Wall Street, approach than the European approach that most other businesses in Australia do?

Mr Trowbridge—We are actually not looking at salaries; we are looking at incentive arrangements. As we said before, the quantum of the salaries is not the focus of our attention; the focus of our attention is the quality of governance and risk management, in particular the risk management implications. When it comes to risk management, the things that matter we think are not the salaries themselves but the incentive arrangements around them—the bonuses and so forth.

Senator CAMERON—Yes, but that is part of the salary package.

Mr Trowbridge—Yes, it is.

Senator CAMERON—I do not want to play games with this and I do not want you to play games with me, ‘salary’ includes the incentives.

Mr Trowbridge—If that is what you meant, then the part of the salary package that our attention—

Senator CAMERON—When you talk about executive salaries, everybody knows you are talking about executive salaries plus incentives. I would like you not to be too cute—

Mr Trowbridge—I took you to mean the salaries. If you are talking about the total packages, the part of the packages we are interested in are the incentive components. We did an initial survey in the early part of this year—the self-assessments that John referred to. I think we got 40 institutions to give us self-assessments against our standards. We are now going through the process of working with the largest listed institutions to understand what their remuneration arrangements look like against our standards.

Once we have completed that, and it will probably take us most of this year, our task is to firstly understand what their practices are and what we think is best practice amongst them. Once we have understood that then we have to make a judgment as to whether what they think is their best practice is good enough to meet our standards. We may conclude that nobody has got good practice, or we may say, ‘These institutions have’ and we will illustrate that to other institutions.

Senator CAMERON—But your standards are about structural issues, aren’t they?

Mr Trowbridge—Yes, they are.

Senator CAMERON—They go to how the structure of supervision by, basically, the board operates.

Mr Trowbridge—Correct.

Senator CAMERON—The problem that the Productivity Commission raised in its report was that the executive salaries—and I include incentives in that—are so complex, so opaque, that it is almost impossible to understand how some of them operate. How are you dealing with that issue?

Mr Trowbridge—The way we deal with it is that we have internal people and we have some expertise from outside to assist us, because it is a newer area for us. We do everything behind closed doors—and we have access to board papers and to any other documents that the companies have. And APRA is staffed by mainly financially oriented people, so we do have the capability to both get the information and analyse the information. And we have the ability

through our supervisory process to have dialogue with the companies. So we believe that we will get to the heart of this. If you are interested in the private sector-wide consequences, then what we all can hope is that if APRA can get at the heart of it in the financial sector then there will be some kind of understanding and influence across other industries.

Senator CAMERON—I hope you really take this up with some vigour, because it is a problem and it is a problem that is ongoing. You say that you get experts to actually analyse what is happening with the salaries and bonuses. So you do not rely on the *Financial Review* annual salary survey.

Mr Trowbridge—No—

Senator CAMERON—Would that be sufficient for you?

Mr Trowbridge—No, no. We have detailed information. To give you an example, the self-assessments that we have received tell us good stories in most cases. We have also got the charter of the remuneration committees, based on our new standards. They all say the right things, but our task now is to understand whether what they actually do matches up with what they say they do. That is an important question in all supervisory matters. People always say they do the right thing, and part of our job is to look at what they actually do and compare it with what they say they do, and then we need to assess it against our standards.

Senator CAMERON—So you have got investigative power.

Mr Trowbridge—Correct.

Dr Laker—Can I just expand on what Mr Trowbridge said. The key document that starts the process of our investigation is the board's own statement of the remuneration policy for its institution. That is what we have required boards to write, showing how they meet not just the formal requirements of APRA and the Financial Stability Board but how they judge an appropriate structure for the sorts of risks that their institution undertakes. It is a very important learning and education process for boards to sit down and write that policy. Some have done that for a long period of time; others are getting their minds around the sort of detail that needs to go in it. But that is the starting point. We are seeing those remuneration policy statements, documents, and assessing those to see whether, as John said, there is meat behind the words. Even getting that part of the structure, getting an independent remuneration committee established, getting that committee and the full board to sign off on the policy for the institution: these are core elements of our approach and then we follow through from there.

Senator CAMERON—So you would not be able to carry out your function if you simply depended on, say, the *Financial Review* annual salary survey. That would be totally insufficient.

Dr Laker—Totally.

Mr Trowbridge—We cannot even do it with the disclosures that the companies make themselves in the annual reports, because those disclosures are often difficult to read. They are usually written by lawyers to meet ASIC's requirements, and what we are doing is getting behind that. We hope that that will improve risk management in the regulated sector. Given that what we have done and what the Productivity Commission has recommended are

consistent, if you are interested in the wider aspects of this then the question is: will what APRA has done influence suitably what happens elsewhere?

We have some good initiatives in this. One is that the CEO cannot sit on the remuneration committee, and we have taken steps to try and ensure independence—not just that the remuneration committee has to have only non-executive directors on it but that the advice they get has to be independent of advice that is given to executives.

Senator CAMERON—Can I just go to that point. Given that there is a directors ‘club’—and it is a very big directors’ club—in Australia, those independent directors could have been part of that chief executives’ or directors’ club. That is an issue that has been written about extensively, and the independent advice is that the remuneration consultants are driving comparative wage justice. These are some of the concerns I have. I have not got a lot of time; I want to come to another major issue. I will be interested to hear at future estimates how all of this works out.

I will now move to another issue—that is, the issue of alternative investments in superannuation, specifically hedge funds. Do you know how much superannuation funds have got invested in hedge funds in Australia?

Mr Chapman—No.

Senator CAMERON—You do not?

Mr Chapman—No. We have had this debate over many years. One of the difficulties we have always had with hedge funds is how you define them. For part of our data collection on super we have a category called ‘other’. The ‘other’ category would in many cases include hedge funds, but some of them may also be in listed equities. Some hedge funds are listed. That degree of ‘other’ is not very high. When we do individual fund reviews and examinations we look at what their investment portfolios are. Ramani might correct me, but I am not aware of any significant number of superannuation funds which we believe have a significant exposure to hedge funds. We obviously have one example which has failed where there was a lot invested in hedge funds; but across the board, Ramani, we would not be seeing significant hedge fund investments?

Mr Venkatramani—No.

Senator CAMERON—What do you mean by ‘significant’, first of all? What is the definition of ‘significant’?

Mr Chapman—I would view a significant exposure as being something above five per cent. But I think we also need to look at this issue from the perspective of: what is a significant exposure for a fund versus what is a significant exposure for an investment option? Then we get back into the same discussions we have had in the past about the degree. The policy over many years has been to allow investment choice, and we do not collect superannuation investment option level data at this stage. One of our proposals is to do so in the future. That is something we are very keen to do. The Cooper review has this as part of their examination. We have slowed our process down to see what comes out of Cooper. Subject to Cooper not recommending otherwise and the government not deciding otherwise, we would definitely be intending to expand our superannuation data collection to include

investment option level, because that is where it starts to become an issue. Of course, a bit like your remuneration discussion about what people can understand, we then flow into disclosure that might be made in PDSs et cetera.

Senator CAMERON—I know that some super funds have two, three or four per cent. That is not unusual in terms of investment in hedge funds. When you calculate that across the Australian industry, there is a significant amount of public investment in hedge funds.

Mr Chapman—I would be surprised if we had four per cent of the superannuation industry invested in hedge funds.

Senator CAMERON—But some funds have.

Mr Chapman—It comes back to the general issue of what a hedge fund is. The ‘bad’ hedge funds are the ones that are heavily leveraged. That is where the difficulty is. Some hedge funds are literally hedge funds around fixed interest investments.

Senator CAMERON—I want to come to that. Are you aware of the developments in Europe in relation to regulation of hedge fund activity?

Mr Chapman—We are aware that there are proposals that have flowed from the G20, and then down to the FSB about whether hedge funds should or should not be regulated. I understand that is something that ASIC have on their plate for consideration.

Senator CAMERON—Can anyone explain to me the proposal that is before the EU Commission at the moment for a directive on alternative investment fund managers?

Mr Chapman—I doubt whether we can.

Senator CAMERON—Could you take that on notice?

Senator Sherry—We have the Markets Group coming next. They may well be able to give you more information. To the extent that hedge funds are used in prudentially regulated superannuation funds it is a sub-investment category. They have outlined the areas of interest here at APRA. The direct oversight of the hedge fund sector is something for ASIC but the markets group would have some information.

Mr Chapman—APRA were the overseers of much of these issues and—

Senator Sherry—Not of hedge funds specifically.

Senator CAMERON—No, I am not talking about hedge funds; I am talking about superannuation funds that are investing in hedge funds. This is where the link comes to APRA, from my perspective. APRA needs to have, I would think, some understanding of the risks that superannuation funds would take when they invest in hedge funds. Is that a proper analysis?

Mr Chapman—That is a fair statement, and we would need to understand the risks when they invest in infrastructure, equities, fixed interest, foreign investment, et cetera. We would not be looking specifically at what the proposals are around the world on how those hedge funds should be regulated.

Senator CAMERON—I am sure the Markets Group is listening in so I am just letting people know that I will be raising this issue.

Mr Venkatramani—In addition to the issues of responsibility of ASIC and the Markets Group, as far as we are concerned hedge funds are one sector into which our superannuation funds can invest. I go back to the statements made by Dr Laker and Mr Trowbridge: in assessing the capacity for regulated institutions to properly care for beneficiaries we first put that test on them. Do you understand what you are investing in? Can you tell me what can go wrong here and what you will do if it does, in terms of member balances, your ability to pay your members on time, sudden drops in value, simply not being able to get hold of information if that hedge fund is operated out of, say, Cayman Islands or British Virgin Islands?

Senator CAMERON—I accept that. I would expect that to happen. But in terms of hedge funds, this is a particular area where the European Commission are now saying that hedge funds were part of the problem in the global financial crisis, and that hedge funds are a significant area that requires regulation. That is what they are saying. If you do not know about it can I ask you to take it on notice? I do think it is important in the context of your supervision of superannuation funds that you have a look at the directive on alternative investment fund managers and advise this committee as to whether it has any implications for your prudential supervision of superannuation funds.

Dr Laker—We will take that on notice.

Senator CAMERON—The other thing I would like you to have a look at is in relation to hedge funds—I am not going to go from there yet. The European School of Management and Technology report has just come out from Germany. It has serious concerns over hedge fund risks.

Dr Laker—I am not aware of the report.

Senator CAMERON—May I table that document?

CHAIR—Yes.

Senator CAMERON—This comes to the issue of superannuation and the capacity of superannuation funds to understand what is happening. I want to alert you to it and maybe get you to see what areas you have concerns on. It came out on 1 June in Europe—and here too, obviously, as I picked it up. It says there is ‘serious worry over hedge funds and the risk to investors’. There are a number of dot points that talk about ‘serious concerns about investors ability to make the right investment choices’. When they are talking about ‘investors’, I assume they mean superannuation funds, pension funds and individual investors. The report says:

... increasing investor protection and curbing unnecessary risks should be a priority for regulators.

That is your responsibility. It goes on:

- Investors naively chase performance at all costs, irrespective of the risk of different hedge fund investment styles
- Style volatility, and investors’ inability to time switching in and out of different investment styles, exposes them to unforeseen risk
- Research raises concern about the efficient allocation of capital and implications for hedge fund regulation

Is that something you would be interested in?

Mr Chapman—The general issues that are raised here we would certainly be interested in.

Mr Trowbridge—From our point of view, this is a secondary interest. The primary interest would be ASIC's responsibility because hedge funds would normally be operating through an AFSL. I say it is secondary because our only interest is in what superannuation funds invest in. It is the responsibility of the trustees to consider whether any particular hedge fund is one they want to invest in, and we hold them accountable as we have said earlier, for their performance overall. But individual hedge funds are part of ASIC's interest.

Senator CAMERON—This is not simply about individual funds. If you look at the document, it is a study over 10 years of 1,543 hedge funds. This is about the industry; it is not about specific hedge funds, it is about the behaviour of the industry. If we have superannuation funds with up to four or maybe five per cent of their members' investment in hedge funds this raises a range of very serious issues about the behaviour of hedge funds and trustees. If it a secondary issue to you, who do I raise this with as a primary issue to make sure these questions are being dealt with?

Mr Chapman—Going to the four dot points you mention. The first three are, I would argue, clearly in APRA's bailiwick to consider in the context of superannuation. This is about what the investors understand, how they made their choices and how they have decided hedge fund x is appropriate. Point 4 is the issue around how you actually regulate hedge funds. We will take the issues covered here and look at them, and how we might build them into investment guidance. Dr Laker mentioned before issues around what we have done on the valuation of unlisted assets. This is another one of those sorts of issues. We did put out a hedge fund commentary back in the early days of APRA when they first popped up on the investment horizon. Certainly issues like these are ones that we can take and consider in the context of how we look at individual funds and what they have done. Whilst we have not seen the report and gone through the analysis, these issues at the top are not dissimilar to many of the investment challenges that trustees face as they move away from traditional fixed interest and equity market investments.

Partly this comes back, Senator, to your comments about the opaqueness and the understanding as you get through it. I would take out of this from a very quick read that we should be looking at how trustees have tried to force their way through that opaqueness. Certainly in the one example we have at the moment where we have hedge fund investment problems the opaqueness has been a significant part of that process. Once you go down three or four levels through different jurisdictions and different types of investments, it is really hard to work out where the money is—or if it is.

Senator CAMERON—That makes it very difficult for a trustee, like I was, on a super fund trying to make a judgment as to whether an investment of maybe up to four or five per cent of the fund's capital in a hedge fund is a risky or non-risky proposition.

Mr Chapman—Yes.

Dr Laker—Can I just add to what Mr Chapman said. This question of opaqueness is really at the heart of the way in which regulators around the globe are seeking to address hedge funds and why it does not fall into a prudential regulator's remit in most cases. The hedge

fund question has been around for a long period of time and the views about how to regulate hedge funds waxed and waned depending on the activities of hedge funds—

Senator CAMERON—Or the short-term returns that are coming out.

Dr Laker—Yes, and the nature of macro hedge funds versus fund-of-funds. The style of hedge funds has changed a lot over the last decade. There has always been a difficulty in working out exactly how to regulate hedge funds by any means, because many of them are registered in jurisdictions outside the major financial centres, so you have a question of legislative reach anyway. But the way in which market conduct regulators are seeking to address hedge funds is through greater disclosure. That is where a lot of the debate is currently taking place. It is why it does not touch us in the direct sense—certainly the issues you have raised here indirectly do. It is because any solution to the regulation of hedge funds will be about removing that opaqueness and making sure that hedge funds are much more visible and that their strategies are much more visible.

Senator CAMERON—This is not a criticism of APRA—

Dr Laker—No. I am just trying to explain—

Senator CAMERON—Yes, I just thought you were a bit defensive. In terms of where I am coming from, I accept and understand that you cannot regulate hedge funds, but you can regulate the behaviour of superannuation trustees and funds who are making investments in this area. So what I am asking you is: is it appropriate that there be some education programs on these types of funds, given the concerns that are being raised in this report? I have not read the report in great detail; it has only just come out. I am just asking you: does this provide any warning bells for our superannuation industry and for you as a regulator that we might need more education of trustees in relation to investment in this type of investment group, which is hedge funds? Should there be some standards set for superannuation trustees in relation to investing, and what checks and balances do we have to make sure we can get the gains of hedge funds if they are there, with the appropriate protections? That, in my view, is what APRA should be about and that is why I have raised it in this session with you.

Mr Chapman—Yes. We will take that on board.

Dr Laker—We will certainly take it on board. I think, while we have mentioned this in other contexts, I need to add here that the Cooper review may well have views about the role of trustees and investor choice. So by the time we meet next we will have the recommendations of Cooper in this area, if it addresses these questions.

Senator CAMERON—Could I just ask you a general question then to take on notice. Could you have a look at the European proposals—

Dr Laker—We certainly will.

Senator CAMERON—and have a look at this report and give me and this committee your view as to whether there are any issues that arise from this that APRA should be dealing with?

Dr Laker—I will take that as a question on notice and we can reply formally.

Senator Sherry—Just to conclude, there is also an issue here for self-managed super funds because it is likely that there would be some exposure in that sector to a greater level of more

exotic and perhaps in some cases less diversified investment instruments, including hedge funds. But again the broader policy issue of the parameters you would have around any form of investment option is a matter that Cooper is certainly considering at the moment as well.

Senator PRATT—I have a question about the insurance industry. I think it might have been you, Mr Trowbridge, who in a speech was highlighting the state of Australia's regulation in insurance in contrast to some other countries that are not as well regulated, and hinting at some of the risks that exist in the insurance sector more broadly because of that. What do you think is the current state of play?

Mr Trowbridge—I think the greatest risk is around group supervision. To illustrate what that topic is, we think of it as the AIG problem, where you have a parent company with subsidiary companies—in that case, one of over a hundred insurance subsidiaries—and the parent company is not regulated or is not well regulated, and that is a consequence of the fact that all around the world insurance regulators, and banking regulators for that matter, are very focused on regulating and supervising the individual licensed entity but when it is part of a group there can be contagion risks within the group, which is what the AIG example shows. So that is the biggest gap. If you look at the GFC, questions were asked here earlier about what is going on in the banking side. The biggest gap globally is group regulation and, as Dr Laker said in his opening remarks, we have recently issued a paper on conglomerate regulation. We at APRA are fortunate that the government has given us the powers to deal with the holding companies. In some other countries that power does not exist. That is a gap in the United States and it is also a gap in some other countries.

Senator PRATT—Is there much sense that there will be movement on those issues internationally to tighten them up?

Mr Trowbridge—The counterpart of the Basel committee in insurance is the International Association of Insurance Supervisors, and the biggest issue it is dealing with is this one. So there are international initiatives afoot. I think it will take some time before it matures and you can tell from what I have just said that there will be legislative change needed in some countries in order to give the regulators the power they need. But that is the biggest issue.

Senator PRATT—Okay. Thank you very much.

Senator BUSHBY—How does APRA plan to take their enhanced statistical collection forward once the Cooper review is completed, and can you report your findings into superannuation data collection?

Dr Laker—Can I just give you a very general answer to that and then my colleagues can fill that in. We had put out a discussion paper to industry on the enhanced statistical collection. We had received a number of submissions on that which were very broadly supportive of what we were seeking to do, particularly in collecting information at the investment option level. But we have, in a sense, deferred that work until Cooper, which has been asked to look at the collection of statistics, provides its recommendations. I cannot anticipate what they will be yet so we will have to wait and see, but if they support the notion of the enhanced statistical collection then we would be ready to go back out to industry with the follow-up material. We have told this to the industry. We have put that work on hold pending the Cooper analysis of it.

Senator BUSHBY—In a more general sense, how has APRA engaged with the Cooper review?

Mr Chapman—We have had a number of discussions with the panel so that they can understand what our viewpoints are on various issues. I would have to say that in those discussions statistics has not always been at the top of the discussions.

Senator BUSHBY—In a more general sense.

Mr Chapman—In a more general sense, we have given our views on some issues that they have raised.

Senator BUSHBY—Did you put in any written submissions?

Mr Chapman—No, we did not put a written submission in. We did debate whether that was appropriate and we decided it probably was not in the context of what the review was trying to achieve as a first step. There are probably areas in their final recommendations that we will be strongly in agreement with. There will be some areas that we possibly disagree with. It has been a productive process for us and them I think in that we have been able to put our points forward and we can understand some of the issues that they are looking at.

Dr Laker—The Deputy Chairman, who is unfortunately unable to be here today, is the person who has taken the lead from APRA's point of view and he has met with Mr Cooper himself. He and our team have met with the panel as the panel on a number of occasions. It has been very helpful in just explaining how APRA approaches certain issues. We have staff on the secretariat that is supporting Cooper as well.

Senator BUSHBY—Are they seconded to the secretariat or are they reporting to Cooper or to you?

Mr Chapman—They are members of the secretariat reporting to Cooper. They are not reporting to us.

Senator BUSHBY—So you are not fully aware on a consistent basis as to what those APRA members reporting to Cooper are doing or working on? They are seconded in the full sense?

Mr Chapman—We picked the people because they understand APRA's perspective. So we are confident they are advocating our perspective in discussions with the secretariat.

Dr Laker—They are very experienced superannuation specialists.

Senator BUSHBY—You mentioned that there have been a number of meetings. Is it a to and fro type of thing where they come to you and test things or are you going to them to make sure that they understand certain things that you want to make sure that they understand? Who is actually asking the questions? Who is making the approaches for the interaction?

Mr Chapman—It is actually both. As Dr Laker said, we have had a number of different forums of interaction with the panel and Jeremy himself. They have been on: 'Here is an individual issue. We read in the *Financial Review* that you made a speech and you said this. Is that really what you meant?'

Senator BUSHBY—So it is reactive to some extent?

Mr Chapman—Some of it is reactive; some it is proactive. The panel has been proactive on occasions in saying to us that we want to have a chat to you because we are thinking about these sorts of issues.

Senator BUSHBY—That was the question that I was going to ask next: are they testing things with you as to how that would play out from your perspective?

Mr Chapman—Yes. It has been quite a good process, but it has also been fairly time constrained and they have had lots of other input into the process. We are not uncomfortable with the degree of interaction we have had to date.

Senator BUSHBY—Does APRA intend to publish data at an investment option level or are you still holding off until the Cooper review comes out?

Mr Chapman—The answer is yes and yes. We do intend to publish it but we are not going to start the process of designing the collection until after Cooper has reported and we know what is happening there. Then of course we will have the normal time lag problem of how long it is before we can publish that data.

Senator BUSHBY—So it could be years before you actually have something.

Mr Chapman—As Mr Jones has said before, we are much keener on having five-year performance data than one-year performance data.

Senator BUSHBY—I recall those discussions.

Mr Chapman—Simplistically that would mean that you will not see investment option data for probably seven years. I think that would possibly be too long as we get into that process, but we are committed to doing it and we have general industry acceptance that it is a good thing to do. We do not anticipate that Cooper will recommend otherwise. There will be some other data collections that we suspect will come out of the Cooper recommendations, but to get a decent set of data will actually take some period of time.

Senator BUSHBY—I imagine I will be asking questions within seven years on that.

Mr Chapman—I have no doubt about that at all.

Dr Laker—We look forward to it.

Senator BUSHBY—As we get closer to seven years, it will depend on the Tasmanian voters. Will the superannuation industry have any ongoing role under the proposed enhanced statistics reporting framework, such as an industry based advisory committee? I guess to some extent it depends on Cooper, but what role will the industry itself have in terms of input into that aspect of reporting?

Dr Laker—The processes that we are required to go through under the Financial Sector (Collection of Data) Act are very consultative processes. If we are given support by the Cooper inquiry to continue with that enhanced statistical collection and we put that collection together, we need to go through a dialogue with industry. We have a very active dialogue on those sorts of matters.

Senator BUSHBY—Is that in setting it up?

Dr Laker—Yes, in setting it up.

Senator BUSHBY—I am also interested in the ongoing role that the superannuation industry would play. Will you build an industry based advisory committee that will have ongoing input and oversight to assist APRA with that?

Dr Laker—We virtually have that structure in any event because the industry associations with which we interact are not shy in putting their views to us on a range of issues on a regular basis. There is a very active dialogue with all of the key bodies involved in the industry and that has been the case for some time. We welcome the dialogue.

Senator EGGLESTON—I would like to ask you about the government's bank deposit guarantee and its impact on first tier lenders, their financial performance, their financial position and their performance ratio to second tier lenders. Are you able to answer this?

Dr Laker—The administration of the government guarantee is not an APRA matter. I can only say that the intention of that guarantee arrangement was to enable all institutions that were tapping an offshore wholesale markets to resume access to markets and achieve that purpose. It got to the point where our institutions were able to raise funding without the guarantee. On that basis the scheme was, as we know, closed. It had achieved its general purpose.

Senator Sherry—Markets group are appearing later. They have the policy oversight or implementation oversight. There certainly would be some relevance there.

Senator EGGLESTON—I will keep these questions until then.

Senator BUSHBY—I have a question on general life insurers. Commercial bank executives have argued that the proposed rules on liquidity could force bigger banks to set aside billions of dollars in largely unproductive assets such as cash and government bonds that could not be lent. Will this not impact on profitability because it is not actually life insurance?

Dr Laker—Is this a question about the liquidity proposals?

Senator BUSHBY—This has come to me from one of my staff and it is a bit confusing. Ignore my opening comments. Here is my line of questioning. Commercial bank executives have argued that the proposed rules on liquidity could force bigger banks to set aside billions of dollars in largely unproductive assets such as cash and government bonds. I might just move on from there to a different question. There has been a proposal by the Cooper review to grant APRA new powers relating to a super controller, giving a greater independent oversight of the expanding industry. What will be the budgetary implications of APRA taking on expanded roles as floated by the Cooper review? Have you had a look at that?

Mr Chapman—We have had some consideration of what it might take and how we might be capable of doing some of the activities that the preliminary Cooper reports have recommended or noted as issues they are considering. We do not know what the outcome will be until we know (a) what the recommendations are and (b) what the government response is.

Our best guess, if you want to put it that way, is that if we had to do all the things that the Cooper review has so far put out in the public arena, we would probably require additional funding but it would not be a quantum leap in funding. Our total budget at the moment is

around \$120 million; we would probably be looking at the order of an additional \$5 million, or an additional 20 staff, if all those issues from Cooper were implemented.

Dr Laker—I would probably be more cautious. I think I would wait until the government has responded to the Cooper inquiry and then, in the normal course of the new policy proposal process, we would look at what that implied for us. We are fully stretched at the moment, so it is not as though we could absorb that extra demand readily within existing staff. We would need to look at that quite specifically after we see the final outline.

Senator BUSHBY—That seems to be quite a sensible approach to me, to actually wait until something is going to be implemented—you are sure it is going to be implemented before you do it, otherwise, as with a lot of the other departments, they ramp up their staffing levels in advance of anything actually happening.

Senator Sherry—APRA will never be accused of that!

Senator BUSHBY—APRA is a very conservative organisation, and that is something I like.

Senator Sherry—Conservative but rigorous. The Cooper review has published from time to time proposals but not final recommendations. I think it is moving too far ahead to conclude what consequential resourcing issues are until, first, the final report is made and, second, there is a government policy response to that report. The next step is resourcing, if that is required.

Senator BUSHBY—Most of the remaining questions I have are about the bank deposits guarantee, but in view of the response that Senator Eggleston received I will not ask those at this point.

Senator CAMERON—What are APRA's staffing numbers?

Dr Laker—The budget for next year is predicated on a level of about 648 staff. About 608 are what we would call formal full-time positions; the gap is made up of some casual staff, who we are using at the moment to help us on this large policy workload we have, and we have a number of fixed-term employees who help us on our contact centre work.

Senator CAMERON—What is your staff turnover per annum?

Dr Laker—It has waxed and waned. It has mainly been a high number through the course of the global financial crisis. I think it is now in single digits, and it was a year or two ago very, very low.

Senator CAMERON—Is 'single digits' nine, or two, or one?

Dr Laker—It is around the high nines level. It has been much lower, but we are starting to see more hiring activity in the financial sector. We now have seasoned staff who have been through a crisis and they are going to look attractive to other employers.

Senator CAMERON—So it has been up to 10 per cent or more?

Dr Laker—It has been much higher.

Senator CAMERON—If we look at it conservatively, seeing as that word is being bandied around, you have 600 odd staff so you lose 60-odd staff a year. What are the

implications of the proposed freeze by the opposition if you cannot replace 120 staff over two years?

Dr Laker—The turnover number at the moment is eight per cent so, as I say, it is in the high single digits. At the moment we are fully staffed and stretched with those numbers. We have been supported by the additional funding we got from the government over a four-year period. We know that that has two more years to run. Beyond that, in any event, we would need to talk to government about appropriate resourcing. We are working that discussion up within APRA, because there is quite a drop down in our funding down the track.

In the end it is a decision for the government of the day to work out what is the appropriate commitment of society's resources to a prudential regulator. The industry funds that but the government make that decision; we have accepted that. So I would wait and see what the government had in mind at the time for the kind of intensity of supervision that was expected of APRA, and we would work within that.

Senator CAMERON—Sure. You are being very diplomatic, and I can understand that, but I am after a bit more meat than that response, I must say. In terms of losing 120 staff, do they go from across the board, from your very high-level staff down?

Dr Laker—Senator, can I just understand where the 120 comes from. I was looking through my papers when you asked about it before.

Senator CAMERON—That would be roughly a 10 per cent turnover of staff with a two-year freeze.

CHAIR—I will have to ask Dr Laker to take that on notice because we are at the morning tea break and the end of APRA's appearance.

Senator Sherry—Just before we break, Chair, this is Mr Trowbridge's last appearance at estimates—he is retiring from APRA—and I want to acknowledge that and thank him. He has worked through what can only be described as an extraordinary period in the financial services sector.

CHAIR—What a way to go!

Senator CAMERON—You had better replace him quickly!

Senator Sherry—I just wanted that on the record.

Mr Trowbridge—Thank you very much.

CHAIR—Thank you very much to APRA and particularly Mr Trowbridge.

Proceedings suspended from 11.01 am to 11.16 am

CHAIR—I welcome the Treasury Markets Group. Do you have an opening statement that you would like to make, Dr Kennedy?

Dr Kennedy—No, Chair. I just note that Jim Murphy is unable to be here today. He is travelling with the Treasurer in China, so I am the acting executive director.

CHAIR—I was just asking about him, so my question has been answered.

Senator HUMPHRIES—I want to ask about the reference in Budget Paper No. 1, on page 217, under the heading 'Dwelling investment':

Demand in the sector is expected to be supported over the forecast period by strong population growth, rising incomes and a positive employment outlook, but tempered by higher mortgage interest rates.

Could you give me an idea of what sort of work Treasury has done to support that statement?

Dr Kennedy—Unfortunately, those questions would normally go to the Macroeconomics Group who prepare the forecast. I can talk in general terms, and I will, around the housing market forecast, but our Macroeconomics Group prepares the budget forecast and makes those assessments, although we feed into them. I am happy to make a couple of remarks. Were you particularly interested in an aspect of that assessment—the demand aspect?

Senator HUMPHRIES—I am particularly interested in the higher interest rates aspect. When you make reference to higher interest rates, do you have a projection or modelling on how high interest rates might go?

Dr Kennedy—I am sorry, Senator, but that is a question that would have to go directly to the Macroeconomics Group. They have a set of assumptions they use in preparing the forecasts. I am sorry that I cannot provide you with that detail, but I would be happy to take it on notice for you. I do know for a fact that they do not independently forecast those interest rates. They have an assumption that they use. In the past it was a 30-day average struck at the time when the forecasts were prepared. I noticed that in more recent times people have tended to use the forward curve—what the market is suggesting interest rates will be. I do not have those technical details with me. The assumptions are usually outlined in the section that discusses the forecast. I will ask one of my colleagues whether he can find that assumption for you.

Senator HUMPHRIES—Thank you. I could find assumptions about growth and unemployment but not one about interest rates. I would be grateful if you could direct me to that.

Mr Lonsdale—The key assumptions are outlined on page 2-7, but the issue of interest rates is not explicitly one of those.

Dr Kennedy—We will take that on notice for you and talk to our colleagues in Macro Group and tell you how that was derived.

Senator HUMPHRIES—Thank you very much.

Senator JOYCE—I just want to explore some of the effects on financial markets of the resource super profits tax. My understanding is that in general the introduction of the RSPT will lower the return on capital for many mining projects. Is that correct?

Mr Lonsdale—I think those sorts of questions are best handled by our Revenue Group colleagues unless there is a particular financial market aspect to that.

Senator JOYCE—Why wouldn't it have a connection with financial markets?

Senator Sherry—If you could perhaps specify the area of the financial markets that we may be able to go to. As you are aware we have had an extensive discussion about this issue in revenue and in macro. If you can go to direct issues, we may be able to assist.

Senator JOYCE—Okay has Treasury consulted with the financial sector on whether banks will adjust finance costs to reflect the role of government as the silent partner in the RSPT?

Mr Lonsdale—In terms of the work of the Markets Group it has not been the case, but in the case of other parts of the Treasury that could well have been the case. We would have to check.

Senator Sherry—To that extent we will take it on notice.

Senator JOYCE—Has there been a reduction in financing for small business since the advent of the global financial crisis?

Mr Lonsdale—In terms of access to finance for small business there is a definitional issue about what is small business. If you take as a proxy, I guess, loans of less than \$2 million, for example, what we have found during 2009 is that access to funding for those loan levels have been flat compared to large business which has probably declined during 2009. In a relative sense it has held up quite well compared to large business. If you like, I could give you some figures.

Senator JOYCE—That would be great.

Mr Lonsdale—The total credit outstanding for small business as at March 2010 is around \$200 billion. That has remained fairly steady through 2009. There has been very little difference during that period.

Senator JOYCE—So \$200 billion remains outstanding in loans to small business?

Mr Lonsdale—Correct, as defined broadly, as I said before, for loans of less than \$2 million. You will be aware that there are different definitions out there as to what a small business is.

Senator JOYCE—I do not know whether you can answer this but we will have a crack at it—is the tenure of that 200 billion static, is it the same loans that are in place? What portion of that is rolling in and rolling out in that 200 billion amount?

Mr Lonsdale—It is difficult to say. What I can say though is that there is a large amount of finance for small business provided that uses an individual's home as security. Usually that is under a variable rate loan arrangement probably over a longer term. I do not have any specific data that would answer your question.

Senator JOYCE—I put a question on notice to Treasury last time—and I got an answer back—about the overall portion of indebtedness of Australia to all sectors in relation to other countries. I think we came in as the sixth most indebted nation as a percentage of GDP in the world. What is the total amount of the debt from all sectors, both the public sector and the private sector?

Mr Lonsdale—I do not have those figures with me. In fact I think it is something that I would have to draw on from other groups to come back to you.

Senator JOYCE—Can you come back to me with that?

Mr Lonsdale—I am happy to take that on notice.

Senator JOYCE—I also want to know how much of that is rolling, and what the terms are of that debt. How much is it? Is it 90 days? What is the tenure of that debt?

Mr Lonsdale—I suspect it would be difficult to get that level of granularity, but I am happy to check.

Senator JOYCE—Have a go at it.

Dr Kennedy—Excuse me, Senator, but, as John was saying, there is some information on the maturity of foreign debt that is held that the Reserve Bank regularly publishes an assessment of the maturity of. My understanding in broad terms is that it has gone out in more recent times as people have tended to borrow on a longer basis through the global financial crisis. But John is right: to get the details we will have to go to macroeconomic group and talk to them about that. Off the top of my head, I think foreign debt as a proportion of GDP is—

Senator JOYCE—Fifty-six per cent or something.

Dr Kennedy—Yes, I thought around 60 per cent of GDP.

Senator JOYCE—What I am trying to break down is when people say, ‘Oh well, that’s all invested in mining projects,’ I do not think it is. I think the vast majority of it is invested in houses. What proportion of Australian debt is for the purchase of domestic housing?

Mr Lonsdale—So private-sector debt?

Senator JOYCE—Yes.

Mr Lonsdale—Again, I would have to check that. I do not have that data.

Senator JOYCE—From what I recollect, it is about \$1.3 billion—sorry, \$1.3 trillion in total debt—

Senator Cameron interjecting—

CHAIR—Senator Joyce, sorry about that. Please keep going.

Senator JOYCE—of which \$850 billion is held by the bank sector. Half of that again is just for housing, and about the same amount that is in housing is on terms of 90 days. I just want to clarify that, because this is part of correspondence that is going around. I want to get to the bottom of it.

Mr Lonsdale—Sure, we are happy to talk to our macroeconomic colleagues and come back to you.

Senator JOYCE—What countries have less debt than us? Or what countries have more? From the answer I got back on notice, the ones that were more than us were Greece, Iceland, Ireland, Hungary, Portugal and Spain.

Mr R Murray—New Zealand.

Senator JOYCE—And New Zealand. That was about it. Every other country was better off than us.

Mr R Murray—Here you are talking about figures of total debt and of course a lot of those countries have significant deficits. As you know with Greece, it has a very long history of a significant lack of credibility in financial markets and that translates through, when you

look at it, to the significant premium on all of their government debt, but also on their private debt. So when you say whether countries are better off or worse off, then I think you would need to take into account all of those factors. We have been, over a very long period, a net importer of capital. That has waxed and waned. A lot of this is because we have significant investment opportunities. If you look at the overall savings record within Australia, in fact taking into account total savings—so that is by the business sector, the household sector and the government sector; the government sector has to be taken into account as well—we have a pretty good track record against OECD countries from a saving point of view. But particularly over recent times we have had significant investment—

Senator JOYCE—Where is that significant investment?

Mr R Murray—It is true that in the early part of this decade some of that was driven by the housing sector, but in recent times most of that build up in private investment to GDP has in fact been in the business sector, and a lot of it in the resources sector.

Senator JOYCE—In the resources sector, right.

Mr R Murray—So you need to take into account all of those issues.

Senator Sherry—A lot of it is in the resources sector.

Senator JOYCE—That is interesting.

Mr R Murray—But it is not the only place where there has been a lot of business investment.

Senator JOYCE—But that is by far and away the majority of it.

Mr R Murray—No, I am not sure that that is true.

Senator JOYCE—If not, then where is it?

Mr R Murray—I would have to check that; I am not sure if that is true.

Senator Sherry—Senator, one of the difficulties here is that—you referred to this in your earlier reference to the answer which was provided by the macro group—we are really crossing back into significant areas of responsibility of the macro group. If you want to ask, as I suspect you will, some detailed questions about foreign investment in Australia then there certainly are issues in relation to foreign investment in Australia we could go to, because that is the direct responsibility of the markets group. But the broader macro issues of national debt, government debt and private debt are issues for macro.

Senator JOYCE—What is the return that we get out of the housing sector? Does it produce an income for Australia once it is constructed?

Dr Kennedy—It produces a strong pile of services for people who live in houses, for the individuals.

Senator JOYCE—The individuals who build the houses?

Dr Kennedy—Who are either the owner-occupiers or the investors. The benefit flows directly to households over a long period of time. As you noted, it is an investment: you buy the house and you get all of the things that come with that house for many years.

Senator JOYCE—So if we had an economy just full of houses, what would it produce?

Senator CAMERON—No roads, no railways, just build houses!

Mr R Murray—We just would not have an economy.

Senator Sherry—That is particularly hypothetical.

Mr R Murray—We just would not have an economy full of the houses. You either have a population that is properly housed, or you do not.

Dr Kennedy—This might help, Senator: as a proportion of GDP, about six per cent of GDP is allocated to housing construction. So that is roughly the size of the economy in terms of activity that is housing—that is renovations as well as new housing. But I cannot go much further into the details.

Senator JOYCE—So how much of the economy is in the resource sector?

Mr R Murray—Again, these questions should really go to macro group. But from recollection, it is about six per cent.

Dr Kennedy—Roughly the same.

Mr R Murray—About two per cent by employment, something like that.

Dr Kennedy—But, Senator, we would have to take these detailed questions on notice and ask our colleagues in macro group for the figures. It is not something that we do.

Senator JOYCE—If there is a discernible effect in the resource sector, what will be the effect for our economy?

Senator Sherry—Can you clarify ‘discernible effect’—

Senator JOYCE—If there is a downturn in the resource sector in the long term, what will be the vulnerabilities in our economy?

Mr R Murray—You should really ask the macro group that question. We can take that on notice, but that really is a question for the macro group.

Dr Kennedy—These are questions for Dr Gruen, who appeared in front of you yesterday.

Senator JOYCE—I will go back to financing. So you are saying there has not really been a winding back in financing in the small business area?

Mr Lonsdale—What we are saying is that what we have seen in terms of credit availability has been pretty flat. Now there are demand and supply factors that are mixed in there, but pretty flat on the definition of small business that we talked about.

Senator JOYCE—What is your definition of small business?

Mr Lonsdale—In terms of how these figures are calculated, it is on the base of loans that are less than \$2 million in size.

Senator JOYCE—And the credit availability has been flat?

Mr Lonsdale—This is total credit outstanding. We understand that credit availability has been available where it is needed. That is a different question to pricing, of course.

Senator JOYCE—Are the securitisation markets an important source of funding for housing and small business?

Mr Lonsdale—We think it is, so the securitisation market, particularly the RNBS that is traditionally issued by the second-tier banks, is an important source of finance for those banks and it provides loans to business, including small business. That is part of the reason why the government introduced its two tranches of RNBS purchases of \$16 billion over the last 1½ or two years.

Senator JOYCE—What measures is the government taking at the moment to try to deal with the effects that have happened in the securitisation market?

Mr Lonsdale—Domestically?

Senator JOYCE—Yes, domestically.

Mr Lonsdale—There are a few. One major measure is the RMBS measure that I talked about, providing AOFM with the funds to purchase new issues of RMBS, or at least contribute to that.

Senator JOYCE—Has that been effective? What is the effectiveness of the RMBS?

Mr Lonsdale—If you like, I can provide you some figures on RMBS issuance. From November 2008 to the present, there have been around \$24 billion of RMBS issued. The AOFM has purchased just over \$9 billion of that amount of RMBS, or around 37 per cent of the total amount issued. That has been a major stimulus to the RMBS market, which essentially dried up during the latter part of 2008.

Senator JOYCE—In quantifying its effect, what are the measures that you are using?

Mr Lonsdale—In term of the figures that I have just provided, the first figure was total amount of RMBS issued by all institutions over that period, and the second figure was the purchase of that amount by the AOFM—what proportion of that amount was purchased.

Senator JOYCE—Is government borrowing in capital markets having an impact on the quantity and cost of finance available to the private sector?

Mr Lonsdale—Again, that is difficult for me to comment on. That would be something that I would have to consult on with our macroeconomic colleagues. I am not aware that that is happening.

Senator JOYCE—Could you take that one on notice.

Mr Lonsdale—I am happy to, yes.

Senator JOYCE—Thank you. Do you agree that, if Australia fails to save sufficient funds to meet all investments and needs, the shortfall must be provided by offshore investors?

Mr Lonsdale—I will add to Mr Murray's earlier response. We run a current account deficit in Australia. We have done so for many, many years. A key part of funding that is money from overseas, and the banks seem to mediate quite a bit of that funding. So we are very reliant on that funding.

Senator Sherry—You raised this issue with Macroeconomics Group, Senator Joyce. I do not know whether you are reading the same question sheet that you put to macro, but I am very reluctant to accept questions—indeed, I will not accept them unless they are taken on

notice—that (1) have been raised before with macro and (2) should be in the macro area, not the Markets Group.

Senator JOYCE—Is the volume of funds available to Australia from offshore effectively unlimited?

Mr Lonsdale—That is a difficult question to answer. In some ways, the banks who draw this funding would be able to provide a more, I guess, current answer than we can. If your question is, ‘Is it unlimited?’ it is certainly not unlimited. What is the limit? It is very difficult to know, but for many years, as I have said, we have drawn on overseas savings to fund our current account deficit and use those funds for productive purposes, and that has contributed to a lot of growth in the Australian economy over a long period.

Senator JOYCE—Do you think that a current account deficit in the long term is completely sustainable, in fact?

Mr Lonsdale—Again, the sustainability of the current account deficit is probably something best referred to Macroeconomic Group.

Senator JOYCE—If the volume of funds is not unlimited, is it possible for government borrowings to crowd out private sector borrowings?

Mr Lonsdale—Again, it is a very similar style of question related to the current account deficit and, again, it is a question for Dr Gruen and his colleagues.

Senator JOYCE—Many retail investors have been unable to withdraw their funds from property trusts due to those trusts freezing redemptions. Some commentators have blamed the introduction of the government guarantee on retail deposits. What is your view?

Mr Miller—The difficulties that those funds were having happened before the guarantee was put in place. It was already quite evident well before the government put its measures in place that those difficulties were emerging, so I do not think there is necessarily a correlation between the two.

Senator JOYCE—Does the government have a role in unfreezing those frozen deposits?

Mr Miller—The government at the moment is monitoring how those funds are going. During the worst times, the government put in place, through ASIC and others, hardship arrangements to ensure that people who had difficulty or needed funds out of those deposits could access them. I think at the moment most of those funds are redeeming or at least offering redemptions at a reasonably high rate, though not necessarily 100 per cent. The ability of the funds to perform their role has certainly significantly come back from where it was. Throughout the GFC, for example, virtually every fund was paying out income distributions, which obviously meant that people who were relying on those income distributions were still getting that money. The government watched very carefully and acted where necessary throughout the GFC to ensure that the effects on investors were minimal.

Senator JOYCE—Is the government considering further changes to the retail deposit guarantee?

Mr Lonsdale—To the retail deposit guarantee?

Senator JOYCE—To the size of the guarantee as part of its considerations. At the moment is about \$1 million.

Mr Lonsdale—Yes. We have a deposit guarantee scheme in place. The government has indicated that there will be a review of the cap—the \$1 million figure—that will be completed by October next year. We are in the early phases of reviewing that now, with, I might add, the Council of Financial Regulators.

Senator JOYCE—Would you say that the Australian domestic house price is at a high level compared to OECD countries? Do we have a high price for houses or a low price for houses?

Mr Lonsdale—Again, I think our Macro colleagues would have a better international perspective of the comparison of Australian housing prices to others.

Dr Kennedy—I could probably help you with that, Senator. If you looked at house price to income ratios in the OECD, I think Australia would have around the fourth highest house price to income ratio.

Senator JOYCE—The fourth highest?

Dr Kennedy—Again, we have to check all these facts.

Senator JOYCE—It has been in one of the reports; I am obviously quoting the report. Recognising the amount of extension that we have to the housing market and the fact that we have, in comparative terms of income to house prices, an inflated house price in Australia, does that put us at risk of having our own domestic housing bubble?

Dr Kennedy—Again, these are questions that go straight to Macro. I can refer you to some material. There was recently a speech given by Luci Ellis of the RBA, who discussed some of these issues in terms of vulnerabilities in the housing sector, if that is of some use. But questions about the over- or underinvestment in housing and house price accelerations should go to Dr Gruen in the macroeconomic group.

Senator JOYCE—Wouldn't we have a connection with financial markets and the fact that, if we have, and we do have, a high house price and we have a large amount of the Australian book—that is, underpinning or loaned—for houses, and if there is a housing bubble, quite obviously it will put one of the key factors of financial markets under stress; that is, it comes back to our banks?

Dr Kennedy—Are you asking about the financial stability implications of high prices?

Senator JOYCE—Yes.

Dr Kennedy—Perhaps that is a question that—

Senator JOYCE—I have a whole range of questions but there is where I am heading.

Mr Lonsdale—There are a range of contingencies in that question. If the question is whether purchasers of housing in Australia draw on foreign capital markets, the answer is: yes, through the banks as an intermediary. But the first part of your question as to the sustainability of that in relation to housing prices compared with other countries is, again, something we would have to get advice on from our Macro colleagues.

Senator JOYCE—What are the key factors out there that could create the instability in what is an excessive house price? If there is a correction in Australian factors, we know the factors that will flow through the economy, and they will be quite dramatic. So where are the sensitivities that we have to be terribly mindful of so that we do not make that asset bubble pop?

Mr Lonsdale—The factors that feed into the banks' ability to access finance—

Senator JOYCE—And the person's ability to repay the asset they have got.

Mr Lonsdale—are very important. That is right: the individual's capacity to meet their debt obligations is, again, very important and that goes to employment considerations as well as a whole range of things. Again, Dr Gruen and his colleagues would be able to take you through the mechanisms that would guide that.

Dr Kennedy—One aspect that we could comment on, on the housing side, is that in the housing market itself it is important that that market operates efficiently and, where there is strong demand—for example, for additional housing—that the market brings forward that supply. That is a somewhat separate question from the ones you are raising with Mr Lonsdale. With a well regulated banking sector and people getting housing loans appropriately, it is obviously one very important factor, but we would also hope to see the housing market itself operate efficiently, with an increase in demand met by an increase in supply. There has been some evidence that the increase in supply has not been as much, perhaps, as what we would have thought, given the increase in demand for housing, though there are some signs that that is coming back.

Senator CAMERON—I am not sure whether anyone was listening to the APRA evidence.

Dr Kennedy—Yes, I was.

Senator CAMERON—I raised the issue of hedge funds. Who did I—

Dr Kennedy—Mr Miller.

Senator CAMERON—Mr Miller, are you aware of the European School of Management and Technology report into hedge funds?

Mr Miller—We are aware of it, but it has only fairly recently come out, so we have not done a lot of work on it yet.

Senator CAMERON—Basically my questions go to the same range of questions I have asked APRA, but they do cut across both APRA's and your responsibilities. The report is the result of 10 years work analysing 1,543 hedge funds. The report raises a number of issues. It raises the issue of serious concern about the ability of investors to make the right investment choices, meaning that increasing investor protection and curbing unnecessary risks should be a priority for regulators. What role would your department play in this?

Mr Miller—There are a lot of aspects to this. There is that investor protection side. As you know, in Australia we have a fairly strong investor protection regime under the Australian financial services regime. To the extent that these funds are being put into the retail sector we already have a fairly strong regime of investor protection through private disclosure

statements and other aspects, and, as you know, some of those things are being improved as we go to ensure that investors really do understand what they are getting themselves into.

On top of that, through the GFC and the work through G20 and particularly through IOSCO, I think IOSCO has come out with six principles around hedge funds—what countries should do about regulating hedge funds. Australia has assessed those principles and we do meet all of them to some degree. Treasury at the moment is currently working with ASIC so that, to the extent that those principles are not 100 per cent met, we can meet them. It is our intention to try to meet those six principles put out by IOSCO fully. That will help to ensure that the regulation of hedge funds here in Australia fully complies with what the international community is moving to. I have to say that Australia has been in a far better position than most other countries with regard to hedge funds. As I said, we already meet all of those six principles to some degree. In the US there was very little regulation, and in Europe the regulation they had was very patchy. We were already one step ahead in the regulation of hedge funds.

Senator CAMERON—I am glad we are a step ahead, because this is a very worrying report. Have you skimmed the report?

Mr Miller—Just skimmed it, yes.

Senator CAMERON—Would you accept that it raises some very worrying issues?

Mr Miller—Indeed, for the world.

Senator CAMERON—You raised the issue of Europe—and I want to come back to another three points on this. Europe are discussing this directive on alternative investment fund managers, AIFM. Are you aware of that?

Mr Miller—Only aware of it, yes.

Senator CAMERON—So you would not be able to compare that with what you are benchmarking yourself against?

Mr Miller—Not at this stage. As I say, we are looking at that report and seeing how it compares with what we do here.

Senator CAMERON—That is this report?

Mr Miller—Yes.

Senator CAMERON—Good. The report says:

Investors naïvely chase performance at all costs, irrespective of the risk of different hedge fund investment styles.

Style volatility, and investors' inability to time switching in and out of different investment styles, exposes them to unforeseen risk..

Research raises concern about the efficient allocation of capital and implications for hedge fund regulation.

What issues does that raise for you?

Mr Miller—To the extent any of those things are happening in Australia, obviously they are a concern. But in each community—the European community, the American community,

the British community, the Australian community—investors do react differently because they have a different set of circumstances in which they invest. We have fairly strong regimes here in the area of financial literacy. We have strong regimes in regulation of financial services and advice. We are doing more, as you know, through the various announcements—future financial advice announcements and other things that are happening in Australia, even strengthening that further. So obviously all those concerns raised by that report are a concern for us, but what we need to do is assess to what extent it is happening in Australia and to what extent any of our regulation does not already deal with those things. On a very brief skim—it is only a skim—most of that is dealt with satisfactorily in Australia. But that does not mean we should not look—

Senator CAMERON—Is that to your knowledge or is that a definitive statement?

Mr Miller—Just to my knowledge. As I said, we are working with ASIC at the moment looking particularly at hedge funds, looking particularly at the six principles put out by IOSCO—this report will form part of those discussions as well—as to what else needs to be done in Australia to strengthen what is already a fairly good regime in Australia.

Senator CAMERON—One of the issues that is raised in this report is:

Despite the perception that hedge fund investors are more sophisticated, our research suggests that this is not the case and that investors are overly reliant on yesterday's performance.

You are saying that that is not an issue in Australia?

Mr Miller—To the extent it is being sold to retail investors—and there is an argument how sophisticated retail investors are—our system in Australia puts a much higher requirement on funds that are selling into the retail investment market, so there is a lot more protection for those people in the retail market. The paper I think crosses across in their concept things that are going both to retail and to wholesale.

Senator CAMERON—Which you have to do, don't you?

Mr Miller—Yes, and in the wholesale market there are fewer protections. That is true. There is an argument that people who are buying in the wholesale market are more sophisticated than those who are buying in the retail market. Also you would be aware that in the future of financial advice announcements recently made by the government one of the things we are looking at is this line that we already draw between what is the retail market and what is the wholesale market—have we got that line right; should the retail market actually be broader than what we think it is at the moment; and therefore should we broaden the protections that we already have to a wider group of people? That is all under discussion at the moment.

Senator CAMERON—Let me come back to this issue of sophistication of wholesale markets. One of the issues that are raised in this paper is the opaqueness of many of these hedge funds. Are you sure that the wholesale market in Australia can make proper decisions to advise trustees on boards of superannuation funds properly given this opaqueness in the hedge fund industry? This is not just one fund; this is over 1,500 funds. I am interested in how sophisticated we really are.

Mr Miller—I might bring someone else in who might have a bit more of that detail.

Ms Kljakovic—I think a decision has been made that, if you are in the wholesale category, you are probably more capable of getting your own competent advice and then there would be the normal obligations on advisers to make sure that that advice is competent.

Senator CAMERON—That comes back to the very point I just made. You may be competent, but if there is a fund that is opaque in terms of its performance, opaque in terms of disclosures, then it does not matter how competent you are; you will not be able to give proper advice.

Ms Kljakovic—I think proper advice in that context would be either, ‘We got the information privately,’ or ‘We cannot tell you that this is a suitable investment.’ I agree that as much information is not publicly available in respect of the wholesale investors.

Senator CAMERON—Assistant Professor Baquero, who is part of the team on this report, says, ‘Now is the time to discuss deep, substantial and effective regulation that will genuinely be of use to investors and protect our financial system for the future.’ Do you agree with that proposition?

Ms Kljakovic—I would agree with that, yes.

Senator CAMERON—So what are we doing to deal with this deep, substantial—does somebody behind you want to say something? I saw a startled expression behind you.

Mr Miller—I think the question ignores in some ways what I was saying. We have a fairly strong system already.

Senator CAMERON—No, it is not ignoring. I was not satisfied with your response. Your response says, ‘This is what we are doing.’ What the professor says is that we need deep, substantial and effective regulation. I did not get the impression from what you said that the regulation is deep, substantial or effective. I am asking the question.

Ms Kljakovic—Certainly in relation to hedge funds as such, compared against the international principles we stack up very well and we are working to make sure that we stack up even better. I think for hedge funds we do have an external measure that we can say we are doing very well against the IOSCO principles.

Dr Kennedy—Senator, are your concerns more the global regulation of hedge funds or particularly the—

Senator CAMERON—Both. This is a global issue but it has got specific issues for Australia because APRA gave evidence to say that some funds have got up to four per cent of their investment in this type of investment instrument. If you take that across Australia, that is a significant amount of investment money going into what this report says is an opaque industry that requires deep, effective and substantial discussion. That is my concern. I just want to make sure that workers whose funds are being invested on their behalf across the industry can be confident that we are doing everything we possibly can to make sure that the concerns that have been raised by this report, the red flag, are being dealt with effectively.

Senator JOYCE—Dougie would know a lot about red flags.

Senator CAMERON—You seem to know a lot about all these houses that have taken Australia over, so give us a break, you dope.

Senator JOYCE—Go back to your red flags.

Senator CAMERON—No wonder the Libs gave you the flick. That is all I can say to you.

CHAIR—Can we get an answer to the question, please, from Senator Cameron, Mr Miller?

Mr Miller—The work that IOSCO are doing is in response to the problems that have been raised globally. The principles that they have come out with at the request of various international bodies are intended to give that deep regulatory response to those sorts of issues. What we are saying is we are meeting those six principles but maybe not to a hundred per cent. We want to make sure we are fully at a hundred per cent, and that is what we are doing—moving to that hundred per cent of all six principles. That is how we are going to get that deep. When I say ‘going to get that deep’, I think it already is deep but it could go deeper. That is what we are trying to do.

Senator CAMERON—Can you take on notice this report and provide a detailed response to the issues that this report raises as soon as possible?

Senator Sherry—We will certainly take that notice. The IOSCO meeting is next week. To summarise, there are direct regulatory and supervisory issues that go to this product. I accept your concern—there are direct regulatory and supervisory issues that go to the product. By taking your question on notice, I will ensure that—whatever occurs at IOSCO, for example, which is to meet very shortly and where this issue will be discussed amongst other things—you are able to get an update and response. ASIC Chairman Mr D’Aloisio is attending that. Our officers have pointed to a range of other work that, whilst it does not go to the direct regulation and supervision of hedge funds as a product, goes to their distribution, sale and oversight indirectly through superannuation funds.

I could point to another area where we have upgraded the regulatory and supervisory system that indirectly but importantly goes to hedge funds—that is, credit-rating agencies. Everyone is well aware of the failure of credit-rating agencies. In response to that, the government and ASIC are implementing for the first time a requirement for licensing and reporting of credit-rating agencies in Australia. That did not exist before, and obviously that could be identified as another area of supervisory weakness of hedge funds. We will for the first time have licensing and reporting of credit-rating agencies, and ASIC will have that capacity. You can obviously explore on future occasions—and I am certainly willing as minister to raise this directly with ASIC or through my colleague Chris Bowen—the extent to which credit-rating agencies in Australia actually report on hedge funds and their operation in Australia. Again, I think it is a perfectly reasonable issue. That is just another example of a—I do not use that term ‘suite’, because I sit on a suite—range of measures that are being very proactively followed by this government.

Senator CAMERON—I am happy with that. I just did want to raise the red flag because this is a big problem and we certainly need to deal with it. When the red flag is up there you have to deal with it, you see. Dr Kennedy, what is the total employment level in your department?

Dr Kennedy—In Treasury?

Senator CAMERON—No, in your specific markets group.

Dr Kennedy—Mr Murray might be able to help you there.

Mr Murray—I had all those figures with me yesterday and I have gone and left them back in the Treasury.

Senator CAMERON—You are obviously pre-empting the question, so, as you are aware, can you give me the responses on notice. I want to know how many employees you have and what your turnover is. Do you have that figure, off the top of your head?

Mr Murray—Do you mean in terms of this group?

Senator CAMERON—Yes.

Mr Murray—I am not sure I have got those figures even back in the Treasury. I am not sure how reliable those figures would be anyhow, given that it is just one segment of the Treasury. Certainly, I can take on notice whether we do have that breakdown.

Senator CAMERON—Okay.

Mr Murray—From my recollection, markets group is about 150. It is about 15 per cent of the Treasury.

Senator CAMERON—Like APRA, people who have had experience in your area would be highly sought after in the general marketplace, I would assume.

Mr Murray—I presume so.

Senator CAMERON—Did you say you hope so?

Senator Sherry—I certainly know it is so. We have such an incredible level of expertise and knowledge. Obviously that is the case, particularly as the financial markets have improved. From my general observance of salary pressure, employment is going up in that area. The financial markets have a very deep and considerable range of experts that are vital to our analysis and oversight of the financial markets in Australia.

Dr Kennedy—You may have discussed this yesterday, but young people who come to Treasury and get a couple of years experience often leave to go and work in the private sector and their experience of working in the department is seen as valuable.

Senator CAMERON—So the general Treasury position would apply to the market group?

Dr Kennedy—Yes.

Senator CAMERON—Mr Murray, without asking for any figures, what would a two-year freeze on employment mean for your capacity to deliver advice to government?

Mr Murray—I think I covered most of that yesterday, but certainly—

Senator Joyce interjecting—

Senator CAMERON—Don't you talk, you goose!

CHAIR—Mr Murray is trying to answer the question.

Senator CAMERON—If I were you, Barnaby, I would just keep quiet.

CHAIR—Mr Murray, please continue.

Senator Sherry—We are here to answer the questions.

Mr Murray—Yesterday I outlined that, looking at overall attrition rates, we had for some years had an attrition rate of around 12 per cent but that had fallen during this financial year back to eight to 10 per cent. But we are assuming again around 12 per cent for next year—that is, 2010-11. That translates to, on average, a loss of about 75 people. Over two years there may be some cumulative effect in that, but it would put a reasonable hole in our capability. What it would seriously affect is our graduate intake, and that is our lifeblood. You asked me a question yesterday about whether that would have serious implications. It has in the past. It may not be felt immediately, but it is certainly felt within two or three years. A lot of these people move reasonably rapidly and they get up to a senior analyst level fairly rapidly. That would be a serious issue for us. That would be two intakes that maybe we could not do.

Dr Kennedy—Markets group would, typically, take 15 to 18 graduates a year—they are roughly the numbers.

Mr Murray—I did outline for you yesterday that whereas previously we had been running with graduate programs of about 50 people, this year, because the graduate supply was so good and we had grown fairly rapidly over the last few years anyhow, we increased that intake to 75. Our forward planning is that we will have another graduate intake of another 75 around February.

Senator ABETZ—I have two brief brackets of questions. The first one is on Ozcar—how are we going with Ozcar? I thought that would bring a smile to your face, Senator Sherry, but it would not be an estimates without me asking about Ozcar.

Senator Sherry—It would not be an estimates without Ozcar, and I did remark that I thought it would be a fairly brief update.

Senator ABETZ—It started off as a \$1 billion fund; how much has actually been drawn, if I can use that term?

Mr Lonsdale—The current size of the Ozcar facility is \$170 million.

Senator ABETZ—\$170 million; would it be fair to say that is not at a break even level? I think that in previous estimates we were told that it would have to be at about \$250 million or thereabouts for it to be at a break even level before there was a cost to the Australian taxpayer.

Mr Lonsdale—Correct; there is a small cost, and that is outlined in the budget papers.

Senator ABETZ—And that cost is—do you know?

Mr Lonsdale—The cost is \$4.45 million.

Senator ABETZ—\$4.45 million—and that is projected to be for this coming financial year, the cost for last financial year or is that the cost overall?

Mr Lonsdale—That is the loss position overall, as I understand it.

Senator ABETZ—Overall.

Mr Lonsdale—It reflects the factors that you outlined before, that at the time the facility was set up the projection was a much larger facility—

Senator ABETZ—Yes, I understand. So the loss overall is to what date?

Mr Lonsdale—This was the loss position as at 31 March 2010.

Senator ABETZ—It was \$4.45 million.

Mr Lonsdale—Yes, correct.

Senator ABETZ—And who are our clients? Ford Credit?

Mr Lonsdale—Ford Credit and a small number of dealer clients from GMAC and GE Money, as I understand it.

Senator ABETZ—I do not need to know the names, but are you able to provide us with what the split up is between Ford and the small ones?

Mr Brake—Perhaps I can add a little bit there; there is only one financier, and that is Ford Credit Australia.

Senator ABETZ—So explain to me then GMAC and the—

Mr Brake—Perhaps I can just give a little bit of history there. We were looking at the prospect of having another financier involved with Ozcar, but recently that financier decided not to participate, principally on the basis that there is only a relatively small period of time before 30 June and that there was only a very small number of potential dealers. The financier was able to take the relevant dealers onto its books.

Senator ABETZ—Right, so how do I understand Mr Lonsdale's answer in relation to GMAC and—

Senator CAMERON—Ask Godwin then.

Senator ABETZ—Is it only Ford Credit?

Mr Lonsdale—Mr Brake's advice is correct. It is just Ford.

Senator ABETZ—That is fine. I make no criticism—these things happen and I can understand how mistakes occur, especially in the Ozcar space. I would be the last one to try to criticise you, Mr Lonsdale! But I do want to have the information absolutely correct. Thank you for that. And the Ozcar facility expires—?

Mr Lonsdale—30 June.

Senator ABETZ—30 June—I suppose I should ask this of the minister—is there any intention to roll it over?

Senator Sherry—I will just have to take that on notice.

Senator ABETZ—Has there been any government announcement, if I can ask the department that, as to its intention?

Mr Lonsdale—The intention is to close the scheme at the end of June.

Senator ABETZ—Thank you for that. Can I move to the area of pathology practices. I have got a lot of blank looks, which is what I was expecting.

Senator Sherry—We are used to Senator Joyce being wide ranging, so I look forward to this one with interest.

Senator ABETZ—Senator Sherry, as I indicated, I have two brief brackets of questions. OzCar was brief; I think this one will be as well. In the 2009 budget there was a decision taken to deregulate the collection centre scheme for pathology services.

Dr Kennedy—I will just check with my colleagues.

Senator ABETZ—Yes, of course. For what it is worth, it is supposed to start on 1 July this year.

Dr Kennedy—I think the best I can do for you, Senator, is take the question on notice. In fiscal group our colleague Ms Peta Furnell looks after social policy inclusion.

Senator ABETZ—I should have asked this in fiscal group rather than in markets. Fair enough. That is fine.

Dr Kennedy—Certainly we look after competition issues, but where they go to a specific industry or market we would look at the area that is responsible for that area, and in this case it is social policy division. But if you want to give me your question—

Senator ABETZ—Thank you. Would you be so kind as to take it on notice, albeit I may be in the wrong area. I would be interested in what Treasury modelling or advice was provided as the background to this decision, because the proposition that has been put to me is that, by deregulating the number of collection centres, there will be a lot more collection centres; therefore, the capital cost will increase; therefore, there will be a driver to try to cover those extra costs; and, therefore, we will see an increase in pathology services to cover all that. When the licensing system was introduced it was designed to restrict the growth in pathology services, and it seemed to have worked. I will leave all that on the *Hansard*. If you can get back to me on notice I would be much obliged.

Dr Kennedy—Yes. I will just clarify. Are you most concerned about overservicing arising out of this deregulation, rather than price?

Senator ABETZ—The extra cost to MBS payments—whether advice was sought from Treasury or any analysis done. I am interested in what the likely impact might be. Can I ask the minister: is this part of the government's policy of letting the market rip by completely deregulating the licensing centres?

Senator Sherry—I would be happy to take up your invitation about my observations as a minister about market and market regulation, perfect and imperfect markets, consumer behaviour and choice, perfect choice and limited choice and irrational behaviour—

Senator ABETZ—That would be one you would be strong on.

Senator Sherry—and default positions et cetera, but it would a very long response, Senator.

Senator ABETZ—I was sure that Senator Cameron was going to ask the question about letting the market rip, so I thought I would get in before he did. Thank you. They are my two brackets of questions.

Senator CAMERON—You have done well. It is a hard gig with no Godwin to help you.

Senator ABETZ—Thank you, Douglas!

Senator EGGLESTON—Can I ask my question in relation to the question that Senator Abetz was asking. As I understood it, the policy rationale for the no co-location rule was to avoid vertical integration between corporate practices and the providers and the orderers of the services, the general practitioners. Is that in effect no longer a concern? Is that the implication of this decision, which is what you alluded to as well?

Dr Kennedy—I am just not across the details of this issue, so I am not sure whether that is a concern or not. I can certainly take your question on notice as well. Are you concerned about a degree of vertical integration and driving less competition in the market?

Senator EGGLESTON—Not less competition, but the deregulation. Vertical integration means that you have a pathology-radiology practice that owns a series of general practices, and doctors in all of those practices refer patients to the pathology and radiology services.

Senator Sherry—I understand the issue you raise, Senator. I am not indicating I agree with your point, but I understand the issue. The difficulty at the moment is that we are not even sure; we will have to check.

Senator EGGLESTON—I understand that. We have put it on notice.

Senator Sherry—We suspect the markets group—but we will take it on notice—probably had no direct input to this policy. It may have been consulted. If it was, we will find out to what degree and give you what we can on that.

Dr Kennedy—I suspect it may have been consulted, but the policy issue clearly would have been led by those responsible for health policy in Treasury.

Senator JOYCE—I return to the effect of the RSPT on financial markets. How will the banks assess the value of refundability of losses under the RSPT?

Mr Lonsdale—It is hard for me to comment on that. It could well be that our revenue group colleagues have had discussions with the banks and can provide information on that. I have not had discussions with the banks on that issue.

Senator JOYCE—Your group is responsible for measures to promote competition, macroeconomic stability and market confidence, including advice on prudential frameworks applying to the banking sector.

Mr Lonsdale—Correct.

Senator JOYCE—You say this is not part of your group, but it is part of your group.

Mr Lonsdale—My understanding of your question goes to a particular budget measure on the resources rent tax and how banks would assess that measure, which is a revenue group measure. That is why I say they have been conducting discussions with industry. I cannot comment on whether or not they have talked to the banks. That is why I say they would be best able to comment on it.

Senator JOYCE—The Henry review argues that the risk associated with the value of tax credits is equal to the government bond rate, because the government is delivering them. Do you agree with this assessment?

Senator Sherry—I recollect hearing these questions before. I go back to my earlier comment: I think you are rereading the questions that you put to the revenue group.

Senator JOYCE—That is just a stupid statement, and you know that.

Senator Sherry—It is not stupid. It is stupid, frankly, to come in here and ask the same set—or a very similar set—of questions that you asked one group to another group. The reason I say it is stupid—

CHAIR—There is a point of order.

Senator BUSHBY—It is not up to the minister to decide what questions should be asked. It is up to the minister to decide how they should be responded to. If Senator Joyce chooses to ask these questions, that is his call.

Senator Sherry—And I had not finished, Senator Bushby. I was about to point out we have no option but to take them on notice, because we cannot answer them unless they are in this particular division's responsibility.

Senator BUSHBY—Senator Joyce has just read from the mission statement of the group, and quite clearly they are.

Senator Sherry—You well know the situation. The same or similar questions have been asked of other divisions. I accept that they were relevant in other areas, but to come back—

Senator BUSHBY—There is no prohibition on asking the same questions of different divisions if it is relevant.

Senator Sherry—All you are doing is wasting time—and it is your time to waste—by repeating the same or similar questions to another division which does not have responsibility. If you want to do that, fine. That is your call, but you should understand that the bulk of the answers will be taken on notice, because they are for another division where they have already been asked.

Senator JOYCE—Have you spoken to the banks on whether they will assess the risks in the same way as the Henry review concluded?

Mr Lonsdale—The risks of what?

Senator JOYCE—The risks associated with the value of tax credits being equal to the government bond rate.

Mr Lonsdale—I have not spoken to the banks, but I would expect that the banks would make commercial judgments on issues in the same way as they do.

Senator JOYCE—Are you aware of anybody within Treasury that would be speaking to the banks on this issue?

Mr Lonsdale—As I said, my understanding is that there is a consultation process around the resources rent tax. It is occurring with industry. It could well be that the banks have been consulted as part of that process—in fact, I would be surprised if there had not been discussions with the banks—but we in markets group have not.

Senator JOYCE—Do you agree that banks make a margin on the money they borrow and lend out?

Mr Lonsdale—Yes, that would be their normal commercial practice.

Senator JOYCE—So presumably the government bond rate reflects the risk of government defaulting on its debt.

Mr Lonsdale—It is hard for me to comment on that.

Senator JOYCE—Has the Commonwealth ever defaulted on its debt?

Mr Lonsdale—Not that I am aware of, but I am more than happy to check.

Senator JOYCE—Has the Commonwealth ever changed tax policy settings?

Mr Lonsdale—The Commonwealth would change tax policy settings all the time. Each year a budget is published and there are many revenue measures in there that have tax change settings.

Senator JOYCE—In what way are the risks associated with the value of tax credits equal to the bond rate?

Mr Lonsdale—Again, I think you are pursuing a line of questioning that relates directly to a revenue group measure and that is not something that I can comment on.

Senator JOYCE—In a speech earlier in the year, titled ‘To build, or not to build: infrastructure challenges in the years ahead and the role of governments’, delivered on 18 March, Dr Henry stated:

These realities often create particular difficulties for private infrastructure investment ... with the strategic behaviour of existing private providers in limiting new entry and sovereign risk that may accompany instability or uncertainty in the public institutions that are designed to support infrastructure investment ...

If sovereign risk is an issue with regard to the regulation of infrastructure, why isn't it an issue in the future settings of tax policy?

Senator Sherry—Dr Henry appeared last week, as I recall. I think we all sat here for two hours as part of the Macro consideration of estimates and then we had another few hours with Macro as well. I think that was the relevant place.

Senator JOYCE—In the markets group are ‘measures to promote competition, macroeconomic stability and market confidence’. If you believe the RSPT has nothing to do with macroeconomic stability or market confidence then I have to disagree with you, Minister. Do you believe that the RSPT has any effect on macroeconomic stability or market confidence?

Senator Sherry—The RSPT issue has been well canvassed in the appropriate areas of estimates and Treasury.

Senator JOYCE—This is exactly the appropriate area.

Senator Sherry—To the extent that I can add anything further, I will have to take it on notice.

Senator JOYCE—This quote is from your own market group's advice on questions to be asked:

... measures to promote competition, macroeconomic stability and market confidence.

Do you agree that that is in your own document?

Senator Sherry—I have on a number of occasions—

Senator JOYCE—Or do you want to take it on notice because you do not know?

Senator Sherry—Can I finish? You have asked me a question and I am always more than willing to try to respond.

Senator JOYCE—I am just quoting your own stuff back to you.

Senator Sherry—You have posed a number of questions over a number of days about the RSPT—

Senator JOYCE—And you cannot answer this, cannot answer a question on your own definition?

CHAIR—Senator Joyce, you are not allowing the minister to answer as you are constantly interjecting. I suggest if you are seriously interested in getting an answer, you might listen to Senator Sherry.

Senator JOYCE—He will not answer it.

Senator Sherry—It is difficult to answer because I have been interrupted three times.

CHAIR—It certainly is.

Senator Sherry—As I said, we have a well outlined this. If you want to waste the time of some of your colleagues who want to ask the officials who are here questions, that is your call and it is predominantly your and your colleagues' time at estimates. We have well pointed out on a number of occasions the areas in which questions on the RSPT are directly relevant. You have had hours of opportunity and have asked—

Senator JOYCE—You think you can just ignore our questions on the RSPT. Is that the Labor Party's tactic in this debate—though shall not answer questions on the RSPT.

CHAIR—Senator Joyce, the minister has pointed out that you have had hours of questioning on this subject and I ask Senator Sherry to conclude his answer.

Senator Sherry—That was the fourth interruption.

Senator CAMERON—Clive Palmer is obviously putting the questions.

Senator JOYCE—On a point of order, Madam Chair:

... markets group will provide advice on measures to promote competition, macroeconomic stability and market confidence, including advice on prudential frameworks applying to the banking sector, insurers and superannuation funds.

The minister is even taking on notice an answer to what he is supposed to answer. How absurd is that? Can it become any sillier?

CHAIR—Senator Joyce, I think it is up to the minister and the officers of the department to know what their department deals with. In that broad, general term, I point out to the minister that we are nearly at our lunch break and ask him to conclude quickly.

Senator Sherry—I have stated, although I have been constantly interrupted by Senator Joyce, where it is relevant for these issues to be raised. They have been raised for many hours over questions in estimates and they have been answered. Whether the senator agrees with the

answers is for him to determine, but there has been ample opportunity and ample response on this issue in the appropriate divisions in Treasury.

CHAIR—Thank you, Senator Sherry. The committee will adjourn for lunch. We will resume with the markets group.

Proceedings suspended from 12.30 pm to 1.30 pm

CHAIR—We continue with Treasury and the markets group.

Senator JOYCE—Dr Kennedy, I would like to ask you a few questions about a speech you gave on 27 May titled, ‘Housing supply and affordability’. We can answer these questions?

Senator Sherry—Yes, he is here.

Senator JOYCE—Could you give a brief summary to the committee on your thoughts about the extent of responsiveness in the supply of housing to the increased demand for housing that we have seen recently?

Dr Kennedy—Yes. Perhaps I could outline a little bit of what I said in the speech. I tried to identify in the speech some of the drivers of demand over the past decade at least. They include things such as population growth, lower real interest rates and nominal interest rates especially through the 1990s, and, to some extent, financial deregulation and access to credit. In the case of those demand drivers, I noted that we had not seen much of a pick-up in the national housing build. It had been around 150,000 additional dwelling units being built a year. That was somewhat surprising. There had been a response to this demand in terms of larger houses and the quality of houses that were being built, but in using that broad macro data without being too precise as to cause and effect I was ventilating some comments about it being somewhat surprising that we have not seen more dwelling units built. Then I discussed a few of the issues that might feed into that, such as planning and zoning regulations and the interaction of various other policies such as local infrastructure provision and that type of stuff. I noted that in the face of quite strong population growth there would be continued demand for additional housing and that in order to be fully effective in, for example, social housing goals, you would really want to see your housing market working as efficiently as possible. My preliminary assessment was that there seemed to be some factors that were inhibiting supply—though I did not identify them exactly because, to be frank, I am unsure exactly what they are or their relative effect.

Senator JOYCE—In finding that efficiency, is there a limit to the size that cities can go to comparative to the growth of other areas—regional towns? Is there a case where the extra house in the city is a more expensive proposition than the extra house in a regional town?

Dr Kennedy—That is a good question. One thing that we have noticed with city planning is that many cities are trying to meet a lot of their additional demand through what is called ‘infill’ rather than greenfields. Rather than continuing to spread out, some cities are talking about meeting much of their additional demand, 60 to 70 per cent of additional demand through regenerating old industrial areas or having more units basically.

Typically, in terms of infrastructure provision, that should be able to leverage off some existing infrastructure to the extent that that increased densification does not overwhelm the

existing infrastructure. However, it is clearly a difficult proposition to get all your planning right to get that to happen. While it might seem straightforward to build new roads or new infrastructure out on the edges of towns or cities, that comes at a cost as well, since you have to lay down all new infrastructure. There is a real trade-off in trying to utilise your existing infrastructure more efficiently in cities compared with continuing to spread out where you will have to lay down new infrastructure. Even in a regional town, if you were going to enlarge the population significantly you would need all the new things that would go with it.

Senator JOYCE—Isn't there a greater efficiency in that, if you are taking a town from, say, 20,000 or 50,000 to 100,000, you can actually plan it so that infrastructure is built in greenfields areas where it is cheaper to lay it down? I will pick a town: Tamworth. You say: 'We're going to make Tamworth 100,000 people. We can build the ring-roads and everything like that and start getting it together knowing that we might be going through paddocks but we are not going through other houses.' You are not stopping everybody from getting to work and all the dislocation that comes from the redevelopment of urban infrastructure, especially inner urban infrastructure. And speaking of inner urban infrastructure, isn't there an exponential cost in that redevelopment of infrastructure to deal with the people who come with the houses is massive? I am thinking of the \$14 billion for the new metro rail that they are looking at for Brisbane. If that money were spent in a regional town—a Wagga, a Tamworth or an Emerald—you would get an immense return for the money that you expended.

Dr Kennedy—I know Mr Murray has some thoughts on the development of cities. He has been involved in that aspect of thinking about this policy from Treasury. Of course, there are other factors going on in the background. There are people locating where the employment opportunities are, as well. I understand people can sometimes think that is a bit of a chicken-and-egg argument—which comes first?—but I would be pretty sceptical of public servants' ability to sit down and start to pick which towns they thought were, if you like, the winners of the future. It is really a question of where business wants to locate and where the employment opportunities are going to follow. But I will ask Mr Murray to comment on the cities aspect.

Mr R Murray—I think probably the answer to your question is both yes and no. It does depend on the circumstances. As we discussed yesterday, cities can be highly efficient but they can also throw up inefficiencies as well. Building in regional towns from scratch can bring with it its own inefficiencies and its own costs.

Senator JOYCE—I am not doubting your point, but such as?

Mr R Murray—Some of it is about having to build new infrastructure from scratch, which you may not have to do in the city. Some of it is about economies of scale and how you deliver, for instance, services in those towns compared with in a city. I am from Goulburn, by the way, so I know a lot of this firsthand. Health services, for instance, are much better delivered on a regional basis—a proper regional basis. So there are pluses and minuses in all of this.

Most cities these days are not about everyone working in the central business district. Even they are regionalising. For instance, I understand that in Sydney the strategic planning is around five or six major centres and trying to get clusters of industry and clusters of

residences around those centres. We do have some really great regional towns and cities in Australia. It would be great to think that some of those will prosper—and a lot of them are prospering—and it would be good to think that we could get some economies of scale and some clustering of industries and whatever in some of those towns as well. But we have been through a process over the years of trying to deem that we can do some of those things, and it just does not automatically, magically happen. Some of this can be organic, but governments and public servants trying to determine some of this is pretty difficult.

Senator JOYCE—There may be overlay. I note that, for instance, in the patents office there is a lot of work that the government has sent out to regional areas because that is where the patent officers want to live and, therefore, you get a number of efficiencies. Someone in Lismore, for instance, may be quite happy on \$80,000 to \$90,000, and, to be honest, in this town they might need to receive \$160,000 or \$170,000 a year to have an equivalent standard of living. Isn't there a capacity for the government to recognise that and say, 'We could have the internet and the capacity to get a cheaper house for the Australian citizen by placing these jobs not necessarily all in Canberra, Sydney, Brisbane or Melbourne but in Tamworth, Longreach, Goulburn or Launceston.'

Dr Kennedy—Just on the housing supply aspect, it does not seem to have been all about the cities. House prices have risen quite dramatically in a number of regional areas, particularly where there is strong demand around mining sector developments or where the rural community seems to be doing extremely well. Potentially, those sorts of planning impediments that may be in the system that I talked about at the city level may well throw themselves up in areas where councils are trying to cope with very strong growth as well. The supply of housing, particularly in New South Wales, to be honest, is falling. New South Wales is building probably around 15,000 to 20,000 fewer dwelling units a year than they were five or six years ago. Many of the other states have picked up their dwelling construction. That does not appear to be just a Sydney phenomenon, for example. This does not detract from your discussion about how to locate people most efficiently, but I was not just talking about city house prices. House prices have been growing strongly in other regions as well.

Senator JOYCE—What is the average house price? Is it possible to give a price for the average house in the outer suburbs of Sydney as opposed to Roma, Charleville or Tamworth? Is any study being done on that?

Dr Kennedy—I cannot give you those off the top of my head. We would be able to provide a regional break-up of median house prices in cities and in the regions. Some of that data is available. It is not perfect. That is another problem in trying to evaluate what is going on in the housing sector. We spoke earlier about the ratio of house prices to income. That has certainly been much higher in Sydney than in any other capital city, although it has fallen back in more recent times. That is a broad measure of affordability—how much people are going to need to borrow relative to their income. I would be happy to take on notice for you those city and non-city house price comparisons and provide some data if you are interested.

Senator JOYCE—Obviously it would stand to reason that there are areas where there is a lack of stock and therefore excessive prices and areas where there is an excessive stock of houses, where, naturally enough, the price of a house would be much lower. If government

policy were in that case to inspire development where it could and create jobs in those areas, then across the nation you are getting more efficient utilisation of your stock of houses.

Mr R Murray—I am not sure that it is about whether governments have incentives over jobs, because a lot of the incentives around relocating to some of these regional towns and cities is about getting away from congestion, having a far more relaxed lifestyle and having a much cheaper house. The cost of the house is obviously lower. So there are some good market and social forces at work there as it is. In terms of jobs, it is a matter of looking forward—that there are some really good factors here for regional Australia. You have asked me questions before about the national broadband, such as ‘Are we ever going to get really efficient, top-notch broadband throughout the regions?’ and I have said that I do not think there is any reason why we cannot. Fibre will bring significant benefits to all the big towns and a lot of the little towns as well, but, even beyond that, satellite and wireless technology—even what we are foreseeing now—is going to improve that dramatically.

That will mean economies of scale over a lot of things will disappear because internet has totally revolutionised how a lot of things are organised and lot of things are done. The other factor around how towns can prosper is to do with reasonable higher education. In most towns there is good vocational higher education but not necessarily university or college-type education. Where there is that, it is a cornerstone of how some of these regional towns can prosper. That is where governments can come into play. Where do the kids in Goulburn go after they get out of high school? They leave the town for higher education and they never come back.

Senator JOYCE—Let us go back to the chicken and the egg thing. What is the reason Sydney is there?

Mr R Murray—Sorry?

Senator JOYCE—Why is Sydney there? There is no real mine there.

Senator Cameron interjecting—

Mr R Murray—From day 4, or whenever it was they moved from Botany Bay to Port Jackson or Sydney Harbour, there was fresh water and huge quantities of fertile land, and then things started growing organically. You cannot turn back the clock.

Senator JOYCE—For the sake of Senator Clouseau interjecting at the back here, there was a government policy of investment in—

Senator Cameron interjecting—

Senator JOYCE—Are you going to look after him, Madam Chair?

Senator CAMERON—He started it!

CHAIR—I would suggest, Senator Joyce, that you do not use pejorative descriptions and then he may not interject.

Senator STERLE—Leave Clouseau alone.

Senator CAMERON—Yes, leave me alone.

CHAIR—Go ahead, Senator Joyce.

Senator JOYCE—What I am saying is that policy comes first. There is a policy of investment in the area and, with that, come the houses and the infrastructure and then we say, ‘Because the infrastructure is there, it’s more efficient to invest in that area.’ Isn’t it a self-fulfilling prophecy? If that were the case, you would just end up with one big city.

Mr R Murray—I am not sure I understand the question. I think a lot of this is ‘chicken and egg’. Some of these things have happened over centuries. Why is London there, for instance? You have got 66 million people, or whatever it is, on a very tiny island in Britain and yet eight million of them live within the M25, in a pretty densely populated city. Why has that happened? I am not sure I know.

Dr Kennedy—Senator, you might ask: why is Silicon Valley located exactly where it is, in California? What is the advantage of it being there? These are actually questions people struggle to answer. It does tend to happen organically. A business opportunity starts up, it spills over and it attracts other businesses. That type of process is one I do not think governments can especially plan for. But they should have regulations and policies that support such opportunities such that if people want to expand, and organic growth starts to take place, regulation is not in the way of businesses expanding and the infrastructure following and those things happening. So, I suppose, that is the way we tend to think about this sort of chicken and egg thing. For public servants to sit down and say, ‘Gee, this would be a good spot to have an IT centre,’ seems to me fraught with all kinds of difficulties—whereas, if it starts to arise, you want to make sure you have regulation designed such that you have an efficient response to that opportunity, I suppose.

Senator JOYCE—What about this town, the one we are in right now?

Mr R Murray—Sorry, what is the question?

Senator JOYCE—That was an inspiration of government policy and now, in Canberra, only about 40 per cent of the economy is the Public Service. It is growing by its own mechanisms now, yet it was started by the inspiration of public policy.

Mr R Murray—Yes, but this is also a regional centre and you could say the same about—

Senator JOYCE—There was nothing here before they made a decision to put it here.

Mr R Murray—No, but would you want to do that all over again? I do not know. You may want to do that all over again, but we have had other experiments, like Albury-Wodonga, and they have been partially successful.

Senator JOYCE—Where we have we had no success?

Mr R Murray—When you have to say ‘partial’ success you have to say that there have been some winners and losers out of something like Albury-Wodonga. But I think what you need to recognise is that probably there comes a time in the economic growth of a city, if you like, when there is a certain critical mass around it, and Canberra has certainly got to that. It then becomes not just a city itself but a whole regional centre. It becomes a centre of education excellence. It becomes the health centre for the region. It even has a cluster of industry around it. The cluster of industry here, of course, is around public policy and around the seat of government.

Dr Kennedy—This is not to argue, Senator, that where regional areas are growing strongly that they should not be supported by good quality policy. There are a number of areas in Queensland and Western Australia that are obviously supported by mining or agriculture, which are growing very strongly, and we would like to see those centres expand and take advantage of those opportunities. It is more this question I think that perhaps you are posing—and tell me if I have got this wrong—that if you took a function of government and put it in an area that you happened to want to support, whether we think that would be a particularly effective way of getting that dynamic going. I guess what Mr Murray and I are going to is that it is really important for the private sector to flourish in these areas.

Senator JOYCE—Dr Kennedy, would you like to get Senator Sherry a pillow?

CHAIR—Senator Joyce, I think that we are all quite tired at this stage of the proceedings and if we do not all look quite as perky as we did—

Senator Sherry—I could make some other observations about your performance—

Senator JOYCE—You would probably be dreaming them. What are the most important barriers—

Senator Sherry—I was not dreaming your performance the other night—

Senator JOYCE—which prevent housing supply from responding more flexibly?

Dr Kennedy—At this stage there is a COAG process where we are working with the states in particular to look at housing supply and affordability with a focus on planning and zoning processes, the interactions of other policies and infrastructure provision—as I said before—and other state and Commonwealth policies, and through that process we are trying to more carefully identify some of these barriers. In that speech I was not saying that this is the issue—I suspect there will not be one particular issue for Australia. I think it is a reasonably complex supply chain delivering housing. There may well be a number of factors that play, but from my examination of the evidence I certainly think that it is worth looking at all those factors to see what opportunities we might have to increase the supply responsiveness of the market.

Senator JOYCE—You spoke at length in your speech of infrastructure charges. In your view are infrastructure charges too high in some areas?

Dr Kennedy—Personally, I have not done an evaluation of the level of infrastructure charges in different jurisdictions. What I was talking about in the speech about infrastructure charges was that economists would argue that infrastructure charges can be useful in sending the signal about which land is most efficient to develop—and it is an issue that you raised a moment ago. If it is cheaper to bring a certain piece of land on because the infrastructure charges with it are less than they would be to bring another piece of land on, that would seem to promote the efficient use of that land. But the point I was making in that speech was that there is a trade-off there. If people are sitting down negotiating over the infrastructure charges that go with each release of different pieces of land, that can create uncertainty and, if you like, it could become quite a lengthy process and you lose all that efficiency that you might have gained by being able to bring relatively cheap land onto the market compared to more expensive land. So there is definitely a trade-off there.

The other point I made was that in markets where land supply is highly constrained, pretty much all land when released will come to market straightaway because the demand for it is so high. So that efficiency effect that I described a moment ago works less effectively. It is more a case that you might want to focus infrastructure charges on increased transparency and perhaps have them of a more uniform nature.

What I was trying to do in that speech in general terms was to start a discussion about the principles we are thinking of in regard to infrastructure charges and how they would be applied when we go about setting them. Of course, this is all happening at the local council and state level; it is not a Commonwealth responsibility. But it is an area we are interested in because we are interested in that market working more efficiently, and clearly better housing outcomes are a very important part of delivering wellbeing to the broader population.

Senator JOYCE—Would you say that we get a fair return on the infrastructure that is currently present in major cities? We are building the duplication of the Gateway Bridge, the Sir Leo Hielscher bridges, \$1.8 billion of investment. I imagine the bridge beside it would have to be worth about the same. So you a \$3.6 billion investment there. There is also the tunnel from which I know they are not getting the returns they expected. What about the public transport systems in cities? What about art infrastructure such as the Opera House—marvellous to look at, but do we get a return on it? And there is the Sydney Harbour Bridge and the rest of it. Why do I say this? If we had a fair assessment of return and efficiencies, you would say that we do not get anywhere close to a fair return on what that infrastructure actually cost. In fact, we not only do not get a fair return on our infrastructure we also have to subsidise the public transport system that runs over it.

Dr Kennedy—You are pointing out some very difficult issues, particularly with transport infrastructure. Trying to identify the degree of an infrastructure deficit in a particular area—for instance, a transport infrastructure deficit—is very hard because the market is not effectively operating there and people are not paying a price to access that infrastructure. All we might know is how much congestion we have got or how long people are lining up to get onto the roads. Because of the public sector's heavy involvement in the provision of infrastructure, it is very difficult to identify where some of those deficits are occurring and the most efficient provision. One place where you could start at least is making sure that cities have strategic plans and they think carefully about how their cities are likely to develop and about transport corridors well ahead of time. Many cities do; Brisbane does, for example. I will let Mr Murray talk about this.

Mr R Murray—I want to comment on transport corridors. To start with, just because transport is being subsidised does not mean it is not actually returning huge benefits overall to the community. If you think about how Australian cities have evolved, they are not very dense, they are huge sprawling cities and they do not use transport corridors very well. Think of the better functioning cities of Europe—London, for instance, where public transport carries 50 per cent of the working population to work every day. British Rail brings people in both from within the city and from the outer counties. Compare that with Australia where we do not really use public transport and the urban corridors along those public transport routes very well. In Sydney, I think, under 20 per cent of workers go to work each day on public transport. If you can get cities to work well, in fact there are huge economies. Just because the

bridges in Brisbane appear to cost a lot of money, (1) they do last a long time and (2) they carry a huge amount of traffic. The benefits have to be looked at in terms of the uses of these things, and a lot of the time the mechanisms for trying to determine who should use these and who should not have been poor in Australia.

Senator JOYCE—Would it be a fair statement to say that the premium that the householder gets in the major cities is because there is not a fair charge on the infrastructure that surrounds them? The freeways, the hospitals, the public transport, the ports, the art facilities and all that goes on in that area are investments of the public dollar. We do not expect it but there is not a fair charge on it. There is a strong correlation between that investment—and the fact that you get it at a discount and do not have pay for it—and a premium in the price of your house. In regional towns there is not as much public infrastructure; therefore you have a cheaper house. If there was more balance in where infrastructure is invested, a point of equilibrium would bring about more efficient prices of houses throughout the nation.

Senator CAMERON—Build a Harbour Bridge in Gunnedah and see what that will do for prices.

Senator JOYCE—Point of order, Madam Chair. Can you control Senator Cameron, yes or no?

CHAIR—No.

Mr R Murray—Halfway through your answer I thought I was going to agree with you but by the time you got to the end of your answer I am not sure I was going to agree with you. A lot of the pressure on house prices is because people want to live in those locations. That is where the jobs are and that is where the services are.

Senator JOYCE—Because the infrastructure is there?

Mr R Murray—No, a lot of services can be provided a lot more cheaply per head in cities than they can in regional towns. That is what attracts people. We have a flow of migrants coming in and it does not matter where you tell them they should live, most of them go to Sydney, Melbourne or Perth.

Senator JOYCE—We have probably got another 22 million turning up. This is why it is a crucial debate and we have got to work out where they are going to go?

Senator PRATT—What is the significance of phasing down the interest withholding tax on financial institutions, particularly when it comes to competition in the banking sector and Australian credit markets?

Mr Lonsdale—There are broader tax policy reasons for the measure itself but there are also some competition aspects to it as well. The broad argument is that the payment of interest withholding tax to borrowings where the borrower is resident overseas particularly impacts on foreign back branches and banks that operate in Australia with a related third party. That typically incurs higher interest withholding tax than would apply to many other banks domestically. So the broad argument is that the phase down of the interest withholding tax would be of benefit to banking competition broadly because it would benefit those foreign bank branches and foreign banks with third party relationships overseas.

Senator PRATT—Can you give me an example of a bank with third party relationships overseas?

Mr Lonsdale—An example might be a bank that operates in Australia that borrows from another entity overseas. That is a related party. Under that arrangement, as I understand it, there is a 10 per cent interest withholding tax that applies. So under the phase down that will move down.

Senator PRATT—Just to be sure that my interpretation of this is correct, the big four banks generally have more access to credit locally and there are a range of other banking institutions that are being more greatly affected by this withholding tax currently and it affects their capacity to compete with those larger financial institutions?

Mr Lonsdale—The big four banks, for example, do get quite a lot of their funding domestically through deposits but they also access significant overseas funds. They do that by issuing paper in the foreign markets. There is a specific exemption for much of that paper that applies. That is why the treatment of interest withholding tax for those banks is probably not as great from a competition angle as it is for the banks that we talked about before.

Senator PRATT—So it is a measure that is seen as important to enhancing competition in the banking sector?

Mr Lonsdale—That is true, but I would go back to the first point as well: it is seen as a measure that has good tax policy attributes to it as well.

Senator PRATT—In general.

Mr Lonsdale—Yes.

Senator PRATT—Does that relate to the measure being important to Australia's future and our desire to develop Australia as a financial services hub? Is that what you mean in terms of the significance of it as a tax policy, in part?

Mr Lonsdale—There are two aspects. It certainly has relevance for Australia as a financial hub. There is a proposal in the Johnson report that looked at that issue, but I was particularly getting to the way the interest withholding tax works now, which my revenue group colleagues can explain better than me. But the way it applies is very disparate in terms of who the borrower is and who the lender is, so you can get inefficiencies in the system. The phase-down of the interest withholding tax will produce a more efficient system and a simpler one.

Senator PRATT—So a failure to implement this policy—and I note the coalition has announced it is opposed to this particular measure—would clearly not realise those benefits?

Mr Lonsdale—Almost by definition.

Senator PRATT—Thank you.

Senator XENOPHON—Can I just ask about the Chinese company Natural Dairy. It has investors, subject to regulatory approval, with over A\$1 billion in New Zealand's dairy sector buying 29 farms, factories and plants. If Senator Joyce has already asked these questions, please stop me.

Senator Sherry—No, he has asked questions mainly not relevant to this division.

Senator XENOPHON—I am sure you will pull me up, Minister, if I am irrelevant.

Senator Sherry—Foreign investment is directly relevant to this area.

Senator XENOPHON—Good—thank you. Can you indicate whether the FIRB has received any applications for investment in Australian dairy farms or Australian agriculture generally from China or elsewhere?

Mr Colmer—There have not been any Chinese investments into dairy that we are aware of. It is possible that there have been some small private Chinese investments that do not need to come to us.

Senator XENOPHON—What is the threshold?

Mr Colmer—The standard threshold is a business worth \$231 million. Anything below that does not need to be notified, except if the investment is by a foreign government related entity, which is what the bulk of Chinese companies are—state owned enterprises.

Senator XENOPHON—Is there a different threshold then, or is there no threshold and it automatically has to go to FIRB for approval?

Mr Colmer—The rule on state owned enterprises is that all direct investments by state owned enterprises must be notified for screening. So there is no threshold as such.

Senator XENOPHON—So you are not aware of speculation in terms of the Tasmanian dairy farms in respect of that? You would not know about it formally unless there has been an application to take over? Is that right?

Mr Colmer—We are unaware of any specific proposals to invest in dairy farms by the Chinese.

Senator XENOPHON—When you consider a proposal, would you consider the environmental and business practices of those entities in assessing an investment decision?

Mr Colmer—The way that we deal with assessing applications is probably best set out in the Treasurer's press release from February 2008. It sets out the sorts of criteria that we look at for investments by foreign government related entities, but they are generally similar to the standard approach that we look at. In terms of the way that we actually deal with it, we would usually rely on advice from other relevant agencies as to things such as competition issues, tax issues and environmental issues. So what we typically do is refer proposals that we receive to other government agencies, as relevant depending on the nature of that proposal.

Senator XENOPHON—If this particular company had a notorious record for, say, over-use of pesticides and its food hygiene standards, would that be something that would be considered?

Mr Colmer—Theoretically, I guess that would be. The reality though is that there are more direct mechanisms of controlling it through the various environmental protection authorities and food standards authorities. If we were aware of issues such as that we would certainly raise those with the company but in terms of managing those that is usually an issue for more directly relevant agencies to deal with.

Senator XENOPHON—In relation to the \$231 million threshold if it is not a state-owned enterprise, particularly with our agricultural sector, how do you deal with creeping

acquisitions—for instance, a number of dairy farms are bought up at well below the threshold and then some others are acquired six or 12 months later, and there are issues then of market concentration and market domination by one entity?

Mr Colmer—The legislation applies to acquisitions of companies and, in some circumstances, land, and it specifically excludes primary production land from screening. The only circumstances in which we get involved in agricultural land are if the acquisition of that land is done through the acquisition of a company that in turn owns the land, or if the acquisition is by a state-owned enterprise.

Senator XENOPHON—But if a state-owned enterprise is seeking to acquire agricultural land from an individual—

Mr Colmer—Then we would expect to be notified.

Senator XENOPHON—Is there a way of monitoring that, or is it just a given that that is what occurs?

Mr Colmer—As a general rule, we have fairly few cases where people fail to notify. There are arrangements in the act whereby, if a company makes an acquisition that should have been notified, steps can be taken but we usually find that most companies are aware of their responsibilities. Occasionally, some acquisitions have been missed for notification and we will follow that up with companies. In general, the approach we take is that if a company notifies after the event we will look at it on its merits and see where it goes from there.

Senator XENOPHON—Would you have the power to divest them of their assets?

Mr Colmer—Potentially. It depends on the precise circumstances. The act provides divestment powers for acquisitions that are caught under the act. As I said before, agricultural land is not caught under the act. It is only a matter of policy that requires acquisitions of agricultural land by foreign governments to be notified.

Senator XENOPHON—If a state-owned enterprise acquired agricultural land—a dairy farm or whatever—and approval was not sought before the event, does that mean that because agricultural land is not caught under the act then there is no power to order divestiture of the asset?

Mr Colmer—The power to order divestiture only applies to acquisitions that are caught under the act so, in that particular case, we would have limited options as to what we could do.

Senator XENOPHON—Does it therefore follow that in terms of the issue of enforcement, because it is pursuant to policy in relation to state-owned enterprises and in relation to agricultural land, there is not any scope there to enforce that?

Mr Colmer—The enforcement of policy is something that depends on the goodwill of all parties involved.

Senator XENOPHON—That is not ideal from a regulatory point of view, is it?

Mr Colmer—From a regulatory point of view we have the legislation. The policy extends the operation of the system past what is in the legislation. We seek foreign government entities to do a range of things that we do not require of non-government related entities. Our

experience is that, by and large, companies are aware of that and, by and large, they do comply with that. In my time in this position I do not think we have had a case where there has been a serious failure to comply. As I said, we do occasionally get ones on the margins where companies are not sure what is the right thing to do and will come to us; sometimes that happens after the event, but it is not very common.

Senator XENOPHON—There is a loophole in the current framework.

Mr Colmer—It is not a loophole; it is what the legislation says. The legislation applies and the policy seeks foreign government investments to come to us in a different set of circumstances. It is not a loophole.

Senator XENOPHON—Perhaps I should frame it in another way: if it is agricultural land that is purchased, notwithstanding the policy, is it the case that a stated enterprise ought to seek approval from the Foreign Investment Review Board? If that is not complied with there is no sanction or enforcement mechanism available. Have I got that wrong?

Mr Colmer—One of the things about foreign government acquisitions is that there are a range of other government-to-government mechanisms that can be used if there is egregious flouting of the arrangements. As I said, we do not have any experience of any serious noncompliance.

Senator XENOPHON—Just to clarify this: in terms of agricultural land that is purchased by a non-state-owned enterprise, that is not caught by the policy or the legislation?

Mr Colmer—That is specifically excluded by the legislation.

Senator XENOPHON—At a policy level has any consideration been given to the issue of food security? If you have foreign acquisition of, for instance, the dairy industry or other key parts of our primary industries, that is not a guaranteed supply of food security for our own nation in terms of decisions being made with regard to exporting produce.

Mr Colmer—That is a question of policy. It is an issue that has been getting a bit of attention very recently, but, at this stage, it is a theoretical question. There is not any work that we have been doing on it in any comprehensive sense.

Senator XENOPHON—Thank you, Mr Colmer.

Senator BUSHBY—Is the COAG reform agenda something I can ask you about?

Dr Kennedy—Aspects of it.

Senator BUSHBY—I want to ask some questions about the progress under the ‘Towards a seamless national economy’ reform agenda.

Dr Kennedy—Yes.

Senator BUSHBY—How would you assess progress under this agenda?

Dr Kennedy—I will ask one of my colleagues to come up to answer the question.

Mr Paine—The COAG Reform Council, typically referred to as the CRC, issued a report in about February this year. It outlined progress under the so-called SNE, the seamless national economy. In broad terms there were 27 deregulation measures. The vast majority of them had good progress. There were then some comments about eight competition ones

where in broad terms the recommendation was that all Australian governments should clarify the milestones, which are essentially the progress points in that agreement. COAG has basically accepted all the recommendations. I think it is fair to say that COAG is also committed to making further progress under the implementation plan.

Senator BUSHBY—Okay, so would you agree that you would classify the report that was released by the COAG reform council as expressing some concerns about progress?

Mr Paine—I think there is some background that is relevant to this issue, particularly on the competition side. The milestones in there dated from prior to 2007. In fact, some dated I think from a couple of years before that. So they were perhaps a bit of accommodation of things but, basically, COAG has agreed to clarify those milestones and progress.

Senator BUSHBY—You mentioned the 27 priority reform areas and the eight competition areas, and in respect to the 27 you mentioned there was progress reported, basically. How many of those 27 and the eight competition areas are actually complete?

Mr Paine—I am now doing it from memory. I think there are about 10 or so of the deregulation ones that are complete and good progress in, I think, all of the others. On the competition ones, I am now looking at my colleague, Mr Archer.

Mr Archer—I am just trying to recall exactly what each of the eight were. There is one reform stream that relates to the Australian government amending the National Access Regime as set out in the Trade Practices Act. Certainly progress has been made in that regard in the sense that there is a bill that has passed through the House and is now awaiting debate in the Senate. The reforms have not been implemented as quickly as were originally envisaged. Partly that has to do simply with the nature of moving legislation through the parliament and delays that can emerge.

There is another set of reforms around access regulation, which are set out in a COAG agreement called the Competition and Infrastructure Reform Agreement, which was agreed in early 2006. An implementation plan was subsequently agreed to in early 2007. Those reforms are still being implemented and, in fact, there are some key milestones to be met by the end of this calendar year. So there were some quite long dated milestones in that original agreement and we think that that is largely on track.

There are other competition reform streams. Steven, can you help with those?

Dr Kennedy—That is probably as much detail as we can provide you with at the moment. The Department of Finance and Deregulation, of course, has the BRCWG secretariat. Minister Tanner chairs the BRCWG where a seamless national economy reforms reported on and progressed. I am not sure if you have had an opportunity to talk to them—

Senator BUSHBY—I have not.

Dr Kennedy—They do all the reporting for government against all of these reforms dreams. So we are pretty much going off the top of our head here, but we will continue to do our best.

Senator BUSHBY—But you do acknowledge that this is an area that you do overseas, to some extent?

Dr Kennedy—We are certainly involved in it, particularly the competition reforms.

Senator BUSHBY—If you could take the detail that you cannot answer on notice. I do have some more questions about it nonetheless.

Dr Kennedy—Sure, as I said, we will continue to try and answer them, but I am just alerting you to the fact that the Department of Finance and Deregulation has a secretariat which—

Senator BUSHBY—has more hands-on knowledge in some respects.

Dr Kennedy—They do all the monitoring, basically, produce the reports and feed the information through to the CRC, but we are happy to take questions.

Mr Archer—I can add a little more information. There are another two reform streams which have now come to my mind. One of them are too previously agreed to transport reforms which go to reforms around road user charging for heavy vehicles. That is progressed under the auspices of the Australian Transport Council of the ministerial council. I think the COAG Reform Council's remarks that that reform stream is largely on track. Similarly, there is another reform stream around energy market reform. There has been some quite significant progress made in that area, including the establishment of the Australian Energy Market Operator from the middle of last year and other associated reforms as well and, again, quite solid progress made in a number of areas. Again, there might be some areas of detail where the CRC has observed things are not tracking as well as they might be.

Dr Kennedy—There was one other reform that has come to mind that has been finalised, which was parallel import restrictions on books. That I believe was one of the competition reforms. That reform stream has been finalised and the government has announced its position on that.

Senator BUSHBY—I am interested in both the 27 priority reforms and the eight competition areas. You mentioned that of the 27 10 are complete, and Mr Archer, you mentioned that at least energy and transport and others were on track. With respect to the 10, I am interested in what information that is based on, because the report in February did not indicate that. In respect of the eight, the report in February indicated that both energy and transport were actually behind schedule. I am interested in what has changed since February to enable you to provide the answers that you are providing?

Dr Kennedy—We will start with the 27, perhaps, with Mr Paine.

Mr Paine—I do not have a CRC report in front of me, but the report related to 2008-09 and there was a period of grace, although that is probably the not the right word, up to 30 September 2009. So of course there has actually been quite a lot of progress since the CRC cut-off for its report. That it essentially explains why, as at this time or very shortly—

Senator BUSHBY—Has any of that been publicly reported?

Mr Paine—No, perhaps they are not publicly reported that they will be included in the CRC's next report, which is 2009-10. The formal cut-off is in a few more weeks. Then they probably again look for the three months, because they recognise there is a bit of a delay while a produce a book of several hundred pages—you might have it there. They do recognise governments take decisions.

Dr Kennedy—I will have to take this bit of it on notice, but I do recall Minister Tanner and Minister Emerson have publicly released some information on this. As I said, is it a process run by Minister Tanner and his department, but we will undertake to a track that down for you. I do vaguely recall a press release being put out updating some of the progress since the CRC report cut-off, but, to be honest, I do not have that to hand. I will undertake to track it down for you.

Senator BUSHBY—Anything you can give me on notice would be appreciated and also an update in respect of each of the 27 and each of the eight, so that I know which of the 10 are completed, which are making good progress et cetera.

Dr Kennedy—Yes.

Senator BUSHBY—Following on from there, I refer to an article in the *Australian Financial Review* on 28 April this year titled ‘States urged to tear down competition barriers’. That article stated:

Prime Minister Kevin Rudd has formed a new group to reinvigorate national competition policy after a sharp rebuke from an independent review last year that warned of a damaging “loss of momentum” in reforms agreed with the states.

What is the role of this new group and what are they mainly doing at the moment?

Mr Paine—Following on from the COAG Reform Council’s report there was a proposal that a subcommittee of the BRCWG—Business Regulation and Competition Working Group—be formed to focus on competition. Because it is a COAG process, as you would be aware, we need to get the agreements of the states and territories, and that is essentially actively underway.

Senator BUSHBY—So at an official level there are negotiations occurring?

Mr Paine—And very well advanced. For the subcommittee to be approved formally, that has to go to COAG, at least out of session.

Senator BUSHBY—I am sorry if I missed it but did you mention the name of the new group?

Mr Paine—That is still to be settled formally, but perhaps just BRCWG subcommittee. Essentially the intent is to have a group of relevant people. Typically, most participants are senior officials—albeit chaired by a minister, so it is a little different to some others—who have responsibility for competition matters.

Senator BUSHBY—Will the group be simply looking at ways to deliver the current set of reforms or will it have as part of its charter potentially expanding the reforms that might be needed?

Mr Paine—Two main focuses are under discussion. One is to deliver the current reforms. As you have noted, the CRC have found some are still a work in progress. In my view, part of that reflects that they are complex reforms, and they have been going for several years. I do not think it is through lack of will. They are just long-term complex reforms.

Senator BUSHBY—I did note that the section of Treasury responsible for it—and this is no reflection on you guys; it may be about how hard you are being driven in that direction—

had to try and recollect what the areas were, rather than it being something you were clearly working on at the moment. I do not know whether that is a direction of priorities that you are receiving.

Dr Kennedy—No. The area that we are directly responsible for is the national access regime reforms, which Mr Archer spoke to. The energy reforms and the transport reforms are pursued through other ministerial councils. Obviously, Treasury as a central agency has a role in promoting those reforms. Of the Treasury led competition reforms, there is the one that has been completed, which was parallel import restrictions on books, and the others are related to the national access regime, which has been a focus of ours.

Mr Paine—Just to expand a little on that, the energy department have responsibility for the MCE, the Ministerial Council on Energy, at the Commonwealth level, and similarly on transport. So we are not directly responsible, but we have a strong interest and an overseeing role because we have policy responsibility for competition in the broad.

Senator BUSHBY—The article I mentioned further stated:

... new requirements have been placed on federal-state ministerial councils in energy, transport and infrastructure access so that their progress can be better measured by federal cabinet.

Obviously the last COAG meeting was dominated by health. Has this affected the progress of reform in other areas like infrastructure?

Mr Paine—I think it is fair to say that the committee has continued to meet—and don't hold me to this—every six weeks or so, so largely unchanged. We seek to progress many things within the department, and the division I am part of does not have a direct responsibility for health so we have remain focused on the measures that are in the SNE implementation plan.

Senator BUSHBY—What incentives are the states actually given to do their bit in progressing towards a seamless national economy reform agenda?

Mr Paine—The seamless national economy implementation plan does have reward payments attached to it. I do not have the documentation in front of me, but my recollection is several hundred million dollars, not in aggregate and it does not apply in every year. Like in a lot of these areas there are various incentives. One is better use of the state and territory public resources. Another one is efficiency benefits in the private sector and dynamic benefits. The last one I will mention, although not always least, is Commonwealth money attached to milestones.

Senator BUSHBY—Okay. Is it intended that the Productivity Commission will have any role in this new group and the way that it is working?

Mr Paine—Again, I will talk in broad terms. I am not quite across the specific details but the CRC has an, I think, annual responsibility to undertake an assessment of the SNE. But there is also a process that the Productivity Commission is involved in about assessing progress against COAG reform goals in broad. Also within the implementation plan there are some appraisals or assessments that have to be made.

Dr Kennedy—The PC also does benchmarking studies within some of these reforms as well. It compares the practice in certain areas across jurisdictions—

Senator BUSHBY—That is benchmarking before they start so that they can see how they are progressing against it?

Dr Kennedy—For example, they are going to do a benchmarking study around planning and zoning and competition implications. It is not especially attached to a particular reform but it is to inform this council about best practices in those areas across the states and how they might be affecting productivity in the broad.

Senator BUSHBY—Okay. In terms of its assessment is the Productivity Commission currently undertaking that? How often do they do that assessment? When do they report? Are they working on it now? Have they reported?

Mr Paine—I will just deal with the COAG Reform Council. They are the ones who actually do a sort of assessment as such. They have got the 28, the eight and there are actually some of the things in the implementation plan by all the jurisdictions. You probably would have seen the multicoloured thing. I think everyone who is involved in this process feels that there is plenty of appraisal going on. The Productivity Commission, I think, is working towards the first of the assessments. I do not think it is the same nature as the CRC assessment. That would be duplication.

Senator BUSHBY—What would the terms of reference be in terms of the assessment? What would they be looking to assess?

Mr Paine—My recollection is that it is at a broader level because they are appraising against, I think there were, seven or eight COAG reform goals. SNE is just one of the things that is taken into account because of course there are many other agreements that are relevant.

Dr Kennedy—It is the CRC's job to do the reporting against the thing you are talking about in that article, the milestones, and the nitty-gritty of whether this was delivered when it was said it was going to be delivered—

Senator BUSHBY—Which is what raised my initial questions about them having some concerns about some of them not meeting their milestones. Coming back to that report, my understanding is that the four competition areas which the COAG Reform Council were concerned about did not extend to the government's decision on the parallel importation of books—is that correct?

Mr Paine—That is correct.

Senator BUSHBY—If I understand that correctly the government actually got a tick for ignoring the recommendations of the report into the matter. Does that indicate that there is a flaw in the process?

Dr Kennedy—It received a green light or a tick if you like for completing the reform. The CRC's role is much around whether the reforms are on track. It is not so much about policy intent but whether the reforms are being done, the milestones are being met and we are clear about what we are trying to achieve. Once the reform has been finalised the CRC ticks it off. The PC is more the body that might discuss issues around the quality of the reform achieved or those sorts of issues.

Senator BUSHBY—So basically the tick that the CRC gives is more to say that administratively the job is finished rather than qualitatively in terms of whether it has actually achieved benefits in a competition sense?

Dr Kennedy—To some extent the CRC's tick is that you have met the milestones that you outlined, yes.

Senator BUSHBY—In that sense the CRC's approach is more about process than outcomes. It is making sure that the process has been completed.

Dr Kennedy—Yes, and it is not an unimportant job. As Mr Paine was saying these are complex detailed reforms. We have to keep them on track.

Senator BUSHBY—Yes, I understand. In government things are very large and very complex. You do need to drive the process. I would have thought there was no point in having the process unless you are actually going to deliver some outcomes. It is nice to be able to say you did it, but if the outcomes you were trying to achieve at the start are not actually part of the end result that you get to then what is the point of the process in the first place? We will move on.

The Australian government committed to introducing a one-in one-out regulation rule before the last election. How are they going in meeting that commitment?

Dr Kennedy—That is very much a matter for Finance.

Senator Sherry—There was extensive discussion in Finance about that and an update was provided.

Senator BUSHBY—Were you there?

Senator Sherry—Yes. I have been at these estimates for almost two weeks now. I do have the Finance responsibilities as well.

Senator BUSHBY—Do you recall what the answer was?

Senator Sherry—There was a lengthy discussion. I am in an extraordinary position when I am asked a question that is not supposed to come to this area of estimates and in fact went to a previous committee and am asked to provide the answer verbally. The best I can do is suggest you look at the *Hansard*, with due respect.

Senator BUSHBY—What is Treasury's involvement in the development of the National Freight Strategy?

Mr Archer—We do not have a direct role in the development of the National Freight Strategy. We do participate in several processes in which progress reports are provided—one example being the COAG Infrastructure Working Group. We are monitoring the developments in that area and we are certainly interested. We have received briefings from time to time from the people who are doing the work, but we are not directly participating.

Senator BUSHBY—Given that one of your markets group outputs again is 'measures to promote the efficient use of national infrastructure', which is what I understand the National Freight Strategy is all about, do you think that the answer you have given in terms of the extent that you take an interest in this is actually meeting the markets group's outputs?

Mr Archer—There is a question about how best the department can apply the limited resources available to it. The team I work with monitors all developments in all nationally significant infrastructure sectors. We have direct responsibility, as Dr Kennedy has alluded to, in relation to some regulatory aspects such as the National Access Regime. Really, we do not have the capacity to engage directly in all policy development exercises relating to infrastructure.

Senator BUSHBY—No, I would not expect you to be hands-on with respect to all of it but I would expect you to be fully across it with a view to being able to meet your remit, which is to be able to provide informed advice on these issues.

Mr Archer—As I said, we are monitoring it. We have received briefings from the people undertaking the work and we are engaging through some of those governance processes that I alluded to.

Senator BUSHBY—Hopefully, your monitoring will have provided you with sufficient background to be able to answer the next questions I will ask. The draft of the National Ports Strategy has been released. What was Treasury's involvement in the development of the Ports Strategy? Will the government respond to the Ports Strategy when it is complete or wait for the overarching National Freight Strategy to be completed?

Dr Kennedy—Senator, we are happy to answer questions about our involvement in these processes—I will give Mr Archer the opportunity to do that—but the Ports Strategy and the Freight Strategy are the infrastructure department's responsibility. Ideally questions about when the government has announced it will respond or what it intends to do should go to that department.

Senator BUSHBY—What was Treasury's involvement in the development of it?

Mr Archer—I thought I had already answered that.

Senator BUSHBY—As part of the National Freight Strategy overall?

Dr Kennedy—Sorry, the Ports Strategy or the Freight Strategy?

Senator BUSHBY—Ports Strategy.

Mr Archer—The national ports review is very much of the same nature as the Freight Strategy.

Senator BUSHBY—Are you aware whether all the states have completed their reviews of ports as required under the COAG reform agenda?

Mr Archer—Yes. My understanding is that they have completed their reviews and that they have been published. The CRC has reported on that progress previously but that report is probably out of date now. My understanding is they have all been undertaken.

Senator BUSHBY—Has Treasury given any thought to the future role of Infrastructure Australia? One of its core functions when it was established was to advise on funding from the Building Australia Fund. That fund has now only \$705 million left unallocated. What is Infrastructure Australia going to do in the future?

Mr Archer—Once again, that is probably a portfolio responsibility matter for the Department of Infrastructure, Transport, Regional Development and Local Government. It is not a Treasury agency matter. It is probably not appropriate for us to comment.

Senator BUSHBY—But I would have thought this section of Treasury would have had policy input into the future of Infrastructure Australia.

Dr Kennedy—It is fair to say we think about all these issues but it is difficult for us to go to the specifics of policy advice that we might be developing for government. That broader set of issues you have identified, around infrastructure governance and the roles of various institutions, are certainly issues that we think about and would, in the normal course of events, provide advice to government on.

Senator BUSHBY—Is the minister able to assist on policy position?

Senator Sherry—No. One, because if it were policy I would not be and (2) we are getting into the position now where it is a bit like some of the questions we get at Finance. It is not the role of Finance nor is it the role of Treasury, indeed this area of Treasury, to comment about another department's responsibilities.

Senator BUSHBY—Treasury has 12 market group outputs and one of them is 'measures to promote the efficient use of national infrastructure including in transport, communication and energy markets'. It is one of the 12 core market group outputs. I am not asking for the details of who spends what and how you do this, that and the other; these are overarching policy questions about how these things are approached. I would have thought that it was reasonable to ask Treasury, given that is one of their 12 key outputs.

Senator Sherry—I think you are fundamentally misunderstanding it, as Senator Joyce is. I know it is difficult sometimes, because I have been in your place when I have sought, in this area and others in Finance, more detailed responses and have not had them because the carriage of the policy is in another department or in another division of a department.

Senator BUSHBY—I am not asking how the policy is being delivered; I am asking what policy direction there is.

Senator Sherry—We will see where we can help you but I will give you the caveat that we may or may not be able to help you on particular issues.

Senator BUSHBY—My next question is: will Infrastructure Australia have a role in providing advice on funding allocated from the proposed state infrastructure fund?

Dr Kennedy—As far as I am aware, the state infrastructure fund is part of the broader set of negotiations with the resource super profits tax. All those matters are still under consideration.

Senator BUSHBY—As far as you are aware that is not yet determined?

Dr Kennedy—I have nothing more to add other than the government has made its announcement that it intends to establish that fund and no further detail has been provided at this stage.

Senator BUSHBY—No further details are being provided to the public?

Dr Kennedy—It is a matter for government that it is currently considering.

Senator BUSHBY—Some of the tasks that Infrastructure Australia is undertaking appear to overlap with other bodies such as the National Transport Commission and the Australian Energy Market Commission. Is it your view that there is some overlap between Infrastructure Australia and these organisations in terms of their roles?

Mr Archer—That is not really a matter I have given any consideration to. My understanding is that Infrastructure Australia aims to work very closely with other agencies that have responsibilities in the areas that they are looking at. Certainly Infrastructure Australia has a mandate to look at Australia's national infrastructure priorities. That necessarily takes it into the territory, from time to time, of other agencies, but I understand that Infrastructure Australia is very mindful of that and does not seek to replicate work but rather to seek advice and information where that might be relevant to what it has been tasked to do.

Senator BUSHBY—Would the potential for the risk of overlap be of concern to you in terms of duplication?

Mr Archer—Certainly one does not like to see any unnecessary duplication or waste of resources but I would be hesitant to suggest that that is necessarily happening in this respect at this time.

Senator BUSHBY—Have you specifically considered that risk or are you just thinking about this as I ask you the questions?

Mr Archer—I have not—

Senator BUSHBY—Or is it something that Treasury has specifically considered?

Dr Kennedy—We are always alive to the risk of people tripping over each other and of duplication. But this is not a concern, if you like, that we have been working on.

Senator BUSHBY—Is Treasury doing any work on the effectiveness of private-public partnerships in financing the infrastructure investment task that we face?

Mr Archer—The role that private-public partnerships can play in the financing and delivery of infrastructure is an issue that we have spent some time on. It is an issue that has received quite a bit of attention in Infrastructure Australia, through a number of work streams and, again, through the role that we have played in participating in the COAG Infrastructure Working Group, which is a bit of a funnel for IA reports. We have certainly had input to, and had been involved with, some of that work.

Dr Kennedy—Dr Henry is on the Infrastructure Australia council. Of course, they have had some quite detailed considerations of PPPs. Of course, we have supported his involvement in those processes through advice on papers and considerations by IA around PPPs.

Senator BUSHBY—Is this looking at effectiveness and efficiency and assessing how effective it is, how it could be improved and that type of approach?

Dr Kennedy—I guess they have taken pretty much a principles approach.

Mr Archer—There has been a couple of streams of work in relation to PPPs. One has been the establishment of national guidelines, which all jurisdictions have agreed to, to achieve

some consistency of approach and provide greater certainty to potential participants in PPPs. That had been agreed in COAG. There has also been work to assess whether there have been any barriers to competition and efficiency in the financing and the provision of infrastructure and the procurement processes around them. So there has been quite a lot of work across PPPs over the last 12 to 18 months.

Senator BUSHBY—The reason I am asking is that there have been some pretty high-profile cases of failures of PPPs, particularly in toll roads. There are also concerns about the costs of bidding for a PPP, which can go into the tens of millions of dollars. What I am trying to establish is how we can improve the efficiency in the way that they work and the process, so that we can get the full benefits for Australians, whilst making sure that it works, essentially.

Mr Archer—Those are questions that are being examined at present.

Senator BUSHBY—Are there any lessons that you can help us with today?

Mr Archer—I am not sure that, off the top of my head, I am in a position to do that today.

Senator BUSHBY—You could take that on notice.

Mr Archer—I think some of the results of that work are likely to see the light of day fairly soon, in that those work streams are nearing completion, and final consideration is taking place within Infrastructure Australia and the infrastructure working group.

Senator BUSHBY—What is the level of concentration in Australia in the market for construction companies to build infrastructure? My understanding is that there is a significant cross-ownership among the sector. Do you know whether that is true?

Mr Archer—I think it is true to say that there is perhaps, in terms of major infrastructure construction projects, two or three dominant companies but I do not have industry facts and figures in my head or with me here today.

Senator BUSHBY—Is the level of concentration something that Treasury has focused on? Has it come to your attention in any way, shape or form in the sense that it might create any issues in regard to stimulating sufficient competition between bidders particularly when we contract out large infrastructure projects?

Mr Archer—Certainly it is an issue that we are conscious of in relation to some of that work that I alluded to earlier. There have been some questions examined around, for example, if there are any barriers to foreign companies participating in the domestic construction market.

Senator BUSHBY—Are there?

Mr Archer—Probably a significant issue is simply the fact that we do not have a particularly deep market for infrastructure projects compared to, say, North America or Europe. So there is a question about whether companies can achieve a sort of sufficient level of scale of operation in Australia to make it worth their while particularly considered against the fact that there are some local dominant companies that are well established within the market. Otherwise, there are issues around bidding costs. As I said, there has been work done on that which hopefully will be revealed soon. There are issues around if we can do more to in

effect have a more certain predictable pipeline of infrastructure projects coming to market in Australia.

Senator BUSHBY—Which would give some of the foreign companies a higher degree of confidence that it is worth setting up here?

Mr Archer—Yes, I think that is right. I guess you move to the fact that there have been some notable failures in the market. That might have had some effect, although there are different perspectives from which a PPP project might be considered a success or a failure. If a road is built and people are driving on it, then from that point of view you have a road that is being used but, from the investor's perspective, it might not be such a successful enterprise.

Senator BUSHBY—Although as well that question about the concentration of the construction market is broader than just PPPs. Not all infrastructure is done as a PPP. So it is more in the sense that I was asking about barriers. I do not know whether you were answering in the broad or specifically.

Mr Archer—In terms of international participation in the market and barriers, I think I was not necessarily just talking about PPPs.

Dr Kennedy—It is certainly a consideration that barriers to entry or mechanisms that might work against competition in these sectors are definitely important to look at. I would also pick up Mr Archer's other point about being a relatively small country and the public sector giving a business the best sense that it can of the projects that are on the horizon and that are likely to be coming to market. Well-known PPP type processes, if that is the way they are going to be delivered, and well-established bidding processes and all those sorts of things would seem to us to be important features of a well-functioning infrastructure market.

Senator BUSHBY—We seem to be experiencing significant escalation in the order of seven to eight per cent a year in construction costs. Is there any sign that this will moderate in the near future? Correct me if I am wrong with those figures and update me with some that are more accurate.

Dr Kennedy—I am aware of strong growth in construction costs. There is a link here back to the macro group and, if you like, the deflators or the construction cost prices that they have got as part of our forecast. I do not know about that aspect and I would need to take it on notice. I probably do not have much more to add than that. Do you, Brad?

Mr Archer—No.

Senator BUSHBY—From a competitive sense, we have discussed concentration and some of the barriers to entry into the market. Do you think that if there were more competition there would be an easing of the price pressures in the sector? Is lack of competition really one of the reasons for the price going up?

Dr Kennedy—That is always a very difficult assessment to make particularly when you have got a lot of activity going on in that sector at the moment, so distinguishing what is coming from the competitive process and what is coming from very strong demand is difficult. You would always be having an eye that your best chance of delivering the lowest price possible is to have the most competitive market so, almost regardless of the

circumstances the industry faces in any particular year, you would want the market to operate as efficiently as possible.

Senator BUSHBY—I guess you could put it in the reverse and say more competition is not going to increase price pressures.

Dr Kennedy—I would not have thought so.

Senator BUSHBY—And it may well, depending on the make-up of the market and other factors, actually relieve some of them.

Dr Kennedy—Yes.

Senator BUSHBY—I want to ask a few questions about a speech that Mr Jim Murphy delivered earlier this year entitled ‘An Overview of Transport Investment and Government Policy’. In that speech Mr Murphy stated:

... investment in Australia’s rail network has gone hand-in-hand, in the past, with higher aggregate output levels in comparison to other types of investment.

What research is Treasury drawing on here to make that point?

Mr Archer—I would have to take that on notice, if I could.

Senator BUSHBY—There is nobody here who assisted Mr Murphy in the preparation of that speech?

Mr Archer—Not directly, no.

Dr Kennedy—No, there isn’t. Sorry, Senator, would you mind repeating that?

Senator BUSHBY—I was just wondering what research basically underpinned that statement by Mr Murphy.

Dr Kennedy—I am sorry to ask you this, Senator, but could you repeat the quote?

Senator BUSHBY—Okay. It was:

... investment in Australia’s rail network has gone hand-in-hand, in the past, with higher aggregate output levels in comparison to other types of investment.

So the return on rail investment is higher than that from other forms of infrastructure.

Dr Kennedy—I did not prepare that aspect of the speech so I do not know that specific piece of research. We can take that on notice and find out for you.

Senator BUSHBY—Okay.

Dr Kennedy—I am sorry Mr Murphy was not able to attend.

Senator BUSHBY—That happens from time to time. Even Dr Henry has been unavailable at times too. Is Treasury doing any work itself on the link between output and rail investment? You may have to take this on notice as well. Given that last statement by Mr Murphy, it would seem an obvious thing to do. Are you doing any work on the link between output and rail investment? Is Treasury aware of any other work on this matter? You may well have to take that on notice.

Dr Kennedy—Do you mean the specific modelling, like if we increased rail networks by X we would get this return on the output side?

Senator BUSHBY—Analysis up to and including modelling but not necessarily modelling—analysing papers or work done by other people.

Dr Kennedy—No, not that I am aware of. In a broader sense we have certainly been giving more thought to the network type effects and spillovers that come with infrastructure and trying to think more carefully about how those issues are an important dimension of advice around any infrastructure that is being built. The return on a specific line or road, for example, may exceed the direct return, if you like, if it encourages much more efficiency and is part of a broader network; in other words, there are big spillover costs or, to use economists' jargon, positive externalities.

Senator BUSHBY—It sounds like a prime ministerial statement!

Dr Kennedy—Certainly we have been giving some thought to those issues but we have not been doing any formal analysis of: should we invest Y billion dollars in rail and what would the return be? The infrastructure department would be thinking much more carefully and deeply about those issues. They have areas that are focused specifically on that issue.

Senator BUSHBY—Mr Murphy may have got his research from them.

Dr Kennedy—He may have. I will give him a call in China and see what he has to say about it!

Senator BUSHBY—Mr Murphy also said in his speech:

... greater population density and rising demand can eventually result in significant congestion costs. At a certain point, these costs will offset the benefits of the economies of scale.

Are we at this point with cities in Australia? How do we determine when this point is hit or exceeded? In a roundabout way it is coming back to some extent to the discussion that we had.

Dr Kennedy—Yes, you are. This might be an issue that Mr Murray might want to comment on.

Mr R Murray—Yes. My answer to that would probably be no, because I think there are a lot of issues around how spread out our cities are and how poorly we have planned the transport corridors in particular and of course the clustering around those transport corridors. Both we and the United States have cities very different to European cities.

There are a lot of different ways that you can do this. If you were to say, 'The way we do things is set in concrete and we do not think it is worthwhile investing anymore in public transport and better planning around transport corridors,' then, yes, we have a big, longer-term issue around congestion. And of course we do not have any systems of road charging other than on toll roads which themselves can be highly problematic. So unless we address a lot of those issues you cannot say that we are at that point that you are talking about.

Senator BUSHBY—I understand what you are saying—it is hard to pin it down. But Mr Murphy did go on to say in the same speech:

Acquiring more land for urban roads, building new bridges or digging new tunnels can be an expensive way to meet our future needs. And in highly developed cities like Sydney, Melbourne and Brisbane such options may no longer be feasible.

Which is, I guess, the context that he was talking about reaching that point.

Mr R Murray—And that is certainly true, and quite often with road construction it is the old story of supply creating its own demand. For instance, just to bring to mind some examples I know of, if you have a four lane M25 around London, it is congested and, if you expand it in areas to 12 lanes, it is still congested. So if you just do some of these things in isolation, that is the effect you get. If you are planning a road network without any decent consideration of how public transport fits in with that then I think you are going to inevitably end up in a mess.

Senator BUSHBY—I think we have, in some of our cities, from lack of coordinated infrastructure planning, but that is probably not a matter for you to comment on at this point. We are travelling over ground that Senator Joyce has already worked through, but I would just like to follow up with a few of my own questions in the area as well. I apologise for going over the same area again. Given Mr Murphy's statements—and yours are not totally inconsistent with what Mr Murphy said, it is just that you are explaining it from a different angle—is it the view of Treasury that expanding the cities of Sydney, Brisbane and Melbourne is approaching a point of infeasibility from an infrastructure perspective?

Mr R Murray—You can gather from what I said that I think the answer to that is definitely no, but what I think we are saying is that you have to think a lot better about how you do the planning. The overall strategic plan is made up of a whole lot of individual parts and individual little markets within it, so we have to think a lot more carefully and do a lot more reforming around all those issues. Integral to all of that, and to all those little markets, is the delivery of infrastructure. Now you can do some of those things by doing toll roads but if you do not do a lot of other things around that then inevitably you are going to have congestion around the toll roads not necessarily on the toll roads. All these issues are really complex and where we would come from is to say that you do not just treat the symptoms, you have got to go out and look at what the root causes of all of these problems are and start addressing them. In terms of where some other cities have got to around the world, I think we are a long way behind.

Senator BUSHBY—Okay. That is probably a subject for further questions another time. I had some more questions that were similar to the ones that Senator Joyce has already asked so I will move on to something slightly different but still very much related. Can you explain what 'wider economic benefit' is to the committee?

Mr R Murray—It is probably a bit of rhetoric I would have thought. There are benefits that Dr Kennedy was alluding to—if you like, the wider benefits out of building a network. But I think in economics we would probably deem them to be more spillover benefits, not the direct benefits of, say, building a particular piece of infrastructure. The benefits that come from connectivity, if you like, in one sense they bring direct benefits but then a lot of dynamic other benefits that flow on from that.

Dr Kennedy—You could think about it in terms of businesses perhaps in markets trying to get scale to get more efficient. If they become better connected by transport they may no longer have to deliver all the components of a particular good in one area. They may be able to both widen their market and increase their focus on a particular aspect of production.

Business can take advantage of efficiencies that can come with scale and deliver to larger markets. Those things are not typically going to be priced into the direct return on that investment on that road but they are worth considering in how parts of cities or even areas between cities are connected and, in a sense, the ability then of business to take advantage of enlarged markets and to achieve efficiencies out of those things.

Senator BUSHBY—I think you are onto what I am talking about with the term. It is one of the criteria that Infrastructure Australia uses—wider economic benefit. I think that your answer shows that you understood that.

Mr R Murray—Having said it is referred to, it could very well be used by Treasury as well. It is just trying to give some sort of colloquial meaning.

Senator BUSHBY—I apologise for not being specific when I asked the question but I was particularly interested in the meaning of the term ‘wider economic benefit’ as a criterion applied by Infrastructure Australia. So it was in the context of the question we were talking about. It is my fault for not making that sufficiently clear. Obviously the three words together could mean an awful lot of things. In that context of the criteria used by Infrastructure Australia, how do you estimate the benefits of wider economic benefit for Australian cities? How do you actually assess what those benefits are?

Dr Kennedy—It is not a straightforward task because the things I just described are difficult.

Senator BUSHBY—It seems very fuzzy in a lot of ways. If it is a criterion that governments are using—government bodies as in IA—how do we actually assess it? How do we measure it?

Dr Kennedy—I will let Mr Murray comment. It is fuzzy. It is always going to be difficult to pin down, but we think it sufficiently important that it should be taken into consideration.

Mr R Murray—It may manifest itself in governments taking a different view of a particular piece of infrastructure than, say, the private sector would. The private sector will take just the immediate direct commercial benefits and they will discount that at a certain rate but a government may view this as having much longer term benefits because of what might be the spillovers and the flow-ons from that particular infrastructure. Therefore, they do not want to discount those longer term benefits at a high rate, bringing it back to now. So that particular infrastructure then would probably be built by the public sector as a long-term investment rather than by the private sector. You can come a bit unstuck with roads, for instance. You are not going to go and put a huge piece of infrastructure through and say, ‘We are building it for the next 10 years.’ You may want to build it for the next 40 years, which means you are over provisioning right from the word go.

Senator BUSHBY—The business case might not stack up in pure economic terms but, in a wider economic benefit, it is justifiable.

Mr R Murray—If you looked at it from a cost-benefit analysis with the social discount rate in it, it may look very attractive. After all, that is how a lot of the infrastructure has been built.

Senator BUSHBY—That is fine and I accept that, but I guess the question is: how do you actually measure what that is?

Mr R Murray—I think what I am trying to say is: where a lot of those benefits are a long way out and you know they may be there but you are going to have great difficulty in quantifying them, you are not going to discount the benefits you do recognise out there back to present value at a high discount rate. You are going to say, ‘We put a lot of store on the longer term and therefore our discount rates are going to be much lower.’

Senator BUSHBY—How would you differentiate the wider economic benefit that is provided in cities of different sizes?

Mr R Murray—That is quite an interesting question because I think it gets back to a lot of the dialogue between Senator Joyce and—

Senator BUSHBY—I was going to ask about that as well.

Mr R Murray—I have lived in Goulburn and Canberra but I have also lived in London and Washington and in a 100,000-person city outside London. They all bring different perspectives and different benefits. What are the benefits? A lot of that is what you are looking for, what sort of job you want to do and what sort of lifestyle you want. A lot of people love living in Sydney or Melbourne and they discount a lot of the costs that they incur compared with, say, living here in Canberra.

Dr Kennedy—There is no doubt that with size business can really get scale—

Senator BUSHBY—As Mr Murphy said, you can actually get to a point where—

Dr Kennedy—That is true: you get diseconomies of scale. Yes, you hit those congestion points. Not having Mr Murphy’s speech in front of me, I think part of what Mr Murphy would have been talking about is that you want to be sure that you are using the existing infrastructure as efficiently as possible. If, for example, there is no cost to use a piece of infrastructure, it may well be being overused and that may not be promoting the most efficient use of the whole bundle of infrastructure that you are providing. Those are the sort of things that you want to think about as well. As to congestion problems that might come about—and I think you mentioned Mr Murphy might have gone to this issue—we are saying that they will not necessarily be resolved by just more roads on top of roads, and that we need to ensure that we are using all that infrastructure that is there at the moment as efficiently as we can.

Senator BUSHBY—That is why I am asking the questions about wider economic benefit. Unless you can actually measure what those are, it is hard to go through that complex process unless you come to a reasoned decision at the end.

Senator EGGLESTON—On the question of infrastructure and cities, a lot of people think that one of the problems with Australian cities is that we do not have much medium-density housing. We still live on single house blocks. Quarter acre blocks are going out of fashion and they are getting a bit smaller. Do you as a policy projector believe that we should have higher density housing and medium-density housing and mass transport—meaning rail—and more use of rail in our cities?

Dr Kennedy—I will be honest and say that this is perhaps starting to get well beyond our particular expertise around the planning of cities. We have some staff who have some town

planning experience, but we are not town planners. We are in a sense becoming more and more engaged with this issue because we are interested in it from the productivity dividends that can come from better organising ourselves and from the fact that there already well over 60 per cent of people living in big capital cities and that is projected to rise.

I think we need to be cautious in deciding exactly how we think people should organise themselves in cities. We want to make sure that the planning and the amenity and the transport that might go with, say, a more dense city is there. For example, it is all well and good to suggest that we should have increased densification of our cities but, if people are living on congested roads and there is very little urban amenity around where they live, that would seem like a difficult thing to deliver. Do you want to comment, Richard?

Mr R Murray—I would agree with that. If you think about what a strategic plan is, a strategic plan is very much a consensus, if you like, at the end of the day. That gets back to the various elements of culture within a society and how people want to live together. You cannot ignore that. Australians have had a culture of having very spread out cities and, deep down, a lot of Australians still want that, but we are running up against various constraints on that. So people have to then think, ‘Are there different ways of doing all of this?’ But it will not be bureaucrats sitting around saying, ‘You have to do all of that,’ because that is not how decent planning actually happens. Decent planning is just about how people want to live together. I think a lot of this is about having a debate in Australia about what we really see our cities looking like.

Senator EGGLESTON—That is probably true. I wonder if I might move on to other things, though. I know you cover the Foreign Investment Review Board.

Senator JOYCE—Can I ask a question before you move on to that.

Senator EGGLESTON—Sure.

Senator JOYCE—You are aware of the Wandoan to Banana rail link for the development of the Wandoan coalfield?

Dr Kennedy—Mr Archer may be.

Mr Archer—No, I am not familiar with that.

Senator JOYCE—Are you aware of the development of the Wandoan coalfield?

Mr Archer—It is not an issue that I have been focused on, no.

Senator JOYCE—Are you aware of the infrastructure requirements in that area for the development of the coalfields?

Mr Archer—No.

Senator JOYCE—It is a billion-dollar piece of infrastructure. You are not aware of it?

Mr Archer—No.

Senator JOYCE—Thank you.

Senator EGGLESTON—Among the Foreign Investment Review Board issues which were raised, I know, by Senator Xenophon and which I gather you are responsible for, the issue of Chinese investment was raised. In the tables I have seen—in the past, anyway—

China has actually been at the bottom of the list of foreign investors in Australia, and the top ones have been Britain and the United States.

Senator Sherry—That is the total aggregate investment?

Senator EGGLESTON—Yes. Are you able to tell us the order of foreign investment nations in Australia currently—who is investing most and so on down to the least?

Mr Colmer—It depends on what measure you are using. The data that we have in the Foreign Investment Review Board is on investment intentions, and it amounts to flows of investment. On that measure, in the last financial year China came in at No. 2. The US was No. 1. In the last report, I cannot remember them off the top of my head, but I do have the list right here. The top five last year in order—this is 2008-09—were the US, China, Japan, the UK and France.

Senator EGGLESTON—That is a repositioning of various countries on the list from previous years.

Senator Sherry—I think your initial question went to the aggregate stock of foreign investment in Australia, as distinct from the investment flow, which I think Mr Colmer was referring to, in this last year.

Senator EGGLESTON—No, actually I was looking for the annual investment. When we in this committee were discussing foreign direct investment in Australia, we saw some tables which indicated that China was a fairly low-level investor compared to the United States.

Mr Colmer—I suspect that you are looking at stocks rather than flows.

Senator EGGLESTON—Fair enough.

Mr Colmer—On stocks, I do not think I have the list here.

Senator EGGLESTON—You are correct; the secretary has just said they were stocks.

Mr Colmer—Yes. The last results on stocks that the ABS has released, I think, were for the end of 2008. At that stage, China was No. 15. I do not have the full list.

Senator Sherry—I actually have the list here. At 31 December 2008, yes, the UK and the US, by stock of investment, were overwhelmingly the largest in Australia, followed by Japan, Hong Kong, Singapore, Switzerland, Germany, the Netherlands and so on. We can table this.

Senator EGGLESTON—If you would.

Senator Sherry—It is sourced from the ABS.

Senator EGGLESTON—Yes, of course. That is gross investment, but from what we are hearing China is now, in terms of actual levels per annum, becoming one of our highest investors.

Mr Colmer—Yes, they are No. 2 but, as I said, that is proposed investment. There are significant limitations to the data, and there are different limitations with both the ABS data of stock and the Foreign Investment Review Board data on intended flows. Just to give you an example of that, we can talk about a proposal that you would be very familiar with: the original investment by Chinalco in Rio Tinto. That was a \$19.6 billion investment, from memory—something of that order—which we have counted in our data as \$19.6 billion. The

reason we have counted that in our data is that it allows comparisons with our established practices over several years. The interesting thing from a data perspective is that that particular investment proposal was carried out by a Singaporean based subsidiary of Chinalco on the Hong Kong Stock Exchange into a UK arm of a dual listed company. In reality, while we have counted that as \$19.6 billion because of the huge assets that Rio Tinto have in Australia, it may never appear in the ABS stats—and you could argue that maybe we should not include it in ours, because of all those sorts of complexities. But, in terms of providing comparative data over time, that is the approach that we have taken over many years, and that is why it is in there. As I said, because it is a Singaporean company which is a subsidiary of a Chinese SOE making a transaction on the Hong Kong Stock Exchange for a UK listed company, it is very doubtful that that would ever appear in the ABS data.

Senator EGGLESTON—That is a very interesting piece of information, because it really means that the figures you are telling us that you produce do not measure levels of actual investment and are perhaps to some degree—and I do not mean this in a very critical sense—misleading as to what foreign countries are investing in Australia. I thought it was interesting that you had France as a fairly high-level investor or potential investor, which is a change, I think, from the past. Are there figures produced of aggregate investments when they occur, per annum? Who would have those sorts of figures?

Mr Colmer—There is no data on that as such. We do discuss this in the annual report—that our figures are investment intentions. We do try to emphasise in the annual report the limitations of the data. There are a number of other limitations on that data but, as I said, we try to maintain a consistent approach to reporting so that the figures are comparable from year to year. There is no doubt that China is a very significant investor in Australia at the present time. But it is also the case that those ‘league tables’, if you like, vary significantly from year to year.

Senator Sherry—FIRB is a foreign investment approval—

Senator EGGLESTON—I hasten to add that I do not have any particular objections to Chinese investment—

Senator Sherry—Sorry—just let me finish our answer, in part. FIRB is a foreign investment approval body. As has been outlined, there are limitations to the data it publishes. There are limitations to the ABS data as well, and when ABS appears they can outline that in detail. But ABS keeps statistics on foreign investment and have for a very, very long time.

Senator EGGLESTON—Is that on actual investments that have occurred?

Senator Sherry—Yes.

Mr R Murray—I would also make this point: why do the US and the UK show up as such huge investors in the ABS data, particularly in the stock? Part of it is historic, but the other part—and this is not picked up by FIRB—is that a lot of businesses are already established here and have been for a long time, and they re-invest. Those are picked up in the flow figures from the ABS but not in the FIRB statistics. That adds considerably to UK and US investment stock.

Senator EGGLESTON—Cumulatively, over the years.

Senator Sherry—For obvious reasons the UK is No. 1, because European settlement occurred from the UK, and then obviously there was the rise of the US. But, even with the rise of Japan—and the debate we had about Japanese investment that took place, I can recall, in the sixties and seventies—total stock of Japanese investment in Australia is a long, long way behind the US and the UK.

Senator EGGLESTON—I do understand that, and I thank you for saying that.

CHAIR—We can continue this discussion after afternoon tea.

Senator Sherry—It might be something Senator Joyce would be interested in seeing as well. I will pass those up.

Senator EGGLESTON—We have a different perspective.

Proceedings suspended from 3.30 pm to 3.45 pm

CHAIR—The committee will begin again. We are still with the Markets Group of Treasury. Senator Eggleston has the call.

Senator EGGLESTON—There are a few other topics that I would like to raise, one of them being the National Broadband Network. We have been told that there has been no cost-benefit analysis, as such, done on this. Do you regard the recent KPMG McKinsey implementation study of the national broadband network as constituting a kind of cost-benefit analysis of the project?

Mr Archer—It is not a cost-benefit analysis. It is very much a study that goes to how the network may be rolled out, the costs of doing so and various options around that, and projected use of the network and, hence, revenues. Having done that, it does build up a business case. But it does not purport, nor was it asked, to examine, for example, the potential long-term benefits of a next generation network. It does not attempt to measure those potential benefits or compare them against the costs.

Mr R Murray—We have always been concerned about the risks around this project. I have explained to the Senate, both to this committee and to the committee that looks specifically at NBN, that, even though we could not quantify the benefits, we thought that there were a lot of benefits, particularly these spillover type benefits that I spoke about earlier, particularly in the long term. We then looked in that context at what were the risks around the project. A lot of our advice to government was around risks to the project. I cannot go into detail about what our concerns were, but this study, even though it is not a cost-benefit analysis, does lay down a cost base, as Mr Archer has pointed out. So it has filled out quite a few gaps for us on that side.

Senator EGGLESTON—Do you have plans to cover those gaps from a financial point of view?

Mr R Murray—A lot of the gaps are on the benefit side, and we have no plans on that. That would be a huge task.

Senator EGGLESTON—The study concluded that under certain assumptions the NBN could make a return just above the government's cost of funds. In your view is the risk adjusted cost of capital for a broadband network at or near the government bond rate?

Mr R Murray—There is a lot of misconception about what this cost of capital concept is really all about. What have they done in this study? They have developed the cost line of this and, under various assumptions, then also built up the revenue side. They have then applied that to a cash flow analysis, which you might very well do in a cost-benefit analysis as well. Then they have solved that thus: if the revenue is not cost through at zero, what is the discount factor in looking at those cash flows that solves that? That has come out at about six to seven per cent, as I recall. So it is not like that has been imposed on it; that is where it has come out.

Whether that is an adequate return is in the eye of the beholder. We are thinking about all of that because we have to give advice to government. I am not at liberty to say where we are coming out on that. If I can use a hypothetical, would we rule out a project that gave a return that at least paid off the bonds on a major public investment in infrastructure? Certainly not. That may very well in a cost benefit world be the sort of social discount rate that you want to use because you think there are a lot of long-term benefits out there. I will answer it in that sense—as a hypothetical.

Senator EGGLESTON—Is it possible to justify the government putting all its costs on the NBN to the capital account—in effect, assuming that every dollar spent on the NBN adds one dollar to its balance sheet? Wouldn't it be fair value accounting rules to require it to evaluate the present value of these investments at a risk adjusted cost of capital value?

Mr R Murray—When this whole thing is built and when you have a complete going concern you might. I do have an accounting background but I am not an accounting expert.

Senator Sherry—There was considerable discussion on this issue at the Macroeconomics Group, as I recall. It goes to budget preparation.

Dr Kennedy—Is it a question that goes to its treatment on the government's balance sheet?

Senator EGGLESTON—Yes, it would be.

Mr R Murray—I can at least give you comfort that there has been, from our point of view, proper accounting treatment applied to this under the IMF's government financial system framework, and it is benchmarked and watchdogged by the ABS. Is there something dodgy going on here? Of course not.

Senator EGGLESTON—I was just trying to evaluate costs. So there is no such fair value assessment of the National Broadband Network being undertaken? Can I assume that from what you have said?

Mr R Murray—Yes. Not in the sense that you have defined it.

Senator EGGLESTON—Would it be better for the study to have produced a figure for the net present value of the project rather than just reporting the internal rate of return?

Mr R Murray—That is not what it was asked to do. It was asked to look at the bottom line and ask, 'What is the business case for this?' That is what it was asked to do and that is what it did.

Senator EGGLESTON—So that is what it was asked to do and they were the terms it was asked to follow. But what are your views on the assumptions that were made in the NBN

implementation study—in particular, regarding the rate of take-up of broadband services, even with the competition from Telstra and the emergence of wireless networks, and the wholesale price for these services?

Mr R Murray—Mr Archer may be better placed than I am to answer this, but I was a member of the steering committee that had oversight over this implementation study and I have to say that I found the McKinsey team unbelievably competent and thorough. I am not a telecommunications expert and I am certainly not a telecommunications marketing expert, but I thought we were asking—without going into the confidentialities of these—a lot of pretty tough questions about all of the assumptions going into this. As I understand it, these assumptions about take-up, for instance, which are critically important on the revenue side, are reasonably conservative. As I say, Treasury is not sitting here as an expert in all of this.

Senator EGGLESTON—No; we take that point, then. We are still rather disappointed that there has been no cost-benefit analysis done, of course, and I think a lot of people would have liked to have seen something such as that done.

I would now like to move on to the question of radio frequency spectrum. The budget has announced that we will be releasing a large amount of spectrum in coming years. How much is it estimated will be received from the auctioning of spectrum? Obviously this is for the digital economy and network.

Dr Kennedy—Yes—the digital switchover dividend, as it is being referred to. I will ask Mr Archer to correct me if I am wrong, but I think the government has announced its intention to target a 126 megahertz dividend. The valuation of that dividend would be a matter for Finance; we would not value that dividend. And it would be done in that way.

Senator EGGLESTON—So has any plan been developed relating to how this spectrum might be auctioned off? Obviously it is very valuable—

Dr Kennedy—Yes.

Senator EGGLESTON—and there will be many groups competing for it.

Dr Kennedy—Yes. It is an issue that is currently under consideration by government.

Senator EGGLESTON—And you are confident that you can maximise the returns to the taxpayer from this sale?

Mr R Murray—We were heavily involved in the earlier part of this where a lot of the issues were about how much spectrum could become available to be auctioned, and I think it is true to say that the outcome of that—the 126 megahertz—is very similar, both in size and positioning on the spectrum, to the United States, and is a particularly good outcome.

Dr Kennedy—In fact I think it is a little larger, Senator, than digital dividends that have been generated in other countries. So, from the perspective of the amount of dividend to be auctioned, made available down the track, that is a good outcome. But the government is still considering all the final processes around that.

Senator EGGLESTON—Do you want to tell us anything about how the United States auctioned off this spectrum? Was there anything particularly different, interesting or innovative about what was done there?

Dr Kennedy—No. I mean, the department of broadband and communications could talk to you about those issues, and Finance may also know about some of those issues, but, just from memory, as Mr Murray was alluding to, a 126 megahertz dividend, if you like, is a very useful piece of spectrum, in part—and, again, we are not experts on these issues, as for the NBN—because it allows the potential for that dividend to be used very efficiently by people who may wish to use it.

Mr R Murray—There are lessons, apparently, that have come out of various auctions around the world, and we certainly should be taking those into account.

Senator EGGLESTON—What other countries have auctioned their digital spectrum? I suppose the UK, France—

Mr R Murray—You are stretching my memory now!

Senator EGGLESTON—It is a very contemporary matter, of course.

Dr Kennedy—Yes.

Mr R Murray—Indeed.

Dr Kennedy—It is—we are in the midst of digital switchover, so yes. Switchover has occurred in the US and—

Mr Archer—The UK.

Dr Kennedy—the UK. As to the spectrum auction processes, I cannot tell you. I would be happy to take it on notice and follow it up for you.

Senator EGGLESTON—If you would, that would be helpful, because I am quite interested in that. My last question on this matter—which you may or may not be able to answer—is this: is there any proposal to time-limit the ownership of the spectrum so that it would be, in effect, leased for five or 10 years and then have to be repurchased rather than being a permanent purchase?

Mr Archer—Like all the other issues around how the spectrum may be auctioned are under consideration. I understand that there are public consultation processes taking place as part of that.

Senator EGGLESTON—The last topic I would like to raise with you is that I understand you represent Australia's interests on investments and financial issues in negotiating free trade agreements in the Doha Round and also in relation to investment and multilateral forums such as the OECD and APEC. How many free trade agreements have we got at the moment?

Mr Colmer—At the moment we have free trade agreements with Singapore, Thailand, ASEAN, the US and New Zealand, of course—the CER arrangement. I think that is the list at the moment. Malaysia is under discussion.

Senator EGGLESTON—I think that Indonesia is under discussion too, isn't it?

Mr Colmer—Indonesia is under consideration, rather than discussion. The current negotiations that are in place are with: China, Japan, Korea, Malaysia, the Gulf Cooperation Council and the Trans-Pacific Strategic Economic Partnership, which includes Brunei, Chile, New Zealand, Peru, Singapore, Vietnam and the United States. There is agreement to discuss

the Pacific Agreement on Closer Economic Relations and there are also discussions with India and, as you mentioned, Indonesia.

Senator EGGLESTON—It is a fairly long list, one has to say.

Mr Colmer—It is indeed.

Senator EGGLESTON—One wonders, when we look at our trading relationships whether in fact we are almost doing a free trade agreement with everybody we trade with. Is there some commonality in these agreements? Is there a problem with overlapping issues within them? Is this a solution to the failure of the Doha Round? What is the rationale for quite so many free trade agreements and negotiations in progress?

Mr Colmer—I think the first point is that with free trade agreements you obviously get the best outcomes by negotiating them with your most significant trading partners. I think that to a reasonable extent the list includes that. Everybody would like the Doha Round to proceed and succeed, but it has been quite difficult—as you would be well aware. However, it may get started again this year; we would hope that would be the case.

Our role in Treasury is fairly narrowly constrained within the overall free trade agreement agenda process: that is first and foremost the role of DFAT. We participate in those negotiations, as do a number of other departments. Our particular areas of interest are around investment and also financial services to some extent. But the actual establishment of the agenda for the negotiations is essentially something that comes out of DFAT.

Senator EGGLESTON—We would appear to be following very much a line of bilateral agreements in lieu of something broader, such as the Doha agreements.

Senator Sherry—I just think, as Mr Colmer has indicated, that this is primarily a DFAT issue; it is not a matter for this area. We can provide you with certain factual information, as Mr Colmer has done, but beyond that—

Senator EGGLESTON—It is an area that this group does cover, as I understand it—that is why I asked the questions. But I thank the officers for the information they have given; it has been quite useful.

Senator JOYCE—Has Treasury given any thought to the increasing costs of urban water supplies?

Dr Kennedy—Sorry, you are in the wrong place; Fiscal Group does water policy at Treasury.

Senator JOYCE—Do financial markets have any crossover with the water market?

Dr Kennedy—Certainly from that infrastructure angle, all areas of Treasury are talking to each other, but water policy and water policy advice is developed in Fiscal Group in the Industry, Environment and Defence Division, who appeared yesterday.

Senator JOYCE—Being general manager of infrastructure, what exactly are you dealing with in infrastructure?

Dr Kennedy—On the infrastructure side we have responsibility for the regulatory regimes—the National Access Regime, for example. We also cover regulatory regimes that are part of the national electricity market, such as the Australian Energy Regulator. We also

provide advice to the Treasurer on other infrastructure matters around energy, transport and communications. We would typically provide advice, for example, on the issues that Senator Eggleston was raising earlier around the digital dividend.

Senator JOYCE—So you provide advice on energy, transport and infrastructure to the Treasury?

Dr Kennedy—To the Treasurer? Yes.

Senator JOYCE—I find it interesting that you did not know about a \$1 billion rail project from Wandoan to Banana in the middle of the Central Queensland coalfields.

Mr R Murray—I think it is probably a bit unfair to think that we are going to know something about everything.

Senator JOYCE—That is a pretty big one.

Mr R Murray—It may be a very big one, but, again, it is a matter of how we cut up our resources and how we use our resources. A lot of questioning this morning was on that same basis—for instance: is the whole department working on the resource super profits tax? Of course it is not; it is concentrated in certain areas. Similarly, with coal a lot of the issues around infrastructure are intricately related to coal, and that is in our Industry, Environment and Defence Division. Again, that is in Fiscal Group, so that is where water is, where climate change is and where most industry policy is. It is around coal. Do they know a lot about coal? I presume they do.

Senator JOYCE—But you would know about regulatory regimes for access to rail networks. That would come under your ambit, wouldn't it?

Dr Kennedy—Yes, providing information around the regulatory regimes that go with transport networks does come under our ambit, but, to build on Mr Murray's response—and perhaps on the subject of how government can organise itself efficiently—there is a Department of Resources, Energy and Tourism, which looks after these issues. We would have approximately four to five staff—is that right, Mr Archer?

Mr Archer—Covering?

Dr Kennedy—Covering, say, resources issues.

Mr Archer—Maybe two staff covering energy sector issues.

Dr Kennedy—So our potential to carry around in our heads all the major projects and remember them all by name is somewhat limited compared to an entire department focused on these issues.

Senator JOYCE—So you believe you are underresourced?

Mr R Murray—I do not believe that for a moment.

Senator Sherry—That is not the issue. Frankly, the issue, time and time again, is asking the questions to the right areas.

Senator JOYCE—I was just wondering if the speech writer for \$157,000 would not have been better appropriated to your department, seeing you need the work. The department has managed to find \$157,000 for a person to write interesting and intriguing speeches. Maybe a

better allocation of that resource by the Australian Labor Party would be to give it to you so you can actually answer some of these questions.

Senator Sherry—Senator, if you want to find out, if you have not learnt by now yourself, and I am, frankly, surprised you have not—anyway, here we are, three years in and you still do not know where to ask the right questions.

Senator JOYCE—At least I stay awake during estimates.

Senator Sherry—I would be careful about going to performance at estimates because I might publicly disclose some of your performance in Senate estimates, so be very careful.

Senator JOYCE—That would be terrifying coming from you!

Senator Sherry—Senator Joyce, where they are not relevant we are taking them on notice.

Senator JOYCE—You are taking virtually everything on notice.

Senator Sherry—You have the option to ring the secretariat, to ring the committee secretary, and check what is the relevant area to ask questions in. You can always clarify the position—as I did, and I know many other senators do—before you come to Senate estimates. But you cannot expect an answer when you are not asking the question of the right area.

Senator JOYCE—Are you involved with the regulatory aspects of water?

Mr Archer—No. As Dr Kennedy explained, water is generally the policy responsibility of Fiscal Group, to the extent that Treasury is involved.

Senator JOYCE—How about Aussie Infrastructure Bonds? Have you got any coverage in that area?

Mr R Murray—Debt financing is in Fiscal Group but I can answer some questions on it. Fire away—I will see what I can do.

Senator JOYCE—The budget suggests that a separate line of Aussie Infrastructure Bonds will be identified in future budgets. As those are used to fund the NBN, will there be any tangible difference between normal government securities and Aussie Infrastructure Bonds?

Mr R Murray—They will certainly be identified separately. In the budget itself there will be clear identification of what are bonds for infrastructure and what are bonds for ordinary financing. But we are anticipating in the sale of them that it is going to be like an indistinguishable product. We do not want to split these things in terms of reducing the liquidity over the various lines that we have there. They are all very carefully structured from a liquidity point of view. We want to minimise the interest burden. From our analysis of all of that, that is the best way of delivering on it.

Senator JOYCE—In your own words, how do you see the Infrastructure Bonds working?

Mr R Murray—I will just talk on wholesale, because it has not been quite worked out yet on retail. Presumably, that could be quite a distinguishable product.

Senator JOYCE—Yes.

Mr R Murray—On the wholesale side, it is intended that we will identify out of various parts of the raisings what is the infrastructure bond component so that can be carefully documented, if you like, into the budget papers and the budget outcomes and in the balance

sheet. People will be able to see quite clearly what components of the whole bond raising are ordinary bonds and what are Aussie Infrastructure Bonds. But we do not want to disturb the sale of the product.

Senator JOYCE—How will the application of the money raised from the Infrastructure Bonds work? Will it go to general Treasury or to a certain fund? How do we identify the infrastructure that it goes towards?

Mr R Murray—The government wants to identify the infrastructure bond components as going to infrastructure. Initially, that will be towards the National Broadband Network. Beyond that I am not sure. Because my involvement is mainly in the National Broadband Network I am not sure what raisings are going to go into other parts of infrastructure.

Senator JOYCE—They will have the same face value as any other bond?

Mr R Murray—Yes.

Senator JOYCE—Are there any tax concessional arrangements?

Mr R Murray—No.

Senator JOYCE—Are you aware of municipal bonds in the United States?

Mr R Murray—Because I have lived there I am aware of them, yes, but I do not know the details of them.

Senator JOYCE—You are aware that they are used directly to invest in certain projects?

Mr R Murray—Yes. For instance, the new Nationals baseball stadium in Washington was financed, not wholly but significantly, by a special DC council municipal bond raising that was marketed, I presume, in New York or wherever.

Senator JOYCE—So who actually books the liability for that raising?

Mr R Murray—I presume the DC council.

Senator JOYCE—And it is not accounted for in the federal government debt in the US, is it?

Mr R Murray—No, unless there is a guarantee over it.

Dr Kennedy—We had specific purpose bonds in Australia in the past many years ago.

Senator JOYCE—I am interested in that. I really am just curious. How did they work?

Dr Kennedy—I am sorry, this is an issue for Fiscal Group, but I will do my best. From memory, they were bonds that tended to get issued by government trading enterprises or that type of activity. But I think specific purpose bonds were mostly at the state level and they fell out of favour a number years ago, back in the eighties I believe, but I know they are still widely used in the US. I am not absolutely certain the municipal bonds are exactly the same as what the specific purpose bonds were, but that was a form of financing that has been used in the past in Australia.

Mr R Murray—Can I give you a bit of background on our own bond program on this. Over the last five or six years, we have carefully restructured the whole of the bond profile. The bond profile is built out to 10 or 15 years. It is carefully structured so that there is a

significant supply of two- and three-year bonds and 10-year bonds—that is out to maturity—because they underpin the bond futures market. The bond futures market is built on three-year futures and 10-year futures. So we have had to very carefully structure that and it means that we have had to build up liquidity in particular lines. In some ways that is what we do not want to disturb. It is a very delicate matter for the AOFM.

Senator JOYCE—Do the Aussie infrastructure bonds receive a full guarantee from the Australian government?

Mr R Murray—They receive the same guarantee as Commonwealth government securities.

Senator JOYCE—To go back over this again, if they have the same nature as normal bonds, why do we separate them?

Mr R Murray—Because we want to make it quite clear in all of the documentation when the budget is presented to the parliament and when the budget outcome is presented to the parliament that certain parts of the bond raisings have been for overall activities but certain parts of it have been earmarked for infrastructure and to show how that has then flowed through to the various infrastructure investments. As I said, what happens on the retail side is not clear as yet.

Senator JOYCE—Will the projected increase in the issuance of government securities be lower than expected?

Mr R Murray—That is for fiscal group.

Senator JOYCE—I have some TPA questions. I want to ask a few questions about the OECD's review of regulation released earlier this year. This review called for a number of changes to the Trade Practices Act, particularly on the competition side. Is the Treasury investigating the need for changes to the TPA at the moment?

Dr Kennedy—There have been a number of reforms over recent years to the Trade Practices Act. Perhaps you are not referring to the consumer reform, but the consumer law reform is an extremely large reform. There are other reforms now around unconscionable conduct and creeping acquisitions, and on an ongoing basis we are continuing to examine and work with the ACCC on needed reforms to the Trade Practices Act. I might ask one of my colleagues Mr Deitz to comment on the OECD report and some of its comments on the Trade Practices Act.

Mr Deitz—The OECD regulatory review was conducted across the course of last year and as part of that framework it examined our competition policy settings. There were a number of recommendations that flowed from that. Specifically in terms of the anticompetitive conduct provisions of the act, it did make some recommendations. I cannot remember all of them off the top of my head, but the ones that I do recall related to private action proceedings, the specific prohibition on predatory pricing, otherwise known as the Birdsville amendment, and the per se offence for third line forcing.

Senator JOYCE—In your study of the OECD, did you make a comparative analysis between their threshold test for the instigation of an action and the Australian threshold test for the instigation of an action?

Mr Deitz—Sorry, the review—

Senator JOYCE—The threshold test—the substantial lessening of competition test being one of them.

Mr Deitz—The review was conducted by the OECD competition committee secretariat. Australia was subjected to a peer review process during that review, but we did not run that process.

Senator JOYCE—Did the report specify encumbrances to the initiation of an action in Australia as opposed to the initiation of a similar action in, say, the US?

Mr Deitz—Which encumbrances?

Senator JOYCE—The substantial lessening of competition test is one threshold that is incredibly hard to prove. In fact, I do not think they have ever proved it. I am talking about an Australian encumbrance that stops the progression of cases and therefore impedes the trade practices law—although it may be glamorously portrayed, it is muted in its effect.

Mr Deitz—I would have to take on notice any of those kinds of concerns, but I would observe that the substantial lessening of competition test is used quite broadly. It is not just an Australian test. It is used throughout our region and in the US and Canada, for example. I do not recall that review commenting negatively in any sense on the use of the phrase ‘substantial lessening of competition’.

Senator JOYCE—Hasn’t it been the interpretation since the Boral case that, before you can instigate an action, you have to prove that a competitor has the capacity to raise prices without losing customers?

Mr Deitz—To raise prices without losing customers would require you to be an absolute monopolist—

Senator JOYCE—A monopsonist.

Mr Deitz—with a perfectly in elastic demand curve, and such a scenario does not exist. The competition law has a far broader application than that.

Senator JOYCE—Does it? Since Boral? Are you sure of that?

Mr Deitz—If you want me to come back to you on notice, I am happy to confirm that. But I would also note that there are specific subsections of section 46 which say it does not require absolute freedom from constraint. There is a specific section which deals with that.

Senator JOYCE—Could you inform me of the cases that have been successfully prosecuted since Boral?

Mr Deitz—Safeway is one case which, I believe, was handed down after Boral. There would be others, but I would have to take that on notice.

Senator JOYCE—Was that a successful prosecution?

Mr Deitz—Yes.

Senator JOYCE—How many others do you know of?

Mr Deitz—I would have to take that on notice. I do not have that information in front of me.

Senator JOYCE—When was the Boral decision?

Mr Deitz—I believe it was in 2003.

Senator JOYCE—How many successful cases do you reckon there have been since 2003?

Mr Deitz—Again, I would have to take that on notice.

Senator JOYCE—Would you be surprised if it was three or four?

Mr Deitz—Again, I would have to take that on notice.

Senator JOYCE—The OECD also saw merit in encouraging more private enforcement of competition laws. Is that something Treasury is considering at the moment?

Mr Deitz—As we said, the government is considering the OECD review. It has put out a response to that. I do not have that in front of me and I cannot recall the details.

Senator JOYCE—When will the response be tabled?

Mr Deitz—The response has been tabled.

Senator JOYCE—My understanding is that there are still reforms to the consumer laws following the passing of the Australian consumer law earlier this year. What is the status of these reforms?

Dr Kennedy—As you know, the first bill has been passed, and this committee recently reported on the second bill. I will ask Mr Writer to take you through where we are up to on that.

Mr Writer—A bill was passed on 17 March and received royal assent on 14 April. That bill did two things. Firstly, it introduced a national unfair contract terms law as part of the new Australian consumer law. The national unfair contract terms law will commence on 1 July this year. On 1 June, the ACCC, ASIC and the state and territory agencies jointly published guidance on that new national law.

The second thing that the bill did was to introduce a range of new enforcement powers for the ACCC and ASIC. They can seek civil pecuniary penalties for breaches of consumer laws, they can seek disqualification orders for those involved in breaching consumer laws and they can seek orders which provide redress to consumers affected by a breach of the law where those consumers are not named in the action. They can issue public warning notices about operators who are either a risk to the public or have engaged in a serious or persistent breach of the law, they can issue substantiation notices to request that businesses substantiate claims they make and they can issue infringement notices with penalties, particularly in relation to minor breaches of the law. Those new powers commenced on 15 April.

There is a second bill currently before the parliament. This committee published a report on that bill on 21 May, and the government is currently considering the recommendations made by the committee and by the coalition senators. That bill includes the entire Australian consumer law, which is essentially a restatement of consumer protection and fair trading provisions for the Commonwealth and each state and territory. That national law is scheduled

to commence on 1 January, pending passage by this parliament and application by all of the state and territory parliaments.

A further bill was introduced on 27 May. It will bring in some reforms to the unconscionable conduct provisions which will be included in the Australian consumer law. That bill is designed to clarify those unconscionable conduct provisions by setting out some interpretive principles. It is also designed to simplify the provisions. Those unconscionable conduct provisions will be part of the Australian consumer law, as I have said, and enforceable at both the national level and in the states and territories.

Senator JOYCE—Are you aware of what the threshold test will be in the unconscionable conduct provisions?

Mr Writer—The test will remain essentially as it is.

Senator JOYCE—Which is?

Mr Writer—Which is that there is a prohibition of unconscionable conduct, and then the provisions set out the range of factors that the court must have consideration of in doing that. I do not have the provision here in front of me, but those factors remain essentially the same as they are now. The reforms in the Competition and Consumer Legislation Amendment Bill which was introduced on 27 May will introduce some additional principles which make clear a number of things in relation to unconscionable conduct.

The first of those is that the section is not limited by the unwritten law on unconscionable conduct, so it has a potentially broader application than the unwritten law. The second is that it makes it clear that this section is capable of applying to a system of conduct or a pattern of behaviour, whether or not a particular individual is identified as having been disadvantaged by the conduct or behaviour. The third is that it makes clear that the court, in considering whether conduct is unconscionable, may consider the terms of a contract and manner in which and the extent to which a contract is carried out and is not limited to the circumstances of the formation of the contract. Those principles are designed to overcome some of the concerns that have developed about the limitations of the practical application of the unconscionable conduct provisions so far.

Senator JOYCE—In looking at the OECD report, where were the major deficiencies in Australia's competition law as compared to the Enterprise Act in the UK or the United States' consumer law?

Mr Deitz—My recollection of the overview of that review is that in general terms there was not held to be any significant deficiency in our competition laws with respect to those applied by overseas jurisdictions. Again, as I said, there were two areas that I can recall that they had specifically focused on. One was the per se offence for third line forcing; the other one was the specific prohibition on predatory pricing.

Senator JOYCE—One of the ultimate mechanisms for dealing with competition is that if there is none or if it has been usurped or absorbed over time—that, I suppose, is why we are looking at creeping acquisition laws—is to vest your powers. Can you point out for me where in Australia's Trade Practices Act there is a section on divestiture?

Mr Deitz—Divestiture powers in the Australian context are contained within section 81 of the Trade Practices Act. They apply primarily to situations of mergers, where the commission can seek—

Senator JOYCE—For a short time after the merger, is not it?

Mr Deitz—For three years after the merger, that is correct.

Senator JOYCE—And in criminal cartels.

Mr Deitz—I am not aware of that.

Senator JOYCE—It was in criminal cartels for a short section after mergers and acquisitions, but only for a short period of time. Can you instruct me, through your knowledge of the OECD, how divestiture powers are expressed—for instance, in the Enterprise Act of the UK?

Mr Deitz—I would have to take that on notice.

Senator JOYCE—Are you aware of the Sherman Antitrust Act and the Clayton Antitrust Act in the United States?

Mr Deitz—Yes, I am.

Senator JOYCE—Are their divestiture powers stronger than ours?

Mr Deitz—Again, I would have to take that on notice.

Senator JOYCE—You would? Come on.

Mr Deitz—The one thing I would refer you to is that the 2003 Dawson review of the Trade Practices Act did consider the role of a divestiture power as a remedy for breaches of section 46, and that review did conclude that there was no such role. That comes on the back of the 1993 Hilmer review of the Trade Practices Act, which also considered these issues and, on balance, recommended against having divestiture powers in the Trade Practices Act. It also concluded on that basis that such a power was better held by governments through legislation rather than through an administrative authority such as the ACCC.

Senator JOYCE—You are talking about markets. Let us look at the fertiliser market, where you have complete centralisation—for all intents and purposes, a monopoly in the market. If you cannot deal with it through divestiture, how are you going to deal with it—just tell them they are bad?

Mr Deitz—I will refer you to my previous answer in which I said that these reviews of the Trade Practices Act have concluded—

Senator JOYCE—I looked at the Dawson and Hilmer reviews and they both said ‘do nothing’. Do you think we should still do nothing or do you think we should get to a point some day where we actually do something?

Dr Kennedy—I do not think we would accept your characterisation that we do nothing. I presume these are matters you might have discussed with the ACCC in the past. While there is always scope for reform and review of the improvement of the Trade Practices Act, as seen through these rather substantial reforms around the Australian Consumer Law, I would not

characterise the current situation as: we do nothing about our competition concerns. I do not think the ACCC would accept that characterisation either.

Senator JOYCE—I was talking about divestiture. I know we do so from trade practices law. With regard to divestiture there is a glaring difference between our Trade Practices Act, the UK's trade practices act, the United States trade practices act and, I imagine, a number of other trade practices acts throughout the world. That would be a fair statement, wouldn't it?

Mr Deitz—Again, I would prefer to take that on notice and give you an answer.

Senator JOYCE—You have read the report, though, haven't you?

Mr Deitz—Which report?

Senator JOYCE—The OECD report.

Mr Deitz—Not recently, but yes.

Senator JOYCE—So, in your summary, you are saying that basically everything in Australia with regard to trade practices law is fairly right except for third line forcing and some of those issues you brought up?

Mr Deitz—It does not have any specific reference to inclusion of divestiture parts, if that is your question.

Senator JOYCE—With the growing population—I am off trade practices law—do you think there is going to be an increase in demand for water?

Mr R Murray—What I was trying to get across yesterday was that you just do not think that we might have these various probable trajectories of population growth but everything else—our water use patterns, our water policies, our pricing—will just stay the same. You just cannot assume that. What we are trying to do through this population strategy is to address a lot of those issues and say alright, we have a lot of challenges here. We have a drying continent, and we have probably had that, at least measurably, for the last hundred years, and climate change presumably means it is going to get drier, so whether we have an increasing population or not, we have to address the issues of water. It is not just about rural water; it is about urban water as well, and the mix between the two. I tried to get at these issues yesterday. This is not just looking at the symptoms; this is getting down to what are the basic problems here that we have to address.

Senator JOYCE—We are going to have to build a dam or something aren't we? We are going to have to build dams, or we will have all these desalination plants—

Mr R Murray—I do not know. If we used water more efficiently, you may have to build a dam or you may not have to build a dam. We have moved to desalination plants. If we priced water properly, and we priced the energy that went into it properly, and we had a reasonable environmental assessment around all of that, I would say that we had made some rational decisions. But in the absence of a lot of those things, as a public policy adviser I could not say to you 'This was the best decision we could make,' because I am not sure I or anybody else knows that.

Senator JOYCE—If we are going to feed the population, we need an abundance of water. Even with domestic needs we have had to deal with lower storages. If we continue on our

current trajectory—I think you said 43.9 million people will be living here in 2050, unless we can cut it down to 180,000 a year, when we are currently at over 300,000—even in the Murray Darling Basin we are going to have to find more water to put into the system, no matter how efficient we are, to somehow feed everybody.

Mr R Murray—We have made it quite clear that the 180,000 assumption in there is pretty reasonable. With a lot of the temporary residents that we have here, eventually you would assume that you get to some sort of equilibrium where those coming in are balanced by those going out. Eventually you get back to the main parameter here, which is around the permanent migration program—which has been running at about 180,000. Looking back in history, we think that that is a reasonable assumption. Some of the press today have portrayed this as though we are somehow telling the government that it will have this huge target. We never said that yesterday at all. I find it very disappointing that that was how it was portrayed. So I want to make that point first.

The second point is about our needing a lot more water. We may do; I do not know. I do not think that the weather forecasters can tell us exactly what our rainfall patterns are going to be within the south and between the south and the north. I do not think many people have got a handle on where we are actually going to be growing in the future. There are a lot of issues about productivity gains within the food sector. We cannot just sit here and say we are not a trading nation. When you look at the United States, they have 300 million people, they have a huge agricultural sector, but they also do significant trades with Canada and significant trades on food with Central and South America. They even do trades with Europe and Asia on food. We maybe an island, but we are not sitting in a tradeless world. There are a whole lot of factors here to be looked at, and a lot of answers are difficult to come up with. I think a lot of talk about food security is pretty misguided and is not taking into account a holistic approach to the whole issue.

Senator JOYCE—So the assumption is that if we do not build dams we will just import more food?

Mr R Murray—No, I did not say that at all. I said that I do not know whether we would need more water; I do not know whether we would need to build more dams. You may build dams; you may not build dams. In the ACT, for instance, we have made what seems to be a reasonable decision that we are not going to build a new dam but we are going to raise the level of the existing dam because it is a significant catchment. There are various decisions. And it is quite clear that the people of the ACT, through their water rates, are going to pay for that, and that seems to me a sensible decision.

Senator JOYCE—But you cannot have the same rating on agricultural food as you do on urban water; otherwise, you will not have any agriculture at all.

Mr R Murray—No, but various consumers place different values on different parcels of water, and certainly a trading system around water—if we ever finally get to that—will allow at least, within reason, the markets to sort out a lot of these issues. It is not the whole answer but it is part of the answer.

Senator JOYCE—You are saying that one of the safety valves that you will be relying on is that if we cannot produce the food we will import it.

Mr R Murray—We import food now.

Senator JOYCE—I know we do.

Mr R Murray—We always have. From day one, we have imported a lot of food.

Senator JOYCE—At the start of settlement we almost starved as a colony too.

Mr R Murray—We are going to still be exporting some food and we are going to be importing some food, and how that mix turns out at the end of the day will depend on a lot of things. You would be the first to acknowledge, Senator, that the ingenuity, the innovation and the productivity gains within our farm sector are huge, particularly when you bear in mind that this is such a sparsely populated continent and a continent with such poor soils.

Senator JOYCE—If we are relying on more importation of food because of increasing population—

Mr R Murray—We may do.

Senator JOYCE—possibly an importation of food—and also possibly driven by a lack of capacity or a lack of desire to create the water infrastructure to create the irrigation, that means that, the more we are reliant on the importation of food, the more obviously we are vulnerable to fluctuations in currency and what that does to the price of food.

Mr R Murray—Yes, but we face those risks in a whole lot of sectors. We have now had a floating exchange rate since 1983, and what this country has learnt to live with very, very successfully is a floating currency, which has been a huge safety valve for this economy and for this community.

Senator JOYCE—But you would acknowledge, quite obviously, that if the currency depreciates and we are relying on imported food then the price of food goes up—in fact, it could race up.

Mr R Murray—It could do, for the imported component, but it may very well then, for the export component, be a very good—

Senator JOYCE—A very good what?

Mr R Murray—outcome.

Dr Kennedy—Of course, when the price goes up here it makes the local domestic producers all that much more competitive.

Senator JOYCE—But this is where the market becomes very interesting, because what we have in Australia is one of the most centralised retail markets in the Western world. That would be a fair statement, wouldn't it?

Mr R Murray—I am not sure in the whole Western world, but I think—

Senator JOYCE—Can you name one country that has a more centralised retail market than Australia?

Mr R Murray—I cannot—

Senator JOYCE—Neither can I, because they do not exist.

Mr R Murray—They may not exist. This whole debate today about competition is very interesting. We are a small market, and it is not even as if we are a whole single market. This is a whole continent that is very sparsely populated. A big disadvantage of the country is even the distances between towns, let alone the distances between the big cities. You just cannot say: ‘Well, look at the United States. Why aren’t we the same as the United States?’

Senator JOYCE—I am not saying that.

Mr R Murray—And probably we never will be.

Senator JOYCE—Would you acknowledge that there has been a centralisation in the retail market over the past 30 to 40 years—in fact, an incredible centralisation in the retail market in Australia?

Mr R Murray—I do not know, but it is a fairly concentrated market; there is no doubt about that.

Senator JOYCE—Okay. How about food inflation? Are you aware that Australia has the highest food inflation also in the Western world?

Mr R Murray—Inflation in the food market has been high from time to time, yes.

Senator JOYCE—Do you think there is a connection between the centralisation in the retail market and food inflation?

Mr R Murray—I do not know.

Senator JOYCE—You do not know.

Mr R Murray—And I am not sure what studies the ACCC has done.

Dr Kennedy—Do you want us to comment on the OECD comparisons around food inflation?

Senator JOYCE—Yes, sure.

Dr Kennedy—Andrew, do you want to make a few remarks on food inflation?

CHAIR—Senator Joyce, before we go on: Senator Xenophon has a question, as he needs to go to another committee. Do you mind if we just interrupt?

Senator JOYCE—Sure. But then come back to the food inflation question, Mr Deitz.

Senator XENOPHON—Thank you. Dr Kennedy, you are familiar with the Productivity Commission research report of March this year, *Market mechanisms for recovering water in the Murray-Darling Basin*? Is that a yes?

Dr Kennedy—Yes, sorry.

Senator XENOPHON—You are aware that the Productivity Commission in its findings was concerned about the value for money that taxpayers were getting in terms of water recovery mechanisms such as infrastructure, saying that there needed to be—I think this is a fair summary—a more rigorous approval process to all irrigation infrastructure projects to prevent inefficient and inequitable investment, with surplus funds reallocated to the buyback and other priorities? That is from their summary of that. Can you advise what advice Treasury

has given both to the water minister and to Treasury in terms of a more efficient use of taxpayers' funds in line with the concerns of the Productivity Commission?

Dr Kennedy—I would be happy to take that question on notice. It is a policy responsibility dealt with by the Industry, Environment and Defence Division in the Fiscal Group in Treasury. I am not across the details of the advice that they may or may not have provided on that issue, but I would be very happy to take it on notice for you.

Senator XENOPHON—And, in particular, what advice has been given to the minister? For instance, will there be a more rigorous approval process? Minister Wong, in response to the Productivity Commission report, said that there was already a substantial due diligence process but she would be seeking advice as to whether any further steps were necessary. Did Treasury advise as to whether any further steps were necessary for a more rigorous approval process for infrastructure projects?

Dr Kennedy—As I said, I am very happy to approach my colleagues in Fiscal Group about those issues.

Senator XENOPHON—Thank you, and thank you to the chair and Senator Joyce.

Senator JOYCE—Mr Deitz: food inflation?

Dr Kennedy—I will ask Mr Paine to come up.

Mr Paine—I think part of this is related to the conversation that was just occurring about a floating exchange rate and also the fact that we are part of the world market. As you know, quite a lot of the food that is produced in Australia is exported, and it is not unreasonable, I think, that the producers of that food are interested in getting the world price. And then, as you know, we import some food. So the movements in food price in Australia compared to overseas really reflect a lot of factors apart from the level of competition in the retailing sector in Australia.

Senator JOYCE—Have we got the highest food inflation in the Western world or not?

Mr Paine—I could not answer that. I do not know the facts on that.

Senator JOYCE—Have we got comparatively high food inflation?

Dr Kennedy—We had comparatively high food inflation, I think, over the period running up to around early 2008, and since that period I think, comparatively speaking, our food inflation has been relatively low compared to the OECD. As Mr Paine was saying, there have been a number of factors at play—but, yes, we did. That question is difficult because it is again always dependent on the time period over which you are calculating these things. We would be happy to produce those international comparisons I have just described in general.

Senator JOYCE—This is interesting. Has our proportion of consumption of imported food increased or decreased over the same period of time?

Mr Paine—I do not know off the top of my head what the facts are. Irrespective of what they are, that might not have all that much to do with the changes in prices, but we are happy to try to find out.

Senator JOYCE—It seems interesting that you say the floating exchange rate has saved us, but we have an increase in imports of food, but we have the highest food inflation in the Western world.

Mr Paine—The factor I was trying to draw out is that they are influenced by each other but there is not necessarily a causation there. As Dr Kennedy was saying, the bit about food price inflation is critically influenced by the starting period. If you pick a different quarter to start the comparison you can get quite different results.

Dr Kennedy—I could add to that. One would also want to carefully consider what the inflation targeting regime is in these countries. For example, in Australia we target inflation in the band of two to three per cent. If you are comparing us with countries that target inflation at a lower level, on average prices will grow more rapidly in this country than in other countries. Similarly, if it is a period of extremely strong demand, the country is growing quickly and incomes are growing very strongly, that will tend to feed into the demand for all goods, including food, which would tend to lead to their prices being higher. This is not to say that making those comparisons is not a reasonable thing to do; it is just important to keep in mind the various factors that might be driving the differences beyond competition.

Senator JOYCE—What is our major export in this nation?

Mr R Murray—For food?

Senator JOYCE—No—major export, full stop—a product.

Senator Sherry—A product or a sector?

Senator JOYCE—A sector. A resource.

Mr R Murray—The top four exports are iron ore, coal, tourism and education. I think that is the order.

Senator JOYCE—Iron ore and coal as a proportion of exports makes up roughly what amount?

Mr R Murray—I do not know. Resources overall make up about 60 per cent of exports. That is, agriculture and—

Senator JOYCE—Export of resources would have a major effect on our exchange rate, wouldn't it—the price and demand of resources?

Mr R Murray—Dr Kennedy is better on this than I am, but there is a significant relationship between commodity prices—

Senator JOYCE—Commodity prices and the value of the Australian dollar?

Mr R Murray—Yes, and that includes agricultural commodities as well. That is part of the mechanism that goes on through the cycle.

Senator JOYCE—So if we do something to affect the price of our commodities or the availability of our commodities, then demand for our dollar would fall, won't it?

Mr R Murray—Yes, but I cannot remember any product where we had enough market power to actually do that—even in wool. We actually stuffed ourselves up rather than the market when we tried to do that.

Senator JOYCE—If we reduce the desire for other people to acquire Australian dollars because they do not want to buy our products, then, naturally enough, the value of the Australian dollar will fall, won't it?

Mr R Murray—I am not quite sure I understand the question.

Senator JOYCE—If the resources rent tax has the effect that the mining industry says it will, then, quite obviously, there will be an effect on the Australian dollar—that is, the Australian dollar will depreciate, won't it?

Mr R Murray—I am not sure that I am here to make comments about—

Senator Sherry—They are making a range of claims. You and I have had some exchange about their claims. They have made a range of claims, Senator. I understand that predicting the value of a currency, up or down, is one of the most difficult areas in economic forecasting. But there is a considerable range of issues that impact on the value of the Australian dollar. If we have anything to add in terms of the resource super profits tax, we will take that on notice and come back to you—if there is any claimed relationship with the currency and whether it moves up or down.

Senator JOYCE—If the value of the Australian dollar depreciates the cost of food will appreciate to the proportion that we rely on imports. That would be a fair statement, wouldn't it?

Mr R Murray—And vice versa.

Senator JOYCE—And, whether the dollar appreciates or depreciates, the more you are reliant on your own food the less it will be affected by exchange rate fluctuations?

Mr R Murray—With other things not changing, yes.

Senator JOYCE—So the more Australia has the capacity to feed itself the more it isolates itself from the vagaries of what would happen to the dollar if it fell over and, therefore, you would have a greater capacity to keep a consistently priced product there for the Australian consumer, in food?

Mr R Murray—That may or may not be right. However, I put this to you. If we take that to its nth degree, we will not trade with anybody and we will be far worse.

Senator JOYCE—I am just talking about the realities of exchange rate fluctuations.

Mr R Murray—I think I am trying to say what the realities are.

Senator Sherry—Senator Joyce, the issue you are raising is the justification in part for Europe, Japan and other countries, in the name of food security, keeping their markets either closed or restricted to imports, which is definitely against our interests.

Senator JOYCE—Do you believe that a large section of the food that is coming into Australia—especially fruit coming from America for processing and canned vegetables coming from Europe—is subsidised?

Mr R Murray—I have got no idea.

Senator Sherry—It really is an issue for primary industry, trade—

Senator JOYCE—I thought it was to do with the market. I thought it would be a fair statement about how the market is going and whether it is perfect or whether it is corrupted.

Senator Sherry—You really are broadening the definition of a market into almost anything.

Senator JOYCE—Do you think food is not in a market? Where does food exist if it does not exist in a market?

Senator Sherry—We have already had this discussion.

CHAIR—This is markets within Treasury, Senator Joyce.

Senator Sherry—It is not every market that exists in Australia and therefore you have got an opportunity to ask any question about any market issue whatsoever.

Senator JOYCE—It is absolutely related. It is related to population. It is related to how we feed ourselves. It is related to the fundamentals of what infrastructure is going to be required. We have spent a couple of days here talking about it.

Mr R Murray—That is correct, but I cannot see why we have got to walk around and then stick our heads in the sand and say, ‘This is all too hard.’ The whole debate about whether we should trade or not and whether we should trade in food and agricultural products—I thought we had had this debate yonks ago, that we had gone over it.

Senator JOYCE—We are talking about the population predictions and where we are going and the fact that you said 43.9 if we continue on in excess of 300,000 people. If that is the case, how are we going to have the capacity to feed these people? Do we need to create the infrastructure? Do we need to have the foresight? Talking about sticking your head in the sand, every time we talk about new water infrastructure, you say: ‘No, that’s too hard. I’m going to stick my head in the sand. I’m not going to answer the question.’ It may or may not be the case. I do not know.

Senator Sherry—I am not sure whether there is a question there, but let us be fair here. You and Mr Murray had a fair conversation about these population related issues yesterday and you are attempting to raise them in another area. It is not the right area.

Senator JOYCE—We have been having a discussion about population. You have been sitting there while it has been happening.

Senator Sherry—I have no problem with having a discussion, provided it is in the relevant area.

Senator JOYCE—Is population relevant?

Senator Sherry—I am talking about the relevant area of estimates. You know what I mean.

CHAIR—Senator Joyce, we are very nearly at the end of the time for the markets group. Do you have one more question?

Senator JOYCE—Yes, I do. I have a range of questions.

CHAIR—Yes, but you have only got time for one.

Senator JOYCE—In your discussion on population, did you have a view to the infrastructure requirements or did you just stick your head in the sand?

Mr R Murray—I never stick—

Senator Sherry—That is unfair. That is an unfair reflection on the witness. When he made his reference earlier he was not referring to you personally, Senator. I do not think you should refer to him personally in that way.

Senator JOYCE—Fair enough. I withdraw that. Did you have a look at infrastructure requirements?

Mr R Murray—Sorry, when?

Senator JOYCE—In the discussions with regard to the population, have you had a look at future infrastructure requirements?

Mr R Murray—That is exactly what we are doing.

Senator JOYCE—Can you nominate one?

Mr R Murray—As I said yesterday, we are trying to get to the bottom of the issues, including around water, and then start trying to look at some of the solutions.

CHAIR—Now is the time for the conclusion of this section. Thank you to the markets group.

Mr R Murray—Madam Chair, on behalf of the Treasury, can I just make one short comment, and that is: we do not come here to take questions on notice—far from it. We would prefer to give the Senate as much information as we possibly can, but I think it is time for my policy coordination office to speak to your secretariat about just trying to sort out which parts of Treasury deal with what and, on particular topics, who is dealing with what. It might help things.

CHAIR—Good luck, Mr Murray, and thank you for offering to try.

[5.02 pm]

Productivity Commission

CHAIR—Welcome to the Productivity Commission. Mr Banks, do you have an opening statement?

Mr Banks—Yes, I do. I will not take very long, just give you a bit of an outline of the things we have done since we last appeared here. The reviews and reports we have completed and have had published since the last estimates hearing in February include one on the contribution of the not-for-profit sector, a research report; one on market mechanisms for recovering water in the Murray-Darling Basin; one on performance benchmarking of Australian business regulation, focused on occupational health and safety; a supplementary report to an earlier report we had done on public and private hospitals with some technical so-called multivariate analysis using some extra data that we had; a report on Australia's anti-dumping and countervailing system, which was released just recently; and a report on an Indigenous compendium drawn from our report on government services, where we extract from the blue book data relating to services to Indigenous people and release that as a separate

report. We have also completed in that period our report on gambling, which has yet to be released by government. It is a very large report, as you can imagine.

We have had three staff papers released in the period: one on the effects of education and health on wages and productivity, one involving some modelling of an urban water system and one looking at discount rates in cost-benefit analysis.

We have had new projects given to us in three quite important areas that involve social, economic and budgetary dimensions. One is on disability care and support, which requires us to look at a long-term care and support scheme, and the design and funding of such a scheme, for people with profound disabilities. A draft report is due in February next year and there will be an opportunity to comment on the draft report, as is usual in our processes, with the final report due at the end of July. The second of those is one into the aged-care system. We have been asked to present detailed options for the government's consideration in this area in relation to the regulation and funding of aged care, and a draft is due at the end of this year, in December, on that one. And we have received a suite of three projects related to the education and training workforce. The first one is on vocational education and training, which we have started, and then, in sequence, one on early childhood development and the workforce in that area and one related to schools and the teaching workforce. They will be overlapping reports that altogether will take two years. The vocational education and training draft will appear in November. Issues papers for all three of those reports have been released in the past couple of weeks. We are now into the submissions and public hearing phase for those three studies.

We have also got five ongoing inquiries, or commissioned studies, which I will just mention briefly: one into rural R&D corporations, with a draft expected in September; one into wheat export marketing arrangements, with a final report scheduled for 1 July; and one on bilateral and regional trade arrangements, with a draft report due in July.

We continue to conduct reviews under the red tape banner. We have one into business regulation benchmarking, where we look at compliance burdens across jurisdictions in different areas of regulation, and currently we are doing a study into planning, zoning and development assessments. We have a continuation of the annual review that we do of regulatory burdens on business, and the current report is focused on business and consumer services, with a draft report expected I think later this month.

There is a range of other ongoing work. I will not elaborate; I have in the past. I will just mention the headings. There is work that we do as a secretariat for a COAG group looking at government service provision and the efficiency and effectiveness of different areas of service provision. We also provide performance reporting for the COAG Reform Council related to the national agreements. We have a report on overcoming Indigenous disadvantage, which has indicators of outcomes for Indigenous people. That report is produced every two years, the next one next year. We are also assisting as secretariat in providing a report on Indigenous expenditure across governments in Australia and, under COAG, we will be looking at the reform agenda with a report on economic impacts and benefits. They are ongoing projects that we have. With that little overview, I will end there and take questions.

Senator PRATT—I want to focus on the question of women's workforce participation, which I think was touched on in last estimates. To begin, I note that the 2006-07 annual report

of the Productivity Commission contained a chapter on challenges and issues relating to enhancing labour force participation. Indeed, it noted that the potential benefits of increasing labour force participation in Australia are substantial, and I know that is a key concern for the Productivity Commission. To begin with, I would like to quote from the report, which said:

... improving workforce participation can ... make an important contribution to Australia's future prosperity—potentially offsetting much of the impact of population ageing ...

My first question is whether the Productivity Commission still stands by the comments it made in its 2006-07 report with regard to the significance of increasing labour force participation and whether the Productivity Commission would still identify women aged 25 to 44 as a significant group in that regard.

Mr Banks—The answer is yes to both questions. Obviously, with the ageing of our society—and there has been further work done in the *Intergenerational report*—those imperatives to raise participation, where we can, remain and there are a number of areas for both men and women where there is room to improve. The area that you just referred to is an important target area.

Senator PRATT—Is the Productivity Commission aware of any work that has been done since that time to assess the influence of various policy settings on the participation decisions of women in that age bracket?

Mr Banks—My colleagues might help you. We have a project underway which I might have talked about last time—it is still underway, which tends to happen in some areas of research. It looks at mature-age women and their experience in the workforce. That report, I think, is due to be completed, hopefully, over the next month or two. There may well be other work—

Dr Kirby—Not within the commission.

Mr Banks—I am just trying to think whether there is other work that is being done outside the commission, but I cannot think of any. There was some work that was referred to last time that had been done by a consulting group, but it was not work that we were part of.

Senator PRATT—On that note, are you aware of the recent Treasury working paper on the responsiveness of female labour supply to childcare costs?

Mr Banks—That is not a report that I personally have seen.

Mr O'Brien—We are aware of that. We keep a close watch on our colleagues' working paper series and we picked that up. I might also add—as, perhaps, a little backward look in for your purpose—that the commission's inquiry into paid parental leave really zeroed in on one of the key concerns that people raised in that inquiry process: the risks of discontinuity and workforce engagement. The entire design of the resulting scheme has as one of its key parameters trying to reduce the risks that parental separation from workforce participation could become permanent or that hurdles to re-entry could be created.

Senator PRATT—I think the Treasury paper concluded that the cost of child care does have a significant negative effect on the labour supply of married mothers with young children. Would you agree with that assessment and do you believe Treasury's findings are robust?

Mr O'Brien—It is an empirical question. I think a value of proceeding this way is that these are transparent pieces of research which are out there in the public domain. They get refined by testing once published.

Senator PRATT—Has the Productivity Commission done any work or is it planning any work to identify the benefits and costs of policies directed at lessening the impediments to women in their child-bearing years to realise their work preferences?

Mr Banks—We have done some work in that area but, once it gets into policy issues to promote participation in that way, it is the sort of work that we would typically be asked to do by the government where we could make some policy recommendations, as in the case of the paid parental leave inquiry. Given the amount of resources we have to do supporting research, we have to make those judgments about what is work that the government would prefer to ask us to do rather than for us to self-initiate.

Senator PRATT—That is a question for government, I suppose, as is the question of whether undertaking such work would be worthwhile, but in a general sense you have already identified that it is worthwhile because you have identified the untapped productivity that lies within that potential workforce.

Mr Banks—Yes. As I say, we have a project currently underway that is trying to explore the circumstances of one segment of the female population who are under-represented in the workforce and see what some of the reasons and the drivers for that are. But, for work of that kind, our ability to go forward and make policy recommendations is obviously quite circumscribed.

Senator Sherry—Because I have administrative responsibility for the Productivity Commission generally, not the policy response to its recommendations, from time to time, usually once or twice a year, I write to my colleagues to seek suggestions for a PC recommendation. You might care to take that up with the minister and we will see what we can do.

Senator PRATT—I will. I think it is notable that Treasury's working paper suggests that further research in the area, taking into account the tax trap transfer system that allows the calculation of net price elasticity, would provide some insights into the relationship between child care and labour supply, and that would be a worth while thing to do. As an extension of that, there are myriad unanswered questions on child care and workforce participation in general, one of which is that ABS statistics reveal that, currently, a very large number of parents are relying on informal care, including grandparents. To what extent is the Productivity Commission aware of the productivity of women in the labour force being released by what is, in effect, the productivity of grandparents in caring for children?

Mr Banks—I am not aware that we have done any detailed work in that area. The whole area of child care and childcare policy is important, and it is precisely the kind of the area where, if the government asked us to do an inquiry, we would welcome it. It is very important and it has come up at the margins of other things that we have done over time. As has been indicated, if you make known that you think that is a good area for us to work in we would be happy to oblige if the government asked us to.

Senator PRATT—I will make my views known to the minister, as advised.

Senator EGGLESTON—How many reports has the Productivity Commission started and finished in this financial year and what were they for?

Mr Banks—I would love to answer that off the top of my head. When you say this financial year, is it the one that just started? No, it is right at the very end of it so I cannot get out of it that way. We can get back to you on that.

Senator EGGLESTON—I believe you have been doing an inquiry into Australia's airports. When will that be completed?

Mr Banks—That was announced as a project scheduled to be commenced in 2011, but Minister Albanese has indicated that he would like it brought forward. My understanding is that it is a project that we will commence in perhaps the next couple of months.

Dr Kirby—I guess we are awaiting formal terms of reference.

Mr Banks—Yes. We are waiting for the government to ask us formally to do that work.

Senator EGGLESTON—This committee has had a number of references and released a number of reports which have thrown up competition issues, most recently in the dairy industry and the recent inquiry into the availability of finance to small business, and there are various other areas which have raised competition issues. In the dairy inquiry one of our recommendations was that the Productivity Commission consider an inquiry into the anticompetitive provisions of the Trade Practices Act and the way that the Australian Competition and Consumer Commission is administering them. Are you aware of that recommendation and do you regard it as a proper inquiry for you to pursue? Banking is another area where there are obviously a lot of issues.

Mr Banks—I was aware of both of those and they both raise a range of policy issues where the commission has undertaken inquiries in the past and made recommendations. But, again, it would be up to the government ultimately to decide whether to send such work to us.

Senator EGGLESTON—Yes, indeed, it would be. But, as I said, this committee has found a lot of evidence of the need for some sort of reform in that area because it seems that competition has been reduced quite significantly in various sectors in Australia, with adverse outcomes.

Senator Sherry—I have not read the report, although I am aware of it. I could make the same invitation to you and the committee—I do not know what position you hold with the committee. Was there a specific reference seeking further work done by the PC in the recommendations from the committee?

Senator EGGLESTON—There was. I am the chairman of the references committee, and we did that report, which was largely concerned with Tasmania—that was the genesis of it, I suppose. But it turned into a broader investigation into competition in the dairy industry across Australia. Because of the other issues which the committee has dealt with where it has found that there has been a reduction in competition, especially in the banking sector and a few other sectors, it was the committee's view that it would perhaps be timely for the Productivity Commission to look into the workings of the anti-competitive provisions of the Trade Practices Act and the way the ACCC is administering it.

Senator Sherry—It may be useful, as you are chair of the committee, to directly urge this with the minister, my colleague Mr Tony Burke, and I will certainly take it up with him. As I say, I have the administrative responsibility for the PC; we will see what we can do to progress that.

Senator EGGLESTON—I am very grateful for that, Minister; thank you. I would like to ask a few questions about a other issues. Firstly about free trade issues: I understand that you are conducting or have conducted an inquiry into bilateral free trade agreements. We did have a discussion earlier with Treasury about free trade agreements in this afternoon's hearings. Do you have any information for the committee on the commonality of these agreements across different countries? Are they largely similar in terms of their scope and treatment of different issues, or is there a great deal of diversity?

Mr Banks—We are currently doing a report in this area. A draft report will be released in July and, hopefully, it will provide answers to a lot of those questions because it is a useful time to take a stocktake. What I can say, without information at hand that will appear in that report anyway, is that there has clearly been a proliferation of regional or bilateral—some call them preferential—trade agreements in recent times. There has been a variety of reasons for that; partly, I think, the difficulties that the multilateral processes under the WTO have faced have led to some diversion into these kinds of arrangements.

They do vary a lot; they vary from ones that are quite comprehensive, such as between Australia and New Zealand, to others that target particular sectors of interest. The study that we are doing will try to learn some lessons from the experience with these not only of Australia but of other countries, and perhaps find some other guideposts for the future in terms of agreements that would perhaps be more beneficial to Australia than others.

Senator EGGLESTON—We do seem to have a very long list of bilateral trade agreements both in place and being negotiated. It is just interesting to think about the implications of that in terms of the variations between them. It seems that we are very much going down the road of bilateral and regional agreements at the expense of multilateral reform. I suppose that one of the issues you might address is the issue of bilateralism versus multilateralism in your report—would that be the case?

Mr Banks—Yes. We will certainly be looking at that. There are various ways to achieve gains from liberal trade. Traditionally, of course, Australia undertook a number of actions unilaterally which it then got credit for within the old GATT or within the WTO and was able to get access to other countries as well. I think the bilateral approach has varied enormously over time and across countries and increasingly Australia has been involved in them. Without pre-empting the report that is due to come out next month, I really cannot say too much more about that. As in all of our projects it will be a draft report and people can respond to that. No doubt we will have a Senate estimates after that draft report when there might be an opportunity for us to talk a bit more about the findings.

Senator CAMERON—You said in response to question on notice from me that the draft reports were your stress tests—is that correct? Your draft report can be subject to a stress test.

Mr Banks—I may have used the colloquial expression that when we put a draft report out, the findings and analysis and recommendations in it are stress tested in the sense that anybody

can give us feedback on it from economists, people in the community or people who are stakeholders. They can test those ideas, put counterclaims and counterevidence, and do that in a public way. That colloquial expression was intended to capture the feedback process of public consultation.

Senator CAMERON—I might come back to that when I get an opportunity but on the question of getting the feedback do you normally acknowledge individuals who make a contribution to the stress test that you undertake?

Mr Banks—Our final report would indicate all those who have been involved in roundtables and public hearings or who had provided further submissions to us. If we had engaged a consultant to provide a detailed critique of work that we had done or comment on modelling, we would also have their names in the final report.

Senator CAMERON—So when I made a submission on executive salaries I did not receive any acknowledgement of that anywhere. Did it just disappear or did you want it to disappear or what?

Mr Banks—Your submission would have been recorded in the report.

Senator CAMERON—I do not think so.

Mr Banks—We can check that and get back to you.

Senator CAMERON—Anyway it is not that important, I just wondered. If you say it is a stress test then not just for me but anyone who makes a contribution to important areas, whether the contribution is seen as meritorious or not, I am just saying that I think people should be at least acknowledged in terms of saying, ‘We’ve got your report.’

Dr Kirby—Certainly it is standard practice that every submission is put up on the website and is available for everyone else to see. There is acknowledgement and listing in the report of all the contributors.

Senator CAMERON—I am happy with what has been said. I do not want chase this. I am sorry I interrupted your line of questioning but I think it is important that people do get some—

Dr Kirby—We will look into it to make sure that the submission was properly acknowledged.

Senator CAMERON—I may have missed the acknowledgement.

CHAIR—You should have received a direct acknowledgement that they had received it plus it should have been in the report.

Senator CAMERON—I do not want make it a big issue. I do not even want you to respond to me in estimates on that. I am just asking a broad question.

Senator Sherry—Chair, as I indicated earlier I have to go to cabinet.

Senator EGGLESTON—I would like to ask you about a couple of other issues. Firstly, I would like to ask about planning, zoning and development assessment. I wonder if I could ask about the business regulation benchmarking report that you have just started and whether that

is going to cover planning, zoning, development assessment and regulations as they apply to regional areas?

Mr Banks—There is no confining of that to urban areas explicitly. When we do these kinds of reviews I guess they are very much data driven and sometimes the data is better, for example, in urban areas than it might be in regional areas, but that is certainly something that we would be scoping at the moment. I am not sure of the extent to which regional areas have been encompassed in the study so far.

Mr O'Brien—It is quite extensively because we are aware that the execution of planning and zoning through development approvals does run out into local governments all over Australia. This dimension of it has been picked up in the issues paper which was released on 21 May. We are planning a survey of around 160 local governments and also a survey of the users, if you like, of the processes. As with previous cycles in the benchmarking process, we have already met with an advisory panel which this time involves Commonwealth, state and territory central agencies and the Australian Local Government Association. We are trying to cast the net as wide as your question pointed to.

Senator EGGLESTON—That is a fairly broad net, including the Local Government Association. In Western Australia we have these regional development commissions—such as the Pilbara, the Kimberley, and the mid-west and south-west gold fields—which cover regional issues. I used to be on the board of the Pilbara Development Commission so I do know a little about what they do and I think they would be quite interested in this sort of inquiry.

Mr O'Brien—I know that the team visited Western Australia probably about two weeks ago and were talking with our counterparts there.

Senator EGGLESTON—On that line, I wonder whether the Productivity Commission is doing any work on the link between infrastructure investment and productivity growth.

Mr Banks—We have been doing some internal research in that area. It is quite a complex area for a whole range of reasons, including the famous data issues and so on. I think that work had been done in the Canberra office but was there anything more you wanted to say?

Mr O'Brien—It was done some years ago and, as I recall, to an inconclusive result essentially for the data reasons that the chairman was alluding to. When we tried to look at the exercise from a national aggregated data point of view we were not getting definitive or unambiguous results from testing that evidence. I think we tended to put the issue aside with the thought that there was more going on at the micro level than was showing up in the data.

Senator EGGLESTON—I see. I do not know whether this is an addition to that but what does the more general work of the commission show about Australia's recent reductions in productivity growth and what have been the main drivers of these changes?

Mr Banks—We made a submission to the House of Representatives review of productivity and what had been driving it. We have also had expositions of that in our annual report. The work showed that there had been a significant reduction in productivity growth, as you know. In fact, MFP growth was negative. We looked at the different industry sectors and their contributions to that.

We found in that work that about 75 per cent of the reduction relative to what it would otherwise have been could be attributed to developments in three areas: in agriculture, broadly, in mining and in the area of public utilities. There is quite a good discussion about those issues in the submission, which we have now published separately and I could make a copy of that available to you.

Senator EGGLESTON—I am quite interested in the mining sector. I just wondered what your views are about the reasons underlying a reduction in productivity in that area.

Mr Banks—There are a number of reasons there. In fact, we produced separately a research study focused just on the mining sector to try to get to the bottom of it. As you would appreciate, with the export boom in mining there has been a lot of investment. The benefits of that investment in output take a few years to be present and in the meantime measured productivity falls because capital has gone up, inputs have gone up but output has stayed the same and has not yet responded. That lag between investment and the fruits of investment accounted for a significant part of it.

There has also been a cyclical decline in the quality of the resource or even the depletion of resources in some areas, which has raised the cost of extracting it. With very high prices there is an incentive to extract ore that may not have been economical to extract when prices were lower. All of these things can be reflected in a poor productivity performance. On the other hand, they are all responsible for a very high income growth performance. That is the apparent anomaly that we pointed out: that you can have periods when productivity performance is low but income growth is very high.

Senator EGGLESTON—That is very interesting, especially with the more marginal mining areas being developed which is probably going to mean productivity is lower. What about electricity, gas and water supply? Why are we experiencing lower productivity growth in these areas?

Mr Banks—I think in those areas we have had a number of investments, again, which have been driven either by drought related issues or issues to do with energy efficiency and which have seen capital costs go up but output has not responded. Indeed, there have been some demand management initiatives taking place at the same time as supply enhancing ones. I think part of that is the short-term effect that we are seeing and part of it may be longer term to the extent that less productive technologies have been adopted over time.

Mr O'Brien—Perhaps I need to add that that is an area where we feel we have a poorer understanding of the causes than we feel we now have of the mining and agricultural slowdowns. It is a topic for our immediate productivity research work. As we flagged in the submission to the House of Representatives committee that the chairman mentioned before, it is also an area where measurement issues are surprisingly tricky, such as what happens when you have a shortage of the input of water to your water distribution system and the numbers do not move as intuitively as you think they should. I think there is a story to be researched and unpacked a bit there and that is towards the top of the productivity research agenda of the commission this year.

Senator EGGLESTON—Thank you. I understand the Productivity Commission is beginning an inquiry into the process of the COAG reform agenda. Have you started work on that at this stage?

Mr Banks—We have done some preliminary work, warm-up work, essentially to refine some of the modelling technologies that we would need to do that, but we have not formally received terms of reference to initiate that work as such.

Senator EGGLESTON—Have you had any indication of when you might be given formal terms of reference?

Mr Banks—We understand that that would be imminent. As I said, in the meantime we are doing quite a lot of work that would need to be done anyway just to seek data sources and improve the modelling capability to look at some of the economy-wide effects of a range of potential reforms that the government may wish us to look at.

Senator EGGLESTON—How long would you expect this inquiry to go on for?

Mr Banks—This work, as it was foreshadowed by the government and by COAG, would be an ongoing task where reporting would occur periodically. We would begin with essentially setting out the kind of framework that would be followed and then, in collaboration with government and COAG, we would focus on particular areas to look at in terms of the wider reform program.

Senator EGGLESTON—Thank you. I now turn to another subject which I understand you are inquiring into—that is, the inquiry into online gambling. There have been a couple of reports in the papers, the *Sydney Morning Herald* and the *Canberra Times*, that the Productivity Commission was in favour of the removal of poker machines from hotels, pubs and clubs. Do you still hold to those views? Will that be part of your recommendation on this issue of online gambling?

Mr Banks—There may be a confusion there between the online gambling and the actual poker machines that are physically located in premises.

Senator EGGLESTON—Obviously, yes—they are different animals.

Mr Banks—But I should say that we are at a stage where we have provided a final report to government and that report, which should be released soon, will set out the commission's revised recommendations and findings in that area. We had a range of recommendations and findings related to poker machines in pubs and clubs, but we also looked at online gambling. That was an area where we received a lot of feedback on our draft report, which we have taken into account and which will be reflected in the final report.

Senator Sherry—As I indicated earlier, I have administrative responsibility for the Productivity Commission, but in this area of the PC's report on gambling I have joint policy responsibility with Jennie Macklin, my ministerial colleague. We now have the final report; it is yet to be released but it will be released shortly. At that point in time people and various community interest groups will be able to make commentary on the final report when it is released. It is certainly true that there is considerable commentary about gambling issues in Australia.

Senator EGGLESTON—Thank you. That covers my questions.

Senator JOYCE—Going to your report on the Murray-Darling Basin, I am interested in the comments in the report about balancing economic, social and environmental concerns. How can we assess the trade-off issues between these concerns?

Mr Banks—The point that we made in that report is that they do indeed need to be looked at. It is always difficult to balance those different considerations, partly because quite often you can have a good go at measuring some of the economic impacts, but the environmental impacts are particularly hard to evaluate. They involve scientific elements and ultimately people's views about how important those things are relative to economic things. The point we were making is that they are all relevant to a decision about water buybacks.

Senator JOYCE—It is fair to say that defining economic benefits is easy—you can work it out on the determination of the gross output and return from the basin. I imagine the social benefits would be the towns, the people who live in the houses, the mortgages, the businesses there, the two million people who live in the basin. How do we actually define the environmental benefits?

Mr Banks—There are economic aspects to the environment that are quite important. But there are also values that people impute to the environment which are important too. When you talked about the social impacts, they are of the same kind. Some of those social impacts will be ones that are essentially economic but others will be ones to do with significance of communities and what they are doing and so on. There is a blend of those things. Some are more measurable than others, but sometimes simply identifying the nature of the impacts in a qualitative way and looking at how you can compare those with impacts that you can measure quantitatively is helpful in making judgments about where decisions are best made.

Senator JOYCE—Obviously you are aware of the pending diversion limits. Do you investigate how much could be diverted from the diversion limits before there was in some areas substantial and major detrimental effects to the economy and social benefit of the basin?

Mr Banks—That is not something that I recall being in the report.

Ms Gropp—It did not go to that level of detail.

Senator JOYCE—It would be fair to say, though, that with the removal of a section of water there would be economic impacts on the basin?

Mr Banks—I think that is correct. We are in a situation where, as you pointed out, we are balancing a range of considerations. The main point we were making is that there was an imbalance in the past. There has been a move to allocate more water to the environment, but it is important going forward that we balance those two considerations and the social, as you said yourself.

Senator JOYCE—I am particularly interested in the comments about balancing, as you mentioned then. What is the estimated value of the environmental flows from an economy-wide perspective in terms of balancing the value of environmental water against other uses of water?

Dr Kirby—The challenge in the first instance, if you are going to consider those three dimensions in trying to come to some sort of conclusion about which way to go, is, as the chairman indicated, in the first instance to identify the impacts to which change might be

leading. For instance, on the environmental front changes in the amount of water allocated to or taken from the environment might be expected to generate change in the quantity and quality of various environmental assets in the area that you are considering. So in the very first instance being aware of what changes will take place is the first step. Trying to value that at some stage is a more difficult second step which might take place as well. At least in the first instance, if you know what environmental changes might take place, you will be able to put that description alongside the economic impacts, which you can more readily quantify.

Senator JOYCE—What are the techniques you are using in determining the environmental assets?

Dr Kirby—We have not been using techniques ourselves, because we have not been asked to make the judgment about balancing those issues or quantifying the environmental impacts. We have not been valuing environmental assets in the Murray-Darling Basin study that we undertook.

Senator JOYCE—Can you tell me about the ways the government can obtain water for the basin?

Dr Kirby—I think the report identifies several ways. The guts of the report was to consider the buyback as one opportunity. In the analysis of that buyback scheme they identified alternative ways of operating the buyback and alternative water instruments that might be part of the buyback process. In addition, the report also considered spending on infrastructure on that issue in order to generate savings which might be used for environmental or other purposes as well.

Senator JOYCE—It can get water without purchasing it, though, can't it? You can just put an SDL target in there and take it.

Dr Kirby—Confiscation of water is an option. Buying water on water markets is an option. Operating tenders is an option. There are many options.

Senator JOYCE—They do not get rid of the licenses; they keep the water. It is just that there is another owner: the environment. You would have seen the Wentworth report that came out the other day. If they had a 30 per cent reduction in water from the basin, as they want, what is your view of what exactly would happen to the economy of the basin?

Mr Banks—We have done some modelling, but I do not think it has contemplated reductions of that magnitude. I should check with my colleague Lisa Gropp.

Ms Gropp—We have not done modelling ourselves. It was modelling that others had done that we referred to.

Mr Banks—That would be quite significant. I would come back to the point where you started with the questioning, Senator. That precisely underlines the point that you need to have more than science involved when you are thinking about diverting water from one use to another.

Senator JOYCE—The Wentworth report talked about a 62 per cent reduction in the Murrumbidgee—a 62 per cent reduction through the rice-growing area. Would we have a rice-growing industry after that?

Mr Banks—I am not an expert on the rice industry, but rice is obviously an intensive user of water. So you could imagine that would have a significant impact.

Senator JOYCE—It feeds a lot of people too. The rice industry in Australia feeds about 20 million people. It is not bad for a small district to feed that many people. Do we do a trade-off between a person going hungry overseas—and, if the food is not there, they will—and the environmental impact?

Mr Banks—I am not an expert in this area, but I think the way the trade-offs are organised is that, when you look at the economic impacts, a lot of that is internalised in those supply-side things. If Australia produces less rice and there is increased demand for rice, that rice will appear from somewhere else. It might appear from a place that actually produces it at higher cost than Australia. It could also appear from a place that produces at lower cost. So you would really need to know how the global market operated to know whether there would be impacts on, as you say, social disadvantage in some countries.

Senator JOYCE—The social impacts of a changing water allocation in the Murray-Darling Basin are not only on the people in the basin. Because it is food, they go to all the people who eat the food.

Mr Banks—That is true, but I guess what I am saying is that, while we are a big island, in an economic sense we are not. We are part of a global economy that has other sources of supply.

Senator JOYCE—There are other things that happen in the globe at times. One thing about food is that it is not constant. Some areas are bountiful; some areas are not. If another area goes through a period of hardship—drought, pestilence, disease—and the world is looking for food and we are not producing it, then we have also affected those people's lives outside our own country.

Mr Banks—It is hard to refute that in principle. But it would depend on, as I say, how the supply situation was in other respects. What would happen in the short term could be overtaken in the long term by supply responses to prices going up. So you could have an adverse impact in the short term, to the extent that we were significant in world markets. But in time we would have extra supply coming in, in response to those price signals. So it is very hard to say what effect what happened to one particular industry in Australia would have globally without knowing all those kinds of responses.

Senator JOYCE—But once the water goes from here, if the price of rice goes up, we cannot produce it. The water will have been taken away and will not be available. The government will have taken the water; it will not be there to grow the rice.

Mr Banks—That is true. Again, even within an economy, resources have alternative uses. I have not studied this, but you would have to look at what alternative use there would be for rice-growing land and whether it could be put to use in other agricultural ways. You would be more expert than I am in knowing what the substitution effects would be on the supply side.

Senator JOYCE—There are certainly substitution effects, but growing that product in that part of the world actually gives a group of farmers a substantial return. If they made a better return doing something else—and you understand this better than I do—then that is exactly

what they would be doing. They are not sold to rice because they love it; they are sold to rice because it makes money for them. Your report made the comment:

... there appears to have been insufficient forethought given to the design, scale and implementation of these initiatives.

What do we need to do differently to get water reform right?

Ms Gropp—One recommendation was for better coordination between the different bodies in that policy area to coordinate their decisions. That was a recommendation for some institutional reform, as well as balancing the trade-offs, which has already been mentioned, in setting the SDLs.

Senator JOYCE—Did the commission do any formal modelling of the basin plan or the water buybacks as part of its recent review?

Ms Gropp—We did not undertake any of our own modelling. We referred to modelling by the Centre of Policy Studies, for example, which had done some modelling work. CSIRO have done some work as well. They were the two studies that we referred to. There was also another paper that was referred to in the study.

Senator JOYCE—Does the Productivity Commission have the capacity to model rural water reform, such as the socioeconomic effects of the draft basin plan?

Ms Gropp—It would have to build that capacity, I think, Senator.

Dr Kirby—But it is the sort of capacity that we would be able to build given our previous experiences in modelling and in public policy analysis.

Senator JOYCE—So if a recommendation was given to you for the draft plan to be modelled for the socioeconomic outcomes of the plan, providing you can get your resources you would be able to do it?

Mr Banks—Modelling is best at looking at things that you can quantify and things that have prices on them, so when you say ‘socioeconomic’, you then have to impute values to the social aspects, which—

Senator JOYCE—What about the economic aspects? You would be able to model the economic aspects, wouldn’t you?

Mr Banks—Yes. Even though it is challenging, at least you have got data—and, presumably, you would have sufficient data—to enable some of those intersectoral effects and so on to be modelled. As Michael said, in the past we have done some work in that area and we could build the capability to do it. But modelling can only provide so many insights and I think that the sorts of areas that you have been raising are actually quite difficult to model because it comes down to judgments about what social or, indeed, environmental impacts there might be.

Senator JOYCE—If I wanted to go just on the economic outputs, that would be quite a sensible, structured process. You reduce the water and you now look into the potential outcome. If they tell you what certain areas there are, you would be able to talk about the potential economic consequences for those areas from which the water was removed or taken or sold.

Mr Banks—How well we could do that would depend on how good the database was for tracing water as an input into regional activity.

Dr Kirby—I guess there would be important spatial or geographic dimensions to the issue as well and once you start getting into quite localised or small areas the data availability diminishes quite rapidly, so it becomes increasingly challenging the more detailed or the more localised you want to make the analysis.

Senator JOYCE—If we have difficulty modelling what would seem self-evident, the economic outcome of areas, how on earth can they determine in the draft basin plan what the environmental outcomes are going to be?

Dr Kirby—As I have indicated, in the first instance you would have to have someone who would understand the sorts of physical implications of less or more water in a particular environmental area.

Senator JOYCE—It would be far more of a value statement or an esoteric belief than dealing with an economic question. The economic question, whether you like it or not, is more ascertainable, more clear-cut. The statement about the environment is a value judgment.

Dr Kirby—There are methodologies around for trying to get some handle on the extent to which people place a value on certain environmental outcomes. They are challenging and difficult and they have got their shortcomings, but there are techniques around to attempt at least to address that issue and perhaps to get a sort of ballpark measure.

Senator JOYCE—How do we ascertain environmental value? This is your view versus my view.

Mr Banks—There have been a number of methodologies, as my colleague said, in which people impute value to the existence of certain environmental assets and so on. You are right, but the same kind of logic applies to social dimensions as well—at least those that are seen as being distinct from the economic ones. Ultimately, I think the value of environmental assets gets expressed politically in the broad, and decisions are made about how important it is to preserve certain assets. Where the economics can be very useful, nevertheless, in that situation is in deciding how much of those assets you might preserve, given the opportunity cost in terms of what other economic impacts there might be. That is where I think the quantitative can complement the qualitative or the more judgemental areas, delineate more clearly what the trade-offs might be and make that transparent. But, ultimately, there is a significant element of political judgment about that.

Senator JOYCE—How do we trade-off feeding 20 million people as opposed to a red gum forest?

Mr Banks—That would be quite hard. But, as I was saying earlier, to invoke the 20 million people in isolation like, you would need to know what else was going on both in Australia and internationally to be able to say that 20 million people were going to be significantly disadvantaged.

Senator JOYCE—Can we go about it the other way and say: ‘As we believe in open trade, maybe there is somewhere else that they want to grow the red gum forest. It doesn’t need to be here’?

Mr Banks—We figure that they could grow them in another country?

Senator JOYCE—If everything else can float round from country to country, why can't we say: 'If we don't grow that rice here, they're going to grow it somewhere else and they'll have an environmental impact there. Why should we be selfish and let them squander their environment? We should be prudently managing ours'?

Mr Banks—I guess the very word 'environment' means what surrounds us and so people think about the environment they actually live in. That is why the environment has such value.

Senator JOYCE—It is very similar to fishing. We say, 'Don't have fishing in the Great Barrier Reef,' but we are quite happy to eat fish from stripped fishing in Thailand. I know that the Productivity Commission had some modelling done by Peterson in 2004. Has the commission updated this work at all?

Mr Banks—That was the modelling that I was recalling earlier. That work was published but it has not been updated, to my knowledge. Perhaps my colleagues can help me in terms of the area in which that modelling was done and the extent to which it encompassed the Murray-Darling Basin or only part of it.

Dr Kirby—From memory, I think it was part of it. It had to do with trade in and out of the region and the impact within the region on trade. The conclusion was that the effects were relatively small in terms of the impact on the equivalent of GDP of the region et cetera. I guess it was an exercise in voluntary trade.

Ms Gropp—That is right.

Dr Kirby—There were sellers of water. They basically exchanged one asset for another—water for dollars.

Senator JOYCE—So you would have the capacity to do a similar analysis to the Peterson study?

Dr Kirby—Yes. That would provide a good base for us to redevelop that capacity if we were asked to undertake more analysis of this issue.

Senator JOYCE—What approach would the commission use? Would it involve outside expertise or would it be able to draw on internal resources?

Mr Banks—I can already think of a couple of people who were with us when that work was done who are no longer with us. So it would be a matter of looking at the skill set that we have in house. As you know, we also contract out work. But, importantly, we like to have people within the organisation who can monitor that work and understand it and interact with the contractors that we use.

Senator JOYCE—Are you aware of the modelling that ABARE did on the purchase of the first tranche of water? In summary, when they purchased the water the model said that the money got spread evenly around town. It did not say it would do what it actually does, which is arrive in the hands of the person who purchased the water and then he or she retires and goes to the coast. The assumption was that everybody in town got the money. Such a model would be highly limiting in how it assessed the economic and social consequences for an area, wouldn't it?

Mr Banks—I guess it illustrates the point that my colleague was making before, which is that the more micro you try to go, particularly at the household level, you are facing very significant difficulties. So when you are talking about social issues, the kind of aggregate modelling and aggregate results that come out of that may well be begging some of the important questions. That is true.

Senator JOYCE—How do they define social issues to you when they say ‘model social issues’? What is the definition of a social issue?

Mr Banks—That is precisely the problem. There is not much modelling of social impacts, partly because models thrive on having quantifiable things that can go into the model and then they generate outputs in terms of what impact that might have on employment or GDP or other measurable things. So where we have done modelling of social impacts it involves imputing the cost to particular social impacts. Where we had work done and some modelling done in relation to the gambling inquiry years ago, some estimates were made as to what the social impacts were on people from problem gambling. That work was worked through the model. So the model itself is just a device for translating what modellers call shocks, or changes in things, benefits or costs, into what the aggregate effects might be.

Senator JOYCE—So ‘social’ could mean a whole range of things. It could be the price of food in urban Australia or the person who loses their house or loses their sense of being in regional Australia. It could be the loss of the doctor or the nurse from a town. It could be the loss of food for a person in a time of crisis—they do not get the food because we do not produce it anymore. That would all have to come under the auspices of social effects, wouldn’t it?

Mr Banks—All of those things would be adverse effects on people. Some of them would be picked up in the economic data and some would not.

Senator JOYCE—So how do we juxtapose a person’s aspiration to drive to a certain area and see a certain environmental asset with the lady who loses the house because the whole economy of the town has gone down the gurgler and they are left with the debt and still have to pay it off?

Mr Banks—There is a limit to which I can speak off the top of my head about things without having concrete information on which to do some analysis. All the points you are making are right. There are a variety of social impacts as well as environmental ones and many of those are very difficult to value.

Senator JOYCE—Are there more sophisticated mechanisms than the equilibrium based models that ABARE used?

Mr Banks—Are there more sophisticated models?

Senator JOYCE—Yes. Is there a more sophisticated approach available in modelling water buyback or do we just have to live with the limitations of the equilibrium based model? Going back to the former question, when I purchase a licence, the wealth is spread around the district when we know the reality is that you purchase a licence and the person who gets the money leaves the district and takes the money with them. Are you aware of a model that

would be better suited to truly reflect what actually happens when water is purchased or when water is taken, rather than an equilibrium based model?

Mr Banks—It is easier to model whole economies than regions within economies precisely because of the mobility of resources in and out of regions, which, from an economy-wide point of view, cancel out but can leave some regions better off and some regions worse off. So that is right. In terms of the modelling technology, coming back to the earlier point, the extent to which it can be used to assess those regional affects depends on whether or not you have got regional input and output data of that kind as well as knowing what the mobility of those resources would be. My colleagues might have a better sense of what technologies are around for doing that but, ultimately, I think it comes down to the limitations of the data.

Senator XENOPHON—Further to Senator Joyce's questions about water buybacks and the like, in terms of the modelling, it really depends on the policy framework. For instance, the irrigator exit packages were altered a couple of years ago so that irrigators could stay on their land but not use the land for agricultural purposes or to irrigate a crop. Is that the sort of thing you take into account? In terms of the socioeconomic impacts, it really depends on the policy framework or the policy settings, does it not?

Mr Banks—I think that is right. I do not have any comment on that specific example, but—

Dr Kirby—That would also have direct economic impacts as well because you are changing the incentives which the individual farmer is facing. So that will influence his production decisions and—

Senator XENOPHON—Sure, or they would not be producing; they would have to rip up the permanent plantings.

Dr Kirby—But they may be able to switch to non-irrigated agriculture or some other use of the land.

Senator XENOPHON—In relation to your research report on market mechanisms for recovering water in the Murray-Darling Basin—which I, and I hope others, found very useful in terms of informing the policy debate—is it fair to say that the commission expressed quite serious concerns about the rigour of approval for irrigation infrastructure projects and that there is a real risk at the moment of inefficient and inequitable investment under the current framework in terms of the current processes in place? Is that stating fairly what the commission's concerns were?

Mr Banks—There were concerns as to the relative pay-off from that kind of spending relative to buybacks, for example. As with any infrastructure spending, having a good understanding of the costs and benefits is very important. That was a general observation that was made. I think the other one was that there was some information in that report about what the cost was of saving water through that route versus others. In general terms, that seemed—with some of the information available to us—a much more costly way of going about it.

Senator XENOPHON—I do not know whether you can answer this, but was the commission surprised at what appeared to be inefficiencies in the current infrastructure

program and what is being proposed in terms of water infrastructure relative to, say, buybacks or other water efficiency measures?

Dr Kirby—I think there had been some data around for a while which suggested that infrastructure spending was a relatively expensive way of getting water compared with many other alternatives. So I think that information had been around for a while. There is quite a difference there.

Senator XENOPHON—Given the work the commission did on the Murray-Darling Basin and your March report, is there a concern that there could be stranded assets—and I think some water economists, such as Professor Mike Young, talk about having gold-plated assets in some areas—as a result of the relative inefficiencies of going down that path rather than, say, water buybacks?

Mr Banks—I guess that as a general proposition—my colleagues might want to comment more—you would be wanting to invest in those assets in a sustainable way, so you would be wanting to invest in areas that were likely to have the highest economic return, which means you need to be comparing an investment in one place with the potential investments in the others that might not otherwise have occurred. To follow your logic, if those investments were inappropriately directed then down the track you could find that they were stranded in the sense that the activity was not viable anyway.

Dr Kirby—We do not yet know what the new diversion limits will be.

Senator XENOPHON—No.

Dr Kirby—So it is hard to judge which assets may be in danger of becoming stranded or not.

Mr Banks—Yes. Are you talking about existing assets or—

Senator XENOPHON—Also building new infrastructure, in terms of your concerns about appropriate use of taxpayers' funds with respect to new water efficiency projects. There is another issue which relates to this issue of infrastructure and the sustainable diversion limits. One of the concerns that have been expressed to me by my constituents in the Riverland of South Australia, which could also apply to other areas, is that they went through a process of installing underground pipes and a number of water efficiency measures over many years, largely self-financed—I think there were some government subsidies, but nowhere near the extent of government subsidies that are now being proposed in other parts of the basin—so their scope for water efficiency measures is much reduced because they have already put in the hard yards. My irrigator constituents tell me that following the 1967 drought they took various steps. If you are looking at sustainable diversion limits, isn't it reasonable in the context of the Productivity Commission's work on this—the Wentworth group, a very respected group, looked at 40 per cent across the board—to take into account whether any particular region has previously undertaken water efficiency measures in considering whether a sustainable diversion limit ought to be across the board? In fixing a sustainable diversion limit for a region, should you take into account whether the region is an earlier adopter, if you like, of water efficiency measures? Is that relevant, in your view as an economist, in any public policy framework? It is not a very elegant question; I am sorry.

Dr Kirby—It sounds as if the solution to the problem that you are posing would be extremely complex in a planning sense as well for decision makers, but your question does remind me—

Senator XENOPHON—Would it necessarily be, though? If you can work out how water-efficient a region is in terms of their being able to produce a tonne of oranges, wheat or irrigated crops so many per cent more efficiently than another region which has open-channel irrigation, do you take that into account?

Dr Kirby—It sounds to me as if it is getting to be a very complex, very detailed analysis for the public policy decision maker to undertake.

Senator XENOPHON—But complexity in itself should not be something we shy away from in trying to deal with a complex problem.

Dr Kirby—I hesitate to use the phrase ‘central planning’, but that is sort of the challenge that you are moving towards, it seems to me.

Mr Banks—With these sorts of things, it is a bit hard. We were not directly involved in that report, and it is a thick report, but if you like, Senator, we could look at the report and draw from the report—

Senator XENOPHON—Perhaps on notice.

Mr Banks—Yes.

Senator XENOPHON—Perhaps, with the permission of the minister, I will seek an appointment to have a further discussion with the commission about that particular policy. The minister is nodding. I do not know if that is, ‘Yes, I can approach the minister,’ or, ‘Yes, he will give the consent.’

Senator Sherry—It was, ‘Yes, I was tired!’ We will organise that for you.

Senator XENOPHON—Yes, in terms of just fleshing it out. Finally, in relation to the commission’s draft report on gambling of October 2009, I understand the government has had it since 26 February, so you have had it for three months.

Senator Sherry—The final report. You were not here earlier when we had a brief discussion about this. Firstly, I have administrative responsibility but in this case I also have joint policy responsibility with my colleague Minister Macklin. The final report of the Productivity Commission will be released very shortly.

Senator XENOPHON—Could you define ‘very shortly’? I think it has to be released by the end of June in a statutory sense.

Senator Sherry—It is 25 June.

Senator XENOPHON—So it will be released by 25 June. Is that the best you can do at this stage, Minister?

Senator Sherry—Yes, it is at this stage. If I can give you a further update I will. But it is not far away.

Senator XENOPHON—Okay. For me it is a bit like waiting for Godot.

Mr Banks—You will appreciate this from your experience last time we did this report. It is a very thick, very detailed report with lots of recommendations in some detail.

Senator XENOPHON—Sure. I want to touch on one thing in terms of the draft report about online gaming and the Interactive Gambling Act. What the commission suggested in its draft report was that regulated access rather than prohibition would significantly reduce these risks by requiring sophisticated harm minimisation and probity measures to be provided to online gamblers. One possible solution to online gambling has been that you would allow the player to void a credit card transaction, which in my experience has occurred where they have played on an illegal online casino. Because it is voidable under Interactive Gambling Act, you cancel the transaction, so it is the casino that loses its shirt rather than the punter, which makes a nice change. Did the commission consider alternative ways of dealing with this problem, and in terms of its approach of regulation did you consider the risks involved where people are having a bet in their living rooms, there is no control, as there is ostensibly in venues, where they are intoxicated or under the influence of anything, kids having access to it—all those sorts of issues.

Mr Banks—It is probably fair to say, without pre-empting our own final report, that this was one of the areas where we got a variety of feedback, which led us to think about all the dimensions of the problem in that area. There always are trade-offs to be made. The concern we have been reacting to in the draft report stage was that people were accessing sites overseas where there were probity problems apart from them not having access to the kind of harm minimisation measures that we would want in Australia. So that was one trade-off. But, as you say, liberalisation brings its own trade-offs in the sense that you potentially have a whole new group of people who have access to the medium who would not have had it before.

Senator XENOPHON—And I think in your 1999 report you made a point, a broad thesis in relation to poker machines, that the more accessible a gambling product is, particularly of frequent intensity such as electronic gambling machines, the greater the risk of problem gambling. I think that is basically the central core of your 1999 report. Wouldn't that be much worse with people being able to gamble in their living rooms? I think Tim Costello said with online gambling you can use your home without ever actually having to leave it.

Senator Sherry—That is a neat way of putting it.

Senator XENOPHON—It is Reverend Costello's, not mine, unfortunately. But isn't that a problem? If the commission said in 1999 there is a problem with poker machines in terms of problem gambling because they are so accessible in hundreds of locations in any given state, apart from WA, doesn't the problem become much worse if you liberalise things and effectively people can play the pokies in their own home?

Mr Banks—People can do that now, as you know. It is not illegal to play on an online site that is offshore, and every now and again you will hear on the radio someone talking about being involved in that.

Senator XENOPHON—It is illegal, though, isn't it?

Mr Banks—It is illegal to provide that service. Under the Interactive Gambling Act there are penalties involved if you provide that service. But somebody who is adept at finding out

sites offshore et cetera could do that. So there is a trade-off. In a sense it is there, but I acknowledge the point that once it is legalised people are probably more likely to play and to use that medium and then you have to think about that. All I can say at this stage without tripping myself up—

Senator XENOPHON—No, I am not intending to do that.

Mr Banks—is that we have given quite a bit of thought to all of that, and you will see that reflected in the final report.

Senator XENOPHON—Minister, I wait with bated breath for that report.

Senator Sherry—Thank you.

Senator CAMERON—Mr Banks, you gave me detailed responses to a number of questions on notice. I want to take you to some of those initially. Question AET-66 is about the ‘directors club’. In your answer to my question about the role of the ‘directors club’, you said:

As noted on p. 362—

that is, of your report—

‘given the desirability of boards operating independently, any potential conflicts of interest need to be effectively addressed’.

I have treated your report seriously; I do not use it as toilet paper, as Senator Joyce would have. I just want to come back to this report. When you say ‘given the desirability’ is that your firm position, or is that a bit of loose language? Is it not the importance of boards operating independently, as distinct from the desirability?

Mr Banks—It is very important. So we have used ‘desirability’ in the sense of the importance that we attach to that. I am sorry if that word, in response to that question, perhaps has not been as clear as it should have been.

Senator CAMERON—It just seems to me that ‘desirable’—I mean it is ‘desirable’ in the same way that somebody wants a flat screen TV, but it is not important.

Mr Banks—Yes, I understand your reaction to that. No, we think it is very important. In fact as you know we made a number of recommendations in the report to bolster the independence and reduce the scope for conflicts of interest in relation to how boards operate and their transparency and the government accepted those recommendations.

Senator CAMERON—I am happy with that response. Question AET-65 is in relation to tax issues. You answered my questions on the tax issues on the basis:

There are also several points in time at which tax can apply and the value of future, or contingent, equity rights can be difficult to determine.

Then you talk about timing, you talk about value and you talk about equity based pay as ‘more complex and less transparent’. This is what Stiglitz has been arguing about on a range of issues where you get information asymmetry. When you have information asymmetry in relation to such an important headline issue as executive salaries, my view is it needs to be addressed. You went on to say:

... it would not have been appropriate to single out executive remuneration in a piecemeal fashion for special tax arrangements while a fundamental 'root and branch' evaluation of the Australian tax system was under way.

You also go on to say, in fairness:

Getting this wrong could be damaging to Australia's national economic interests.

But given that there is not going to be a root and branch change, there are significant and very important changes being undertaken by the government in relation to taxation. But this issue in relation to what you have identified as an information asymmetry, is it reasonable then to start analysing whether—now that the Henry report is done and dusted and out there, isn't it important that we now have a look at this issue of taxation on equity based payments and more getting rid of the information asymmetry?

Mr Banks—My colleague might have more to say about this, but I think where we talked about the information asymmetry it was in relation to the board designing packages to encourage executives to align their actions with the best interests of shareholders. The symmetries that we talked about there were the difficulties of the so-called principal agent problems that arise and the important role of the board. In relation to taxation, one key issue we raised was the taxation of executives when they leave a company and to what extent the current arrangements were consistent with them having some skin in the game even after they left the company and, therefore, conditioning their behaviour in an appropriate way prior to them leaving. But I do not know whether there are any other comments we would want to make on taxation.

Ms Gropp—I think that recent changes to taxation of equity based pay have addressed some of those concerns when, prior to those changes, executives could opt to pay tax upfront. They could make a decision when it was first negotiated or later, for example, when options vested. Those arrangements have been changed somewhat. But even under those earlier arrangements it was not clear, whether you paid before or after, whether you got an advantage. It depended on what happened to the value of the options, for example. But I should say they were still paying income tax at that point—

Senator CAMERON—Well hopefully!

Ms Gropp—Yes, it was not a capital gains tax, they were taking income tax, but it was based around the value of those.

Senator CAMERON—Can I now take you to question AET-63, which is about disclosure issues. I am summarising your responses, Mr Banks; I do not want to go through all the detail. Again I thank you for taking the time to answer them in the comprehensive way you have, but it does raise some questions for me. On the disclosure issues, you say:

Some participants claimed that there is insufficient disclosure of performance hurdles (related to annual bonuses), others argued that requirements are met.

Then you go on to say that you found, and this is a quote from your report:

Nevertheless, companies should be encouraged to disclose as much relevant information as possible by including, as ACSI suggests, a narrative about commercially sensitive hurdles and, where feasible, by disclosing them after the event

We had APRA here today and APRA were talking about how they are dealing with disclosure issues in relation to regulated entities under the act. They take a different approach, and it is quite an interventionist approach in terms of getting information. If it is good enough in those regulated areas, why shouldn't executive remuneration generally not be subjected to more openness in relation to disclosing information? I am not saying that the information has to be disclosed publicly, some of the information, but it could be disclosed to the regulator and it could give people like myself a bit more confidence that these problems of information asymmetry, these problems of opaqueness, these problems of murkiness and unfairness that the public see in executive salaries can be dealt with. Why can't we do something like that?

Mr Banks—We obviously agreed with you that it is important to get more transparency around the short-term incentives, as they are called. I guess you acknowledge in the way you asked the question that in some cases those short-term incentives are related to quite confidential things about the strategy of the firm over the next 12 to 18 months.

Senator CAMERON—Sure.

Mr Banks—You could have the perverse effect, if you force that to be public, that firms would avoid the sorts of incentives that would have been in the interests of the shareholders. We need to get that balance right. And that is why we said that even in those circumstances—two things: a broad indication of the nature of the incentives without giving away the confidential detail would be one thing, but then, ex-poste, providing more information about it.

In relation to APRA, I was not able to listen to the conversation but where these issues are most acute and where APRA has regulatory responsibilities is in the finance sector where what an individual company does can have contagion effects much more widely, as we have come to discover in recent times. So there are systemic problems that warrant a regulator being more directive and having access to more information than might be warranted for a company that is operating in a reasonably competitive market where, if it went under, its shareholders would be disadvantaged but it would not have big flow-on effects to the rest of the economy. So I think it is horses for courses in a sense and, although I did not hear it all articulated, I think the APRA approach seems to make sense in their domain. More broadly I think it is important for the boards to have pressure on them to (a) make the right decisions about how they structure those packages (b) explain that to their shareholders and (c) be accountable if their shareholders feel that they are not doing a good job.

Senator CAMERON—In question AET 61, in the first part of the two-part response, you talk about the efficiency of the executive labour market and say:

In particular, as the report notes, information asymmetries pervade—

and pervade is a very strong word—

the relationship between boards and shareholders and executives.

APRA today said basically what we are trying to do is change the culture. The question I put to APRA today was: do we have to wait till there is a cultural change? Is it good enough for government, when these issues are of such public interest and importance, to wait for a cultural change when there are these pervasive problems with executive salaries? I know you have put up a number of recommendations. The government has accepted those

recommendations. But in terms of these issues, now that I have had a closer look, I think you are raising even more significant issues if asymmetries pervade executive salaries within Australia.

Mr Banks—That is correct. I guess the judgement is then, if these asymmetries are pervasive and these informational difficulties are pervasive, how do you minimise the potential costs that arise from that? We saw the boards as being central to reducing those asymmetries. In fact, the function of boards in the modern corporation is precisely to do that. As you say, you can never eradicate those, but it is very important that boards do their job as well as they can and that regulation encourages them to do that where there might be some doubt. You never get perfection out of that.

In terms of cultural change, again, I did not hear the earlier conversation. I think we are seeing some changes, whether it is cultural or just a learning that boards have gone through. A point that we made was that they got a bit bamboozled, particularly in the nineties, with all these new intricate forms of equity based remuneration, which had some quite permissive hurdles on them, and they delivered some of the big payouts that obviously shareholders and others in the community have reacted to since. Since then, the kinds of arrangements have become more sophisticated. I think boards have started to take all of that a bit more seriously, so hopefully some of that cultural change has already occurred, at least for the larger companies.

Senator CAMERON—On question AET 59, which was about the lack of long-run data, I questioned APRA about your view that the *Australian Financial Review's* executive salary database is the most comprehensive available data. You said:

That database is compiled from publicly disclosed, verifiable and audited data in companies' remuneration reports.

APRA said they would not rely on that and they said the issues for executive salaries are detailed, complex and they employ specialists to actually look at it.

I know your argument about the issues in the finance sector. Executive salaries are higher in the finance sector but they have many similarities to the general industry in Australia. The issue is that most executive salaries are at about the European level, as you indicated in your report, but in finance they are at Wall Street levels. So if APRA needs to do that detailed stuff, why is it still okay to depend on the *Financial Review* executive salary database and Egan Associates or the Hay Group?

Mr Banks—I think APRA's response is not inconsistent with what we said in the sense that they are looking at the risks involving individual companies and they would therefore not want to rely solely on information that appears in annual reports but obviously get more information that they thought related to the risks they perceive. I could see, from a regulator's point of view, concerned about a number of companies, that generally available information that comes out may not be good enough. We were talking more in terms of trying to understand on average what is going on—

Senator CAMERON—Trends.

Mr Banks—More about trends, that is right. That is probably the difference in perspective that we had.

Senator CAMERON—I asked about the overseas academics and visiting researchers. You responded in question AET83 and you outline 12 visiting researchers. Your answer was that most of them have been Australian. But the reality is that the bulk of them are not Australian trained. Eight have been trained in the US and two in the UK. In relation to the general argument and critique out there, this school of thought from the UK and the US is part of the problem,—we have lack of flexibility and innovative thinking in terms of economics. What do these people bring to your work and why don't you go to any of the European economists who may have a different school of thought, for instance?

Mr Banks—With the visiting researchers that we attract it is partly demand and partly supply. Even though, as you say, a number of these have training overseas, which I think if you are an academic—

Senator CAMERON—The majority.

Mr Banks—A majority, that is right. It is a badge of honour to have been to Oxford or to have been to one of the better overseas universities in terms of their academic career. These people have then gone on to have experience in a whole range of areas. Depending on that experience, it might have been relevant to productivity measurement or it might have been relevant to looking at the services sector or it might have been relevant to looking at trade analysis and so on. It has been a matter of horses for courses. The Australians have training in Australia and they have capped it off with postgraduate study overseas.

Senator CAMERON—I do not argue about their qualifications. It is the school of thought that they bring that is the issue for me. You know that that is important. Diversity and school of thought are what I am interested in. The University of Chicago, which has a reputation for neoclassical economic approaches, is represented in this. The question I am asking is: is there some variety in the school of thought on these issues?

Mr Banks—I can see the point you are making. It depends on the kind of work we are doing and where we think academics can help us. As I have said before, we have done work in areas like behavioural economics. They were not called visiting researchers, but we had people from the States come to a conference in Australia who were certainly not in the neoclassical frame at all and have contributed to that work. I know we have talked about the Snape lecture in the past, but the last lecturer was a Chinese academic and hopefully the next one will be an eminent Indonesian.

So I hear what you say, and certainly a range of perspectives are important. We are hosting a seminar for Professor Stiglitz, I think I mentioned to you, in July which is also an important way of getting other perspectives. So we try to have as much diversity. But as you say, as it has turned out on the page a number of those people have been trained overseas, but they have particular skills that have been relevant to bits of our work stream.

Senator CAMERON—Sure, but again I come back to the point that those skills may be from a set school of thought. Because, as you know, my criticism of the Productivity Commission in the past—

Senator JOYCE—That you do not have any neo-Marxists in there—

Senator CAMERON—You can basically see the classical economic approach and not much of other schools of thought coming out in your reports.

Senator JOYCE—The University of Havana—maybe a couple of people from there might suit you.

Mr Banks—In our reports—and I know we have talked before about the diversity of qualifications of our staff—at the end of the day the process we go through means that the arguments we put, the analytical frameworks, are all tested in the public domain, and we have modified those in inquiries where that seemed to be important. For example, in the consumer policy inquiry that we did we imported into that some insights from the behavioural economics literature, which is quite a different stream of literature to the neoclassical one and has input from psychologists and so on. So it is one thing to have had some visiting researchers with neoclassical type training and another to ensure in our reports that we have been able to take on board insights more generally which the process, in a way, forces us to do.

Senator CAMERON—If I have time, I might come back to that issue. Can I take you to the speech you made on 5 November 2009, ‘Back to the future: restoring Australia’s productivity growth.’ I will alert you to the fact that there may be a number of questions that I want to put on notice in relation to issues in that speech. However, I do not have time tonight so I just want to go to a couple of points in the speech. On page 5 you talk about procurement policies and you single out the New South Wales government for introducing a price preference on locally supplied goods and services but you also mention that at least 15 countries have imposed such measures over the past year. I am happy for you to take this on notice, but could you provide details of those countries that you have looked at and what those impositions, as you call them, have been in terms of procurement? Is that logistically feasible?

Mr Banks—I think we can do that. That would have drawn on our publication the *Trade and assistance review* which we bring out once a year. So I will have a look at that. It may have come from a secondary source that we may have used, from the WTO, but to the extent that we can get those country details, we will.

Senator CAMERON—Can you also take on notice in terms of procurement and preference for procurement whether in your analysis of the differential in price you take in the carbon cost of imported goods, whether you take into account the benefits to the skill base of producing goods here, whether you take into account the benefits of improving management skills and the management in Australia and whether you take into account the multiplier effect that these price preferences bring about. Because you talk about all the negatives but I never hear any of the positives. I just want to see if there are no positives from your point of view or whether there are some balancing issues.

Mr Banks—I would want to give a considered response to that. I guess the context for this was a concern in previous periods where you have had something akin to a global financial crisis or a great depression and you have had protection in a whole bunch of countries compounding the problems for each of them. So it was in the context of asking whether there

were signs that this could happen and adversely affect Australia or not, and it looked more optimistic this time.

This was one area where quite a lot of countries had introduced local procurement policies which discriminate against Australian exporters of goods and services. The point that was made was that, to the extent that one of our governments has a similar policy in place, it is hard for us to argue in the WTO for other countries to reduce barriers to Australia's exports.

Senator CAMERON—I only have a few minutes left. You are going to give me a more considered response to that.

Senator HEFFERNAN—Will you consider non-market currency and currency speculation? That has a big part to play when you are competing against a non-market currency like China. Do you think about that?

Senator CAMERON—Can you come in later on that? You are going to have a few minutes, I understand.

You also are very critical of industry assistance, which I think reflects the school of thought within the Productivity Commission. You talk about the level of industry assistance. Have you benchmarked industry assistance in other OECD countries, other comparable countries or trading countries?

Mr Banks—We could get back to you on that. We have compared Australian tariff levels and so on, internationally, because they are more measurable. It is much harder once you get into non-tariff forms of assistance and so on to make international comparisons.

Senator CAMERON—Could I ask you to take that on notice, because I am running out of time.

Mr Banks—Okay.

Senator CAMERON—On page 8 of your speech you talk about coastal shipping and the need to open up Australia to foreign vessels. Again, can you take on notice and give me a response to the question of the implications of foreign vessels coming in here—the so-called 'ships of shame'—and the issues surrounding that, and whether that is an issue the Productivity Commission takes into account when it deals with this issue. Can you also come back to me in relation to what I was told the night before last night at a tourism dinner—that there are tax benefits for indigenous seafarers in most countries in the world. Indigenous seafarers in the UK and in Europe are employed on the basis of some tax incentives. Can you tell me whether you have taken that into account when you talk about opening up our coastline even more? If so—

Mr Banks—What I did talk about was the cost of unduly restricting access. There are legitimate reasons for having regulations about access of foreign vessels. I was not here arguing that there should be just an opening up, but rather that we need to think about not unduly restricting access. The point I was making was that those costs are likely to be higher for us, given the length of our coastline relative to the scale of our economy. So it was an observation; not a recommendation.

Senator CAMERON—I will have other questions. This is the last question tonight, because I want to give Senator Heffernan a go. On page 9 you raised the issue of industrial

relations and the need to have flexibility in industrial relations. Do you want to go back to Work Choices, because the public have made a decision about that and we have brought a balance into the industrial relations system? Where do you want to go in terms of industrial relations, and what are the social implications of going back to a Work Choice type of approach, because that is where you have to go if you do not go down the track that we have adopted? Can you take that on notice, as well.

Mr Banks—I am not sure how much more there is for us to say, because both sides of politics accept that it is important to balance the legitimate rights of workers with the need for enterprises to be able to make organisational changes to enhance their productivity. Again, it was an observation; it was not a recommendation about any specific aspect of the regulatory framework.

Senator CAMERON—I am so thankful for that!

Senator JOYCE—The report on wheat that you did: you were happy with what has happened to the wheat industry?

Mr Banks—‘Happy’ is probably not an expression that we would use in our reports. That report was looking at how the regime was operating and how it could be improved. We are now in the last couple of weeks of finalising that report.

Senator JOYCE—I will tell you how it is operating: it is operating terribly.

Senator Sherry—The report has not even been finalised yet.

Senator Cameron interjecting—

Senator JOYCE—Madam Chair, did we speak through his questions?

Senator CAMERON—Yes!

CHAIR—Senator Joyce, are you complaining about people interjecting on the side? I understand that is what you have been doing all through the last couple of minutes of Senator Cameron’s questions.

Senator Sherry—I think that was the one question. I am very sure Senator Heffernan is keen to have a go too. He is pointing to himself.

Senator JOYCE—Was the view that was conveyed to you as you travelled around that the wheat industry as it stands is operating efficiently now that it has been deregulated—everybody is happy with it?

Mr Banks—In the time available to us I probably could not go through all the elements of the deregulation and how it has affected different parts of the economy. There would be some parts of Australia where they would be delighted with what has happened—

Senator JOYCE—Where is that?

Mr Banks—and prospering under that new regime, and there are other parts that are doing it tougher. In New South Wales, for example, we got far more negative reaction than we did in Western Australia. All of that will be reflected in our report. We put out a draft report, people respond to us and we take that into account. Hopefully that will be reflected in the final report.

Senator JOYCE—You might want to send a copy of the draft report to Senator Cameron.

Senator HEFFERNAN—It is just a shame that it is going on all around the world. In Canada they are in severe reversal and wondering whether they should continue with a single desk arrangement, because the price of wheat has collapsed, the same as here. Could I take you to the Productivity Commission's view on water?

Mr Banks—I can handle it, or we could get back with you in a question on notice.

Senator HEFFERNAN—Your mission statement says, 'well-informed policy decision making and public understanding on matters relating to our productivity.' Do you take into account, on water, the actual vagary of the science for the future of water availability?

Mr Banks—Are you talking now about the buy-back regime?

Senator HEFFERNAN—I am talking about how much water will be available, if the science and a percentage of the science—all science has vagary—how much water will be available based on the science of the future rather than, I hope that the Productivity Commission does not take a snapshot of what happened back when granddad was around. Do you take into account what the science is saying is going to happen? If you do, you would know that, if the science is 40 per cent right, in most river systems in the lower Murray-Darling Basin will have zero allocation for general purpose water in most years. Do you give consideration to that in terms of the buy-back?

Mr Banks—We are not scientists. When we are doing an inquiry that requires an understanding of the science, as we did years ago when we looked at greenhouse—I think we did the first inquiry into that—we have people who know about that. I guess in broad terms, however, the point you make is quite valid. That is that you need a policy framework that is sustainable or robust—

Senator HEFFERNAN—And you need a framework that allows for the vagary of the science to be 10 per cent right, 20 per cent right, 50 per cent right. Somewhere between 3,500 gigs and 11,000 gigs is predicted to disappear from the runoff in the Murray-Darling Basin. The biggest impact is going to be 38 per cent of the runoff which comes from the two per cent of the landscape—

CHAIR—Senator Heffernan, if you have got a question you had better ask it now, because time is about to run out.

Senator HEFFERNAN—Can you come back to me on that, on notice?

Mr Banks—I will—

Senator HEFFERNAN—Perhaps you would like to come along and give evidence to my select committee on agriculture. Is that a proposition? Maybe that is a good idea. Could I also ask what consideration you give to competitive tension in the market when you are competing with non-market currencies, like China?

Mr Banks—Do you mean non-market countries or—

Senator HEFFERNAN—Non-market currency. I mean, the Chinese currency is not a market currency. It is a non-market currency.

Senator Sherry—Fixed exchange rate.

Senator HEFFERNAN—And also, the impact on the long-term outlook for productivity of the warehousing of toxic debt?

CHAIR—These are big issues and—

Senator HEFFERNAN—Could I ask, through this committee—

Mr Banks—Normally, Senator, we can respond where we have done work, and you asked me a question that relates to the research that we have done, such as Senator Cameron has—he has asked a number of questions in relation to executive remuneration. If we have not done detailed work it is not possible for us to have a research-based answer to your question. But we will do our best to answer any question—

Senator HEFFERNAN—Could you come along and test your hand at my select committee and we will see what you do know and what you do not know and what we think you should know?

CHAIR—That is a good invitation, and we will finish on that note. Thank you to the Productivity Commission for coming in this evening.

Proceedings suspended from 7.00 pm to 8.00 pm

Australian Office of Financial Management

CHAIR—I welcome representatives from the Australian Office of Financial Management. Mr Hyden, I understand you do not have an opening statement to make, so we will go straight to questioning.

Senator JOYCE—Thank you very much. Does the AOFM have the highest paid public servants?

Mr Hyden—Certainly not.

Senator Sherry—I think if you look at AFMA's and ASIC's annual report, you will get a pretty good indication who is at the top of the scale.

Senator JOYCE—Someone said, 'AOFM? You would be surprised. They're the highest paid ones.' Surprised? I would be fascinated.

Senator BUSHBY—There was an article about a year and a half ago that listed the heads of a number of the agencies and the top bracket paid. I think the AOFM may have featured in that in an overall sense, but not the highest level.

Mr Hyden—I do not recall having seen that article. My salary fits into the Treasury salary scale, so it is not outside the norm in that regard.

Senator JOYCE—What is our current—you know I always ask this—gross debt, as we speak?

Mr Bath—As at 1 June, it was \$143.5 billion, consisting of \$121.8 billion of Treasury fixed coupon bonds, \$11.1 billion of Treasury indexed bonds and \$10.6 billion in Treasury notes. You can add to that \$500 million for a tender we did yesterday in Treasury bonds and another, I think, \$600 million today.

Senator JOYCE—You add to that another \$500 million?

Mr Bath—Yes, in Treasury bonds that we would have issued yesterday and another \$600 million, I believe, in Treasury notes that we issued today.

Senator JOYCE—So \$600 million is another bill? We are up about \$144.6 billion?

Mr Bath—That sounds right, yes.

Senator JOYCE—What is our general rate of issuance? I have been watching. It is about \$1¼ billion up to \$2 billion a week?

Mr Hyden—Normally we have two bond tenders a week. That is not necessarily every week, but most weeks we would have two bond tenders. Generally, they are \$500 million to \$700 million, so \$1.2 billion on average a week. Not every week but most weeks we would have a Treasury note tender as well. The size of those depends on our actual cash needs for that week, so it can vary. In recent months we have been largely rolling over the same amount of those each week.

Senator JOYCE—Mr Hyden, how long have you been with AOFM? How many years?

Mr Hyden—I have been there for six years.

Senator JOYCE—What about you, Mr Bath?

Mr Bath—It will be eight years in August.

Senator JOYCE—Have either of you ever seen a time where we have been issuing securities at this rate?

Mr Hyden—We have been issuing them at this rate over the last 18 months.

Senator JOYCE—Over the last 18 months?

Mr Hyden—Since February last year.

Senator JOYCE—Is your issuance accelerating, plateauing or going down?

Mr Hyden—It has been quite even—a level amount through that period. That will continue next financial year at about that same amount. But thereafter with the prospect of a reduced budget deficit and eventually going to surplus, the rate of issuance will decrease.

Senator JOYCE—If there is not a reduced budget deficit then the issuance will keep going on at that rate—will it not?

Mr Hyden—The issuance depends primarily on the size of the amount to be financed for the budget. It also depends on maturities of stock previously issued. With the increase in issuance that we have had over the last 18 months, that means we will have higher maturities in future years for some time. It is a balancing act between those two factors.

Senator JOYCE—When do you reckon you will get to the first week where you actually have less gross outstanding than you did the week before? Every week we seem to owe more than we did the week before. At what point do you think we will get a week where we actually pay some back?

Mr Hyden—Whenever we have a maturity of an existing line of stock, we would have a greater reduction in the volume of debt than the increase in debt from new issuance. For example, the 10 August line will mature in August. In that month or on the day that it matures,

we would have an outflow of \$7.6 billion that we have to pay out. So the debt will go down by that amount.

Senator JOYCE—You hope.

Mr Hyden—Hopefully we have maturities once or twice a year where we have large steps down and then a gradual building up in between. That is because we spread out the issuance.

Senator JOYCE—What has happened to the yield curve since the last time we met? Has it gone up or down?

Mr Bath—Rates have fallen over the last month or so. To give you some sort of perspective, I refer to the chart that I suspect Senator Bushby will ask for an update on.

Senator BUSHBY—Are you able to table that while we are talking about this?

Mr Bath—We can if I can find it. When did we last meet? February. Rates have been broadly arranged, so long bond rates of 10 years or thereabouts have moved around about 5½ per cent. They have traded up towards six per cent. We issued a new 12-year bond in March or April. It traded slightly above six per cent as it was a new line. Those bonds are now just under 5½ per cent. I have not checked the rate today, but the last entry on the chart that I have got for Senator Bushby is just under 5½ per cent. Our shorter bond yields have fallen quite significantly, so our bond that matures in June 2011 has been down to around about 4.17 per cent or thereabouts. It is currently around about 4¼ per cent. It is about 25 basis points under the cash rate. Then there is a positive gradient to the yield curve from 11 June out until our longest bond, which is 22 July. So they range from about 4¼ per cent up to about 5½ per cent.

Senator JOYCE—We know we have an appropriations bill that authorises you to go up to \$200 billion. When do you reckon you will hit that?

Mr Hyden—I do not know that we have a precise estimate of when we would reach that limit, but we are not seeing it as this financial year on our current data. By this financial year, I mean the coming financial year—2010-11.

Senator JOYCE—Yes. I hope you do not get there in the next couple of weeks. But you are not expecting to crack \$200 billion in the coming financial year either?

Mr Hyden—No.

Senator JOYCE—If we are drawing down \$1¼ billion or \$2 billion a week, that would be good because the way it is looking at the moment we could be there in about 35 or 40 weeks.

Mr Hyden—Are you saying into the subsequent financial year?

Senator JOYCE—Yes. Basically from where we are now, which is \$144 billion, we have \$55 billion or \$56 billion up our sleeve. We are issuing at about \$1¼ billion. That would have to be around about 40 weeks.

Mr Hyden—We have two lines of nominal bonds maturing next financial year and one line of indexed bonds, so they represent a substantial deduction from the total amount.

Senator JOYCE—To the best of your knowledge, who is buying the bonds at the moment? Have we got any further information there? Are they being purchased by people overseas?

Mr Hyden—The share of the holdings of our bonds overseas is about the same as it has been over longer periods—around 65 per cent in the March quarter.

Senator JOYCE—About 65 per cent held overseas?

Mr Hyden—Held by non-residents. This is on the ABS statistics that came out earlier this week. The figure has fluctuated a little from quarter to quarter, but I think that 65 per cent is in line with where it has been over several years now.

Senator JOYCE—Would the largest foreign source be China?

Mr Hyden—I do not know that we have any clear figures on that. China, Japan and the United Kingdom would be major holders.

Senator JOYCE—The UK would be using a lot of vehicles as trust vehicles, and other companies are basically using the UK as a trading house?

Mr Hyden—Yes. A lot of the bonds we issue are held by nominee or custodian companies, including in Australia. We are not able to get information from them as to where the residents of the ultimate owners of those bonds are. But some held in Britain would be held through nominee companies.

Senator JOYCE—What is happening with these Aussie infrastructure bonds? Are they ever actually going to amount to anything or are they just going to be a name?

Mr Hyden—As far as we are concerned in the AOFM as the issuer, we will not be distinguishing them in any way from other Commonwealth government bonds that we are issuing, so they will be standard Treasury bonds or Treasury indexed bonds.

Senator JOYCE—Just with a different name on the cover?

Mr Hyden—They will not even have a different name on them.

Senator JOYCE—They really just exist?

Mr Hyden—Well, they will be identified as infrastructure bonds by the Treasury in the budget papers.

Senator JOYCE—But for all intents and purposes, they are exactly the same line as any other bond?

Mr Hyden—That is right as far as the financial markets are concerned. That is in relation to wholesale bonds. The government has said it is also considering some form of retail infrastructure bonds, but no decisions have been made on that so far.

Senator JOYCE—When Senator Conroy was talking about having these Aussie infrastructure bonds and everybody was feeling very patriotic and thought that that was the sort of thing they wanted, all they were really getting was just another bond. It is exactly the same bond. If you do differentiate it, there are extra costs that come into place for differentiation—are there not?

Mr Hyden—Yes. To put it the other way around, there are benefits in having them integrated with our other bond issuance.

Senator JOYCE—Are you aware of municipal bonds in the United States and how they work?

Mr Hyden—In general terms, yes. They are just bonds issued by local governments.

Senator JOYCE—They are not part of the federal government debt in the United States, are they?

Mr Hyden—No.

Senator JOYCE—Basically, it is caveat emptor—the people who buy the bonds take the risk. If the bond goes bad, you lose your money.

Mr Hyden—That is correct.

Senator JOYCE—Are they liquid? Do they move?

Mr Hyden—I think there is a wide variety of circumstances, but some of them are quite large issuers and it is a liquid market.

Senator JOYCE—Can anybody set up a bond, or do they have to get approval by the fed? How does it work?

Mr Hyden—I could not answer that, I am afraid.

Senator JOYCE—What is Australia's total debt position within the public and the private sectors? Why I am asking this question is I am looking at the total exposure right across the board and how Australia's gross debt fits into that.

Mr Hyden—I cannot give you any figures off the top of my head on that.

Senator JOYCE—What about the state government debt? It was \$164 billion. Is it still about \$164 billion?

Mr Hyden—I think we do have some figures on that. I am not quite sure where. State debt on issue at the end of the current financial year is estimated at \$163 billion.

Senator JOYCE—Estimated at \$163 billion. By the end of the financial year, we would be pretty close to \$150 billion gross?

Mr Hyden—Yes.

Senator JOYCE—Somewhere between \$310 billion and \$320 billion will be total gross debt between both the federal and the state governments?

Mr Hyden—That is correct.

Senator JOYCE—When we started going down this path of debt, I asked this of Dr Henry—and it all seemed far off then. He stated to me that if we got to, I think, 60 per cent to 80 per cent of GDP, Australia would have a problem. Our GDP is about \$1.2 trillion—is that right?

Mr Hyden—Yes.

Senator JOYCE—I am just doing this quickly. That means \$960 billion is a problem for us, if that is 80 per cent of GDP. I am taking their top level. So \$960 billion would be 80 per cent of \$1.2 trillion?

Senator Sherry—Well, I think the officer would need to verify. You have put forward a number of figures that Dr Henry put. I am not suggesting that you are in any way deliberately misleading.

Senator JOYCE—No, I am not.

Senator Sherry—I think it is reasonable to expect if you are going to claim someone said something to provide some evidence of that before the witness responds.

Senator JOYCE—I will take that on notice, though I am sure I can do that. But \$310 billion is about one-third of the way there at the end of this financial year.

Mr Hyden—Our debt, including the debt of the states, is still relatively low compared with many other OECD countries. With regard to the US federal government by itself, the debt this week reached the point of 90 per cent of GDP. There are some others somewhat higher than that. The UK is heading up towards 80 per cent of GDP. So the level of debt we have now relative to GDP is about the peak, given that the budget deficit will be reducing.

Senator JOYCE—What is very important there, of course, are two things: one is how we are in our region. Is our debt as a portion of GDP higher than China's?

Mr Hyden—It is similar; about the same.

Senator JOYCE—So their debt as a portion of GDP is similar to ours?

Mr Hyden—Yes, maybe slightly higher, as I recall.

Senator JOYCE—What about Singapore?

Mr Hyden—I cannot off the top of my head give you a figure for Singapore, but—

Senator JOYCE—In our region of South-East Asia, which countries would definitely be higher than us?

Mr Hyden—I am not sure that I should try and answer that without checking. In a global span and particularly amongst advanced economies, our debt is fairly low.

Senator JOYCE—But that takes into account places such as Europe. We see it on the news every night. We know what is happening there. We are slightly disconnected from the European economy at the moment—are we not, thank goodness?

Mr Hyden—Well, in global financial markets, Europe and the US are quite important.

Senator JOYCE—They are the global financial markets. But with the structure of the economy and what is driving it, we are more linked now to China, India and South-East Asia than we are to Belgium, Germany and France.

Mr Hyden—In terms of the economy and what is driving the economy, it is certainly true that our exports to those countries are much larger than the Europeans'.

Senator JOYCE—So if we are comparing apples with apples, we would be comparing our debt to other countries in South-East Asia, and our debt compared to other countries in South-East Asia is high.

Mr Hyden—Yes. Our economy is being driven significantly by the strong growth in Asia. But in terms of where we can market our debt and sell it to, the investors are looking at the other advanced economies.

Senator JOYCE—When we look at the global meltdown, as is happening in Europe—I do acknowledge that that is part of a global market—will that affect the price of debt if it

continues? Will what we are seeing in Greece have an effect on the price of debt? If it goes on to Portugal, Italy and Spain, will the ructions there affect the price of our debt here?

Mr Hyden—It is a volatile and rather uncertain situation at the moment so it is hard to make predictions. But, in terms of what we have seen so far, I think the impact has been substantially an increase in demand for our debt, and that has been one factor tending to push down the yields on our debt, particularly at the short end. So we currently have some of our bonds trading in the secondary market at less than the cash rate, and that is essentially a reflection of the high demand.

Senator JOYCE—I suppose that is good news. Does that mean the money is taking flight from there and trying to be deposited in Australia, in a way?

Mr Hyden—I think it means that some investors are rebalancing their portfolios a little away from Europe and maybe also from the United States and a little more towards us. It only needs a small proportion of those large portfolios to come our way to have a significant impact on us.

Senator JOYCE—With the current draw-downs in facilities, when is it, in your timeline, that you expect the debt to peak at a gross level? What will that gross number be?

Mr Hyden—I am not sure we have some figures on that. The budget is projected to go into surplus in three years. The gross amount of debt on issue will level out at that time and so will start reducing, say, in 2013-14.

Senator JOYCE—What is that number? Is it \$222 billion?

Mr Hyden—It is \$220 billion, roughly.

Senator JOYCE—And what will be the state debt, then, at that point in time?

Mr Hyden—The figures I have are only on a financial year basis because that is how we project. We have the budget figures for the year, and that is all we could get at the moment. To get an estimate of when in the financial year, we need to have figures on the expected flow of funds in and out of the Commonwealth's account over the course of the year, and we do not get that until much closer to the event.

Senator JOYCE—I know you have the date 10 August. You have \$7.6 billion or something that you are expecting to reduce it by. With the NBN, is there an expectation that you will be issuing bonds to cover that? They would have been the Aussie bonds, but the Aussie bonds are just any old bonds. What are your predictions of what you are going to be issuing for that?

Mr Hyden—The government's equity contributions to the NBN are included in the forward estimates, or the budget figures.

Senator JOYCE—Of the gross figure?

Mr Hyden—And the forward estimates. So they are part of the budget funding, or budget deficit and surplus, so they are included in the figure I gave you.

Senator JOYCE—They are included in the \$222 billion. When do you expect to start issuing? When do you expect there to be a pick-up to cover what we presume is somewhere in the range of \$43 billion or maybe less? It may be \$30 billion; who knows? You would have to

have an expectation that these funds will be required. I know they are in the budget, but when will they be required?

Mr Hyden—The current year's budget—the year that is just finishing—already has some funding for the NBN.

Senator JOYCE—How much?

Mr Hyden—My recollection was \$4.7 million, or something like that.

Mr Bath—But that is not included. It is not requiring additional issuance because there are funds in the Building Australia Fund.

CHAIR—Senator Joyce, I will come back to you if there is time at the end.

Senator JOYCE—But it is \$4.7 billion? I am just confirming that.

Mr Hyden—It is \$4.7 million.

Senator JOYCE—Million or billion?

Mr Hyden—Million.

Senator CAMERON—You do not want to stuff that up, do you?

Senator BUSHBY—Thank you for assisting us again tonight. Senator Joyce has asked some of the questions I wanted to ask, but I do have others. Thank you, firstly, for updating the graph. It is good to see. I was going to ask whether the reason for the fall in yield was because people were looking for a safer option, given what was going on in Europe, but I think you have already answered that to some extent. Are there other factors at play that would have contributed to that?

Mr Hyden—It is always hard to be sure just what is driving the market, but that appears to us to be the main factor—a general increase in risk aversion. We are seen as a lower risk investment prospect.

Senator BUSHBY—As the rest of the world goes backwards, I guess we are left standing in that sense. Nothing has necessarily changed here, but circumstances have changed elsewhere and that leaves us looking better relative to the other options. I see you are nodding.

Mr Hyden—It is a general equilibrium type situation, where factors all over the world interact with one another.

Senator BUSHBY—What is the current upper borrowing limit permitted by law? How much are you allowed to go to at this point?

Mr Hyden—This is the \$200 billion.

Senator BUSHBY—So that will need to be adjusted before you get to the projected \$220 billion peak?

Mr Hyden—Yes.

Senator BUSHBY—What is the anticipated gross value of securities that will be on issue at the end of next financial year—essentially, 13 months from now?

Mr Bath—I have \$209.4 billion as at 30 June 2011.

Mr Hyden—That is a market value figure.

Mr Bath—It is market value, that is true. But it is consistent with the \$222 billion number that we quoted earlier.

Senator BUSHBY—So we are getting pretty close to the peak at that point.

Mr Bath—Broadly speaking, it will peak a millisecond before the budget goes into surplus.

Senator BUSHBY—Particularly until the point when we actually balance the budget, to that point our debt is increasing?

Mr Bath—That is right.

Senator BUSHBY—It is an absolute clear fact that, until you are actually balancing your budget, you are having to borrow money to cover the costs?

Mr Bath—That is correct. The stock of debt will still be outstanding when we do go into surplus. It is just that it will stop growing.

Senator BUSHBY—And that is actually a misconception I have seen in some media commentary on the government's budget. I am quite sure that the government was quite happy to let it stand when they talk about us being out of debt in three years when the reality is we are—

Mr Hyden—They talk about net debt.

Senator Sherry—That is right. We have never been out of gross debt, do not forget.

Senator BUSHBY—No, but in three years—

Senator Sherry—It was government gross debt when you were in office just over three years ago. We have always been in gross debt.

Senator BUSHBY—I know that.

Senator Sherry—We are talking about the level of gross debt.

Senator BUSHBY—You have money going over. There is always some there because it is more of a timing matter. There are all sorts of things going on. Are you saying, Mr Hyden, that we will be out of net debt in three years?

Mr Hyden—Out of net debt? Into negative net debt.

Senator BUSHBY—Negative net debt in three years?

Mr Bath—It is longer—sorry.

Senator BUSHBY—I think more than likely we were actually thinking it was a real surplus as opposed to actually having paid off the debt that we have accumulated while we have been in deficit.

Mr Bath—I think it is beyond the forward estimates period.

Senator BUSHBY—It is beyond the forward estimates. I do not think there is any projection at this point as to when we might be able to—

Mr Hyden—Sorry, I am confusing going into surplus with net debt.

Senator BUSHBY—Which is exactly the point I am making about what the media reports have been doing. Some of the commentators have actually confused going into surplus with actually being out of debt in a net position. I just want to establish for the record that up until the point when we do go into surplus, as we discussed and clarified, we are actually accumulating debt. Debt is getting higher and continuing to get higher until such point as we are out of deficit, which you have already—

Mr Hyden—No. The gross amount of debt will peak around about the time the budget goes into surplus and then it will start falling.

Senator BUSHBY—That is right. Exactly.

Mr Hyden—But it will take some time before we go into negative net debt.

Senator BUSHBY—Until you go into surplus. It is getting higher, until you reach that point. So long as you are not in a balanced budget situation.

Mr Hyden—No.

Senator BUSHBY—So long as you are in deficit, you are actually accumulating debt.

Mr Hyden—That is right.

Mr Bath—I will just qualify that, Senator, if I may. There are assets that we have been accumulating. We could, for example, meet the tail end of a deficit year by running down the stock of assets, for example. But notwithstanding that final technicality, the point you make is correct.

Mr Hyden—I will just clarify those figures. I think the question was really about the end of next year—2010-11. We said that there would be \$209 billion market value of debt on issue. That corresponds to a face value of \$202 billion. But there is a small amount of debt that is indexed bonds which was previously issued before the cap was introduced and is not counted towards that cap. So at the end of June next year, we would still be below the cap on our current projections.

Senator BUSHBY—Still below the \$200 billion. So on the basis of that projection, you are not actually going to need any legislative change to the cap. But I imagine that a prudent government, given where you are projected to head not long after that, would be taking steps to actually adjust that cap.

Mr Hyden—The government has said that it will introduce legislation to amend the cap at an appropriate time.

Senator BUSHBY—It will clearly need to unless something major changes in the budgetary position between now and then.

Mr Hyden—Well, it is always possible that the budgetary position could change.

Senator BUSHBY—Things could deteriorate. Things could improve. There are circumstances that we face that we do not yet know. I might move on. Senator Joyce also asked some questions about the country of residence of those who own the Commonwealth securities. You gave some figures which I found interesting. I have been to your website and pulled off the statement of beneficial ownership by country of residence of Commonwealth government securities and state government securities guaranteed by the government. My

analysis of that—I admit that it is very much a layman’s analysis—showed that roughly for almost 60 per cent of the owners of Commonwealth and state government securities, their country of residence was unknown. If 60 per cent are unknown—I know that this may well be the answer because it includes Commonwealth and state—you indicated that 65 per cent of all securities were held overseas. But we have a figure in your table which says that 60 per cent are unknown. If 60 per cent are unknown, how do you know that 65 per cent are held overseas?

Mr Hyden—That the information comes from different sources is, I think, the short answer to your question. The 65 per cent figure comes from surveys that the statistician undertakes—the ABS. The figures we have published are ones that we have collected from the register—from Austraclear and from other sources, including Euroclear. The statistician is able to collect more information because under the Census and Statistics Act he has the power to require the provision of information whereas we do not have that power. So we have had to collect information on a voluntary basis. And we did not get the cooperation of domestic custodian and nominee companies, which said that in the absence of a legal requirement they would not provide the information to us.

Senator BUSHBY—That explains the variance between the two figures as reported tonight. I guess my question, though, is: given that the ABS does actually publish that information, why do you not take that information and build it into your figures for your table?

Mr Hyden—Well, the statistician will not give us any more information than he publishes. So if we did that, we would not be able to publish anything different to what the statistician does. The statistician’s quarterly figures are simply on a resident/non-resident basis. They are not broken up by country. The statistician does publish annually figures that give some detail by country, but that comes out with a considerable lag and does not have a lot of detail by country. Finally, I should say that the legislation requires us to provide information in terms of the beneficial ownership of the stock. We felt that meant that we needed to try to get that information as best we could. I suppose I should add that we would not be able to combine other sources of information with the statistician’s information unless we had access to the statistician’s information at a very detailed level so we could see what was already in there and what was not.

Senator Sherry—There is effectively a firewall built around the ABS in terms of anyone being able to access. They are obviously on soon. You could ask them about it.

Senator BUSHBY—It sounds like maybe the ABS would be better placed to be directed to put this table together than the AOFM would be.

Senator Sherry—You could ask them, but I suspect we would have to change the act because the basis on which the data is being gathered is obviously confidential and it is published in the aggregate.

Mr Hyden—I think the statistician faces very much the same constraints we do. In addition, the statistician, under the Census and Statistics Act, has a requirement to respect the confidentiality of the data.

Senator BUSHBY—But I do not think that what you are asked to report on in your table, which I think is now a statutory requirement, actually exposes confidential information in any shape or form. If you did know the country of residence of the 60 per cent that you cannot identify, that would not be exposing the beneficial owners to any breach of confidentiality, I would not have thought. You are not saying who they are. You are just saying what country they are in.

Mr Hyden—Firstly, I do not think the statistician can provide information to us, so it is just what he publishes. Secondly, he is concerned to protect confidentiality in relation to not only the ultimate beneficial owners of stock but also the intermediaries who provide information to him. For example, in some parts of the market, there may be only two or three custodian companies who hold stock on behalf of people in a particular country. If a total were published for that country, of those two or three custodians, they would know what is happening in their own figures and they might be able to deduce what is happening for their rivals. They regard that as commercially confidential.

Senator BUSHBY—You mentioned, though, that the ABS does annually publish a greater degree of information even though there is a lag. To what greater degree do they publish other than the quarterly one they do? What extra information is in the annual one?

Mr Hyden—They publish by country, but for a very limited number of countries. For example, they do not publish any information on holdings by investors in China. They say they have that information but it is not for publication. Similarly, France, Italy, Korea and a range of other countries like that would be quite significant holders of our bonds.

Senator BUSHBY—Absolutely. So why do they publish for some countries and not for others? Is that a statutory requirement placed upon them, or is it a value judgement that they make for reasons that are either publicly known or not publicly known?

Mr Hyden—It is a statutory requirement.

Senator BUSHBY—It actually identifies which countries they need to publish for?

Mr Hyden—No. The statutory requirement is to protect commercial-in-confidence.

Senator BUSHBY—So they would make an assessment?

Mr Hyden—I am not quoting the precise wording of it because I do not have it in my mind, but it is a general provision in the Census and Statistics Act, which is one of those very old acts that goes back over 100 years. It requires the statistician to exercise judgment.

Senator BUSHBY—So it is a judgment call on his part rather than government setting out which countries?

Mr Hyden—This is not a new requirement, and the statistician, I think over the years, has built up his own practices as to how he applies that.

Senator BUSHBY—We will move on from there at this point.

Senator Sherry—The ABS is appearing next.

Senator BUSHBY—I know.

Senator Sherry—Rather than get things second-hand—and I am not suggesting that the information is not accurate—we have the ABS coming.

Senator BUSHBY—I understand that. That is why I was going to move on a little. I understand now the source that you use, which is the voluntary request to those who purchase securities. Do you actually have any other information or knowledge that would assist in identifying the country of beneficial ownership for the 60 per cent that you cannot identify in this table?

Mr Hyden—No.

Senator BUSHBY—There is nothing else that is available to you or that you are aware of?

Mr Hyden—We have put everything into this.

Senator BUSHBY—So you do not actually know? Nobody at the AOFM would actually know the country of residence of those beneficial owners or any of them in that 60 per cent?

Mr Hyden—We are aware of the figures published by the statistician. We are also aware of figures that the IMF collects from a rather different angle. But we cannot marry those figures together in a way which provides a more detailed answer to the questions we are being asked to answer.

Senator BUSHBY—This table does apply to the Commonwealth and states. The total outstanding on the bottom as at 31 March 2010 of both Commonwealth and states is almost \$205 billion. That does not seem to marry up with the numbers that we were talking about earlier. If we have \$533,000 million on issue, that would suggest there is only \$60 billion left that is guaranteed by the Commonwealth. Is that because not all state government debt is guaranteed by the Commonwealth?

Mr Hyden—That is correct, yes. Only two states availed themselves of the guarantee and they did not apply the guarantee to all of their bonds on issues. So the figures are shown there. The \$205 billion includes \$132 billion of the Commonwealth, \$24 billion from New South Wales and \$49 billion from Queensland.

Senator BUSHBY—That explains it. So the remainder of the state government debt that Senator Joyce asked about is not guaranteed by the Commonwealth?

Mr Hyden—That is correct.

Senator JOYCE—It still got to \$57 billion or something, didn't it? It is \$57 billion that you have guaranteed.

Mr Bath—As at 31 March, \$73 billion was guaranteed by the Commonwealth.

Senator BUSHBY—I want to ask some questions about residential mortgage backed securities. In the context of your announcement of 25 May, can you update the committee on where it is at in terms of its investments in RMBS? In particular, how much has it invested since the onset of the subprime financial crisis? How much has it traded, if any? Where is it at with the investing of the \$8 billion announced by the Treasurer last October?

Mr Bath—In total, we have purchased \$9.02296 billion. We have sold just under \$80 billion, which we announced a few months ago.

Senator BUSHBY—Sorry, what was that?

Mr Bath—It was \$80 million, I beg your pardon.

Senator BUSHBY—I thought you said \$80 billion.

Mr Bath—I am sorry. We sold just under \$80 million. That was essentially done just to slightly rebalance the portfolio and—

Senator BUSHBY—Did you make a profit on that?

Mr Bath—We actually sold them at par in a yield sense, so we made a profit on them in the sense that we held them at a running yield of between—you are testing my memory now—160 basis points over the bank bill rate to 195 basis points over the bank bill rate for about a year. We were funding them at probably a good 40 or 50 basis points under the bank bill rate. So we made a holding return profit, but we sold them essentially at their par value, adjusting for any accrued interest on the day. What was your third question?

Senator BUSHBY—The third question is: how much is invested? Has it traded any? Where is it at with the investment of \$8 billion announced by the Treasurer last October? That presumably means that you have invested \$1.02296 billion.

Mr Bath—Effectively that is right. There is just under \$7 billion to be invested.

Senator BUSHBY—So that has not changed since 25 May?

Mr Bath—No. That is right. We just announced a slightly different change to our investment strategy.

Senator BUSHBY—Would you take us through that, please.

Mr Bath—Yes. Over the 18 months or so since we have invested, we have been happy to respond to changing market conditions. So in the first phase we essentially, if you like, held the market at around 130 basis points over the bank bill rate for the most senior pieces. The secondary market was trading out to over 200 to 300 basis points over the bank bill rate. That meant that, by and large, we were the only investor in a lot of these transactions. In fact, on average for the first six to 12 months of the program, we were probably about 80 per cent of purchases. The market improved significantly through 2009 such that secondary market spreads came into about the level where we were buying tranches in the primary market. In fact, transactions were conducted without our support in late 2009. This trend continued in early 2010. There were several deals conducted during that time. As at the end of March, we conducted an analysis that showed that our share of the investments had dropped from the 80 per cent I quoted earlier at the beginning of the program to around 20 per cent for the first three months of March.

Senator BUSHBY—Which is why you still have \$7 billion that you have not invested?

Mr Bath—That is part of the reason. But through April we did not transact a single deal. Until 25 March, we had invested \$10 million into a single transaction. So what we had seen is that there was a bit of a stalemate in the market. Issuance was not going on. There were a number of reasons we could—

Senator BUSHBY—It was not going on at all or it was not going on with the AOFM?

Mr Bath—There were what we would call private deals that did not involve us. For example, one bank had a portfolio of mortgages in what is called a warehouse facility, where another bank has provided part of their balance sheet. For whatever reason that suited the two of them—it suited them to convert the warehouse facility into a term RMBS deal. But I do not think it was publicly offered. It may have been, but it did not fit our characteristics because it was essentially a bespoke deal that was a function of the legacy mortgages that were in that warehouse facility. That is one example.

There are other similar ones where individual transactions that were conducted several years ago were due to be called or refinanced and those transactions were undertaken without our involvement. So given that our mandate is to invest a total of \$16 billion into mortgage backed securities to drive competition in the mortgage sector and to get finance to the small business sector, having had significant improvements through late 2009 and early 2010 and having that stall in late March or early April, we took the view that we should be looking to get the market moving again. We suspected that there was some unmet demand, particularly for shorter dated RMBS securities. So we entered into an arrangement with, as it turns out, Suncorp, but we made the decision—

Senator BUSHBY—Did they approach you?

Mr Bath—They approached us in the sense that they put a deal to us through our reverse inquiry channel, as we call it. But we asked them to modify the deal to tap what we thought would be unmet demand for a short data transaction. So, if you like, the way these deals work is that there is usually an amount of subordination—let us say five per cent to 10 per cent—at the bottom of the capital structure. Let us just put that to the side for the moment. They are not the AAA securities, generally speaking, that we buy. But the top part of the transaction will typically have what is called a weighted average life of three years. So it is not structured like a bond that we would issue, which has a fixed maturity date and you get all your capital back at that maturity date. You get your principal and interest gradually through time in the same way that the underlying mortgages repay in the style of a credit foncier. So we tend to talk about weighted average lives in the mortgage backed security space.

The transaction that Suncorp originally proposed to us had, I think, a weighted average life of three years. We suggested to them that there might be unmet demand for a particularly shorter dated security. We said that we would be prepared to purchase a longer dated transaction to facilitate that. You can imagine the top tranche that had a three-year weighted average life. We were prepared to split it into two components—roughly two-thirds of it into a note that paid back with a weighted average life of one and a half years, and we were prepared to buy the other one-third at a weighted average life of six years. Provided that the weighted average cost of funds across the two of them was less than 130 basis points, they would see that as a good outcome. We indicated to them that we were interested in supporting this transaction and getting the market moving again, and that we would be prepared to buy the longer tranche at between 110 and 130 basis points. They were able to then market the shorter dated security knowing that we were prepared to buy the longer dated security. Provided that they were able to sell the shorter dated note at less than 130 basis points over the bank bill rate, they would be better off. I want to stress that it was not a Suncorp specific deal. They

were just the first bank to bowl a proposal to us after we had decided in early May that we wanted to get things moving again.

Senator BUSHBY—So the primary motivation was to get things moving again?

Mr Bath—That is right.

Senator BUSHBY—And you wanted to affect the price at all?

Mr Bath—That is right. Also to—

Senator BUSHBY—Tighten it up?

Mr Bath—Tighten pricing so that it would then be passed on to competition in the mortgage sector.

CHAIR—Senator Bushby—

Senator BUSHBY—Can I finish the RMBS? I have a few more questions on this, if I can.

CHAIR—Senator Cameron and Senator Pratt both have questions.

Senator BUSHBY—I will try. I would like to go into the approach a bit more. There has been some criticism of the approach by some industry players, who say that it fails to balance the desirability of driving the margin tighter with the need to see continued private sector participation and that, by tightening the price, you may actually make it less attractive to investors. What is your response to that?

Mr Bath—We were at pains to stay out of that top note that I explained to you. While we were prepared to buy all of the six-year note, we made it very clear that we were not going to participate in the super senior 1½ year note. Therefore, it would find a market price without our intervention. So we were aiming to give investors that message through our operational notice, which I believe you have in front of you; essentially we were not going to try to manipulate the price of the top note. We were prepared to buy all of the second piece—the long dated piece—at a level that is still a very good margin. Bear in mind that these may be the same investors who were perhaps a little bit negative about the program 18 months ago when they were able to find investments at 200, 300 and 400 basis points over the bank bill rate, but we were buying them at 130 over the bank bill rate.

Senator BUSHBY—To what extent was the motivation for the change or doing this a need to actually expend the \$8 billion? You mentioned you have a charter to expend it. Do you feel obliged to approach the market with a view to actually spending the \$8 billion?

Mr Hyden—No, we do not. The Treasurer made quite clear when he announced the government's provision of the further \$8 billion that the government was not necessarily expecting that it should all be invested. If the need for the Commonwealth to be investing reduces—the market becoming sufficiently competitive—we would not keep on investing. We see this as something of an exit phase. The market has improved quite a bit. It is not quite to the stage where we have the fully competitive amount of competition in the housing lending market that the government would like, but there has been improvement. The sort of pause that was evident in the market was not necessarily a sign of the market deteriorating. In fact, it may to some extent have been that the market was improving. Arrangers were not so anxious to go to issuance because they could get more ready accommodation from the warehouse

providers. To some extent, they may have been waiting to see if the yield improves—that is, falls—from their point of view so they could be more competitive. So I think our action was designed to give things a bit of a push along. But that is viewed in terms of getting to the stage where we have a reasonably competitive housing market rather than just a desire to invest the amount that has been allocated to us.

Senator CAMERON—What has been the impact of the uncertainty in the financial market from the Greek and European financial crisis on sovereign bond issuance in the last four weeks?

Mr Hyden—Well, clearly, there has been a lot of turmoil and uncertainty in markets, particularly in Europe. The impact on us has been limited. There has been a strong demand for our securities. I think that has certainly continued. I think it has probably strengthened over the last four weeks or so, not necessarily so much directly from what has happened in Greece but from the uncertainties about what is happening in Europe more generally and the greater risk aversion and wariness that investors have to sovereign issuance in Europe at the present time. I had a question earlier from Senator Joyce on this. We have actually seen some fall in the yields on our bonds, particularly at the shorter end, which I think is coming largely from increased demand from global investors, who are sort of rebalancing their portfolios a little.

Senator CAMERON—There has been a lot of scaremongering and alarmist nonsense that Australia is a sovereign risk. There is continued talking down of the economy from the opposition while we are working hard to keep the economy moving and going strong. Do you see any drop-off in international take-up of sovereign bond issuance since the announcement of the RSPT?

Mr Hyden—No. We have not seen any drop-off. On the contrary, I think, as I said, there may have been an increase in demand. It is hard for us to gauge from the actual tenders as to who the buyers are because they buy through intermediaries—Australian dealers. But anecdotally, talking to people in the market, one has the impression that there has been an increase in demand.

Senator CAMERON—So for a country with a high sovereign risk, what does that do for its bond issuance?

Mr Hyden—Higher risk appeals to a different sort of investor. Investors certainly look for a higher yield to compensate them for the risk. We are very much at the high quality, low risk end of the spectrum, even in terms of AAA, the select group of highest quality countries, where we are well-regarded within that group.

Senator CAMERON—So we are AAA low sovereign risk?

Mr Hyden—Well, AAA is a standard that the credit rating agencies apply. I have been using the term ‘sovereign risk’ in terms of the risk of sovereign debt issuance. It is, of course, often used in a wider context of the risk about changes in policy or the legal framework by the government affecting investments in that country.

Senator CAMERON—Senator Joyce continues to talk about gross debt. Why would the Reserve Bank and the Treasury continue to deal with net debt? What do you look at in terms of issuance of bonds? How would bond issuers around the world deal with this?

Senator JOYCE—Are you going to put them out?

CHAIR—Senator Joyce, I really think that none of us in here 100 per cent of the time ask really good questions. I do not think we should attack each other if—

Senator JOYCE—You are very protective of your colleague. I am showing that up, Madam Chair.

CHAIR—Well, he said the same to me about you, so we will continue with the question.

Senator CAMERON—I do not get upset about what is said by Senator Joyce about me.

Mr Hyden—These things, like many economic and financial concepts, depend on the question. So different concepts will be more relevant to different purposes. From the point of view of the credit of the country, the riskiness of its financial position and its ability to meet its obligations, net debt is maybe more relevant. The short-term or even long-term financial assets are available for meeting the payments the government has to meet. So it is sensible to take them off—subtract them—from gross debt. When one is looking at things like the liquidity and size of the market, which is what is relevant to individual investors, we will want to talk about the gross debt. So both concepts are relevant.

When one is looking forward into the future and projecting budget outcomes, which Treasury does, and then converting that into the financial position of the Commonwealth, net debt is the first step along that path because net debt corresponds basically to the budget outcome, or the change in net debt represents the change in the budget outcome. So if one is going into gross debt, one has to look at how that change in the budget outcome is allocated between debt and assets. You have the same net debt whatever the allocation between debt and assets is, but the gross debt might be quite different. So if, for example, as the previous government did, we built up large cash amounts and then put it into the Future Fund, that does not affect net debt. When we have uncertainty, as in years ahead, as to what specific decisions may be made in that regard, we cannot really make a projection about gross debt, whereas one can be more confident about net debt. The gross debt figures that I have quoted and that we are using assume that all of the budget surpluses, if you like, or the funding requirements of the budget are all allocated to reducing debt.

Senator PRATT—What evidence is there that the government's investment in Australian residential mortgage backed securities has impacted on interest rates?

Mr Hyden—I do not know that they were intended to have a measurable impact on interest rates. They were designed to maintain competition—

Senator PRATT—Yes, that was my next question.

Mr Hyden—in lending for housing. There is a connection there in that more competition in the market will tend to have an impact on interest rates. The financial crisis has brought some greater concentration in lending for housing with the major four banks. Some of that has come from amalgamations and takeovers, so it does not necessarily represent a change in the underlying structure of the market. But there has been a weakening of the lending coming from smaller lenders. The RMBS that we have purchased have helped offset that and have kept that sector going and I think helped maintain competition over this period. As the market improves, we would expect, having kept competition alive, that the market will become more

competitive. It would be hard to identify what component of movement in rates over this period has come from our activities or what it would have been in the absence of that competition.

The major banks, of course, are very keen to build up their balance sheets at the present time coming out of the financial crisis, so that is something which perhaps makes them hold rates a little higher. But I think they have been constrained in that by the competition from the other parts of the sector.

Senator PRATT—That makes sense. Thank you.

CHAIR—Senator Joyce or Senator Bushby.

Senator BUSHBY—I have almost finished with the RMBS questions. I am happy to leave it, thank you.

Senator JOYCE—You were saying that we have currently underwritten \$73 billion now of state debt.

Mr Hyden—That is right, yes.

Senator JOYCE—That has increased lately, has it? For some reason, that has gone up from where it was. From what I can recollect, it used to be \$57.7 billion or something.

Mr Hyden—The states are still able to issue debt with a guarantee or to get a guarantee on debt until I think the end of the current year, or October.

Mr Bath—October.

Mr Hyden—So there was some extra guaranteed debt being issued. On the other hand, they are also seeking to establish new lines of stock without the guarantee so they will have liquid lines to issue into when they do not have them. So there is some increase.

Senator JOYCE—So we are still getting state governments requesting the guarantee to get money?

Mr Hyden—There is still some use of that guarantee, yes.

Senator JOYCE—What states? Queensland, I imagine.

Mr Hyden—Queensland had \$47.8 billion at the end of December and \$49 billion at the end of March so that in three months it has gone up \$1.2 billion. I suspect that may have been more than the earlier part.

Senator JOYCE—Queensland's debt, as it currently stands, is about \$50 billion.

Mr Bath—That is Commonwealth guaranteed debt.

Senator JOYCE—We are talking about net and gross debt. Your gross debt is going to be \$222 billion and the net, you say, is going to be about \$96 billion or something. Can you just go through all the figures in some precision that takes us from \$222 billion down to \$96 billion? I recollect that there is one table that says 'other'. It has \$65 billion in it.

Mr Bath—The majority of the assets that go from gross to net debt or that are used as the offset are not on the AOFM's balance sheet. We can tell you the ones that are on our balance sheet.

Senator JOYCE—What are the ones that are on your balance sheet?

Mr Bath—There is about \$9 billion of mortgage backed securities.

Senator JOYCE—Mortgage backed securities?

Mr Bath—I can tell you exactly, if you bear with me for a moment. This is as at Monday night, 31 May. We had \$22.9 billion of term deposits with the Reserve Bank. We had \$4.045 billion of negotiable certificates of deposit with commercial banks. We had \$3.55 billion in short dated state government bonds that we use in our liquidity book. I will retract the \$9 billion because some of the capital has come back to us. We have not actually settled on the Suncorp deal, so it is closer to \$7.73 billion in mortgage backed securities. As I said, they are the assets that are on the AOFM's balance sheet. But outside that you have other debt like assets that are used in the calculation of the net debt figure. So any fixed interest or cash-like assets that are held by the Future Fund would be a large part of it.

Senator JOYCE—What do we use the Future Fund for? What does that mean, therefore?

Mr Bath—I believe that the money is there to defray the cost of public sector superannuation liabilities.

Senator JOYCE—Senator Cameron is quite happy for you to use that money to pay off the debt. Would you be able to do that?

Senator CAMERON—I raise a point of order. I did not say that.

Mr Bath—I would not be able to use it to pay back the debt.

Senator JOYCE—You would not be able to use it to pay back the debt, though?

CHAIR—Senator Cameron had a point of order.

Senator CAMERON—I know it is getting late and I know Senator Joyce has been struggling most of the evening, but he should—

Senator JOYCE—Point of order.

CHAIR—No. There is a point of order here.

Senator Sherry—You cannot pull a point of order until the first point of order has been ruled on.

Senator CAMERON—The point of order is that Senator Joyce is asserting that I made certain claims which are not true.

CHAIR—That is no real point of order. What is your point of order, Senator Joyce?

Senator JOYCE—That he called a point of order.

Senator CAMERON—I told you he was struggling.

CHAIR—That might be a good time to call the session to an end. I thank our officials for coming along and putting up with this. Thank you to AOFM for coming in this evening.

Proceedings suspended from 9.14 pm to 9.28 pm

CHAIR—I welcome representatives from the Australian Bureau of Statistics. Do you have an opening statement that you would like to make?

Mr Pink—No. I do not. Thank you very much, Chair.

CHAIR—Thank you. We will get straight into it, then.

Senator EGGLESTON—I just have a few fairly straightforward questions. Firstly, the ABS had some funding cuts two or three years ago which were said to have meant that you had to change your methodology in collecting statistics. Could you update us on that situation? Are you happy with your funding and methodologies?

Mr Pink—We are certainly happy with the methodologies and funding, Senator. We had a reduction in our work program because of a range of issues that were affecting the budget leading up to 2008-09. That meant that we did reduce the work program in that year. That meant some reductions in a range of our statistical outputs. In the following budget, the bulk of that funding was reinstated, and all of the collections that had been reduced as a consequence of the problems in 2008-09 were reinstated in 2009-10 with the exception of the census, where, because of the long lead times in planning and testing for the census, the decision was taken back in 2008-09 that the census in 2011 would be a repeat of the census in 2006.

Senator EGGLESTON—Sorry, I did not quite catch that.

Mr Pink—The census in 2011 is essentially a repeat of the census that we ran in 2006. So there was no opportunity to explore whether there would be any changes in the content of the 2011 census. That saved some considerable amount of money—on average, about \$5 million a year for three years. All of the other changes that were implemented in 2008-09 have been reintroduced in 2009, 2010 and 2011. In fact, we reversed the decision to reduce the sample in the retail survey more quickly, because of the obvious need for governments and the markets to understand what was happening with particularly household spending in the second half of that period.

Senator EGGLESTON—So you have restored your operation to its previous functional levels? That is effectively what you are saying, is it?

Mr Pink—In 2009-10 we have also received additional funding to in fact expand the program. Most of that additional funding has come to provide new information or improved information associated with a variety of the COAG reform initiatives.

Senator EGGLESTON—Can you give us some examples of that?

Mr Pink—Well, Indigenous is a very good example, where in the 2009-10 budget and in the census period we have additional funding coming through that will allow us to implement some different strategies in the census numeration processes, particularly but not exclusively associated with seeking to get better quality outcomes in terms of our Indigenous counts. Then, in the postenumeration period, we will be undertaking some additional analytical work that will also help us to improve some of the population estimates and population data in relation to the Indigenous peoples.

Senator EGGLESTON—When you collect Indigenous statistics, are we talking about a race item on the census or are we talking about collecting statistics from remote communities, which is what people often mean when they talk about—

Mr Pink—Well, we collect statistics from remote communities. But the concept is self-identification, so people who identify themselves as Aboriginal and Torres Strait Islanders are part of the Indigenous population.

Senator EGGLESTON—Most of whom are really located in big cities and towns rather than remote communities, it would seem. So are you happy with your staffing levels?

Mr Pink—We are still struggling to come up to the staffing levels that we need to support the expanded work program. We are working pretty hard to find people with the skills and capability that we need. Through 2009-10 we are going to be around 100 staff below the level that we would have wanted to undertake all of the work in that year, so it is a constraint of supply rather than one of not having the funding.

Senator EGGLESTON—So how many staff would you have wanted? What percentage are we talking about that your staff deficit represents?

Mr Pink—Well, it is 100 in about 2,600. So we wanted 2,700 full time equivalents and we had through the year on average about 2,600.

Senator EGGLESTON—What difference does that make on the ground?

Mr Pink—Well, in the short term we have reshaped the work through the year to be able to ensure that we continue to provide all of the committed outputs. But what it does mean is that some areas of work that can be deferred for a short period of time, such as some of the work we do associated with maintaining and upgrading our infrastructure, has been put on hold. That is a situation that we would like to see recovered in 2009-10 and beyond.

Senator EGGLESTON—I see. Thank you very much. I want to turn to a specific issue. I notice that there was an article in the *Weekend Australian* on 10 April which was headed 'Immigration spike only a statistical illusion'. It said:

The recent spike in immigration numbers is at least partly due to a pen stroke — a change in the way the Australian Bureau of Statistics calculates its figures.

Tens of thousands of people who were not considered migrants before the ABS's change in 2006 are now included in the count.

Would you like to tell us a little more about that?

Mr Pink—Yes, I can, but I will pass over to my colleague Denis Farrell. The main change in the methodology was in relation to the way in which we counted people who were in the country for a given period. The change was that now if you are in the country for 12 out of 16 months you will be counted as a new addition through the migration data. Previously, if I am correct—because it happened after I came back from New Zealand—I think it was 12 months.

Mr Farrell—Yes. The methodology changed—just to explain before and after—prior to the September quarter 2006. If somebody came into the country and within 12 months left the country, they were treated as a temporary resident. They could come and go on several occasions even though their main place of residence may have actually been in Australia. Post that period, we changed the methodology to count how long they are in Australia within a 16-month period. If it is in excess of 12 months, they are treated as a temporary resident. So to the extent that that change occurred, there is an increase. But there has also been a dramatic

increase in population in that time as well in terms of migration, particularly in the area of education, as you are aware.

Senator EGGLESTON—Yes.

Mr Farrell—The point of this is that the ABS did not just do that on its own behalf. We consulted very widely with people—academics, departments and others—on the methodologies that we were using to actually measure migration in that context.

Senator ABETZ—Can I interrupt and ask whether those consultations about the methodologies were international as well?

Mr Farrell—Not to my knowledge. There was general agreement that it was appropriate to adopt a new method. That new method was introduced in the September quarter 2006.

Senator EGGLESTON—Thank you very much. You calculated Australia's population would reach 36 million by 2050. Do you still stand by that figure, or is this somewhat altered by that error?

Mr Farrell—We do projections twice each five-year cycle. We did them in 2008 following the 2006 census. We actually did 72 different series of projections based on a combination of different assumptions around fertility, mortality, life expectancy and migration. There are three main series that we produce. I could go through what those assumptions were. Population projections are very much based on the assumptions that you make. The assumptions that you make can vary from time to time. The reason we do them twice every five years is to account for that factor. Usually when we do them, we do them on the basis of the prevailing fertility, mortality and migration levels. We vary around that level both upwards and downwards to produce different models. People use those models for different reasons.

Senator EGGLESTON—What is the margin of error on your projected population? Is it plus or minus five per cent or something like that?

Mr Farrell—It is not really something you can say. These are not forecasts or predictions. They are projections based on assumptions. So it depends on what the actual fertility rate is and what the actual migration level is at the end of the day that drives how good, bad or otherwise those projections might be.

Senator EGGLESTON—Coming back to your earlier information—that you now have built up your workforce again—does that mean that the broad range of statistics that you are producing is now restored to its previous levels of reliability? Can we say that confidently?

Mr Pink—I will answer that: yes, they are. Sample sizes that were reduced in a number of the series—retail and the labour force in particular—have been restored to the previous sample sizes, so reliability is back to where it was previously.

Senator EGGLESTON—Thank you. I think that is all I have, really.

Senator JOYCE—What are the ABS's long-term projections for population growth? What does the ABS predict that Australia's population will be by 2050?

Mr Farrell—We do not make a prediction. We build a set of assumptions and we project the population based on those assumptions. It is not actually a prediction or a forecast.

Senator JOYCE—What is your assumption of what it will be?

Mr Farrell—What period did you say?

Senator JOYCE—2050.

Mr Farrell—Offhand I do not have it. We will have a look and get back to you on that. Offhand I cannot answer.

Senator JOYCE—That is all right. Can you also give me the assumptions of what you think the cities will be at that point in time?

Mr Farrell—We can. I do not have them at hand.

Senator JOYCE—Can I get that on notice as well?

Mr Farrell—Yes, certainly.

Senator JOYCE—Is there any appreciable difference between the ABS projections of Australia's population and those produced in the *Intergenerational report* either in results or methodology?

Mr Farrell—The *Intergenerational report* was prepared some time after the projections done by the ABS. The assumptions were taken independently. There are some differences—they are not substantial—around the three main series. They fall somewhere between the middle assumption and the higher assumption that the ABS uses as the three main series that we produce.

Senator JOYCE—I want to go to some questions about the Treasury paper that was released last Monday entitled *Disparities in average rates of company tax across industries*. On page 5 of the Treasury paper, it says about gross operating surplus—GOS:

GOS is a measure of the surplus from the production of goods and services available for distribution to those that hold a claim to corporations (ABS 2000). However, GOS is not the most appropriate measure of a corporate income tax base as it excludes income unrelated to production — such as property income, land and natural resource rents, net interest receipts, and capital gains or losses — which rightly forms part of company income and profits.

Emphasis added. But when I go to the *Australian National Accounts: Concepts, Sources and Methods*, paragraph 11.48, the ABS defines the gross operating surplus as follows:

Both gross operating surplus (GOS) and gross mixed income (GMI) measure the surplus accruing from processes of production before deducting any explicit or implicit interest charges, land rent or other property incomes payable on the financial assets, land or other tangible non-produced assets required to carry on the production.

So the Treasury seems to be saying that the gross operating surplus includes things like interest rates and land rents whereas your definition seems to suggest it does not. Can you clear up the definition of gross operating surplus for me? Please do not say, 'Repeat the question.' But I can if you need me to.

Mr Pink—I am looking at the definition of gross operating surplus as we include it in the quarterly national accounts. There it says that we are calculating gross operating surplus before deduction of consumption of fixed capital dividends, interest, royalties and land rent and direct taxes payable but after deducting the inventory valuation adjustments; so gross operating surplus does include most of those elements.

Senator JOYCE—So you are saying that the two definitions are the same?

Mr Pink—Well, I believe I am, if I understood as you were going through reading out the Treasury one.

Senator JOYCE—I will read out the Treasury one. On page 5 of the Treasury paper, it says:

GOS is a measure of the surplus from the production of goods and services available for distribution to those that hold a claim to corporations (ABS 2000). However, GOS is not the most appropriate measure of a corporate income tax base as it excludes income unrelated to production — such as property income, land and natural resource rents, net interest receipts, and capital gains or losses — which rightly forms part of company income and profits.

Treasury are saying they exclude those amounts. You are including them.

Mr Pink—Yes. We are.

Senator JOYCE—You are. So there is a difference?

Mr Pink—We will take that on notice and come back because I do not know what is in the Treasury document, but we will certainly reference it and clarify it for you.

Senator JOYCE—Even just going to something as simple as percentage of tax on taxable income, the numerator in that is the tax paid and the denominator is the taxable income, is it not?

Mr Pink—Well, based on the definition of whatever the taxable income is.

Senator JOYCE—You would have heard the debate lately with regard to the so-called pie charts that were issued by Wayne Swan's office; we found that out. How can they come up with a description of taxable income which does not actually take into account the proper denominator—that is, that their taxable income is not actually taxable?

Senator Sherry—Who came up with it? Treasury?

Senator JOYCE—In question time today you would have found out that your Treasurer came up with it.

Senator Sherry—Well, I was in here, so it should be unsurprising that I did not see question time today. But who came up with it, in your question?

Senator JOYCE—The Treasurer, Wayne Swan, or his office in that pie chart—that complete fiasco, the one that we were bringing around here the other day.

Senator ABETZ—This one.

Senator JOYCE—Yes, that one that he issued is wrong. It is completely and utterly wrong because he bodged it up in his office.

Senator Sherry—That is an argument, not a question, and an assertion. I will take it on notice.

Senator ABETZ—Before I entered the room, did you provide us with a bit of an update on the census?

Mr Pink—Yes, one aspect.

Senator ABETZ—I will see what the *Hansard* says on that, thanks. In relation to your population estimates, I think you, Mr Pink, indicated that there were 70-something assumptions.

Mr Pink—Mr Farrell.

Mr Farrell—There were 72 series of population projections, yes.

Senator ABETZ—Seventy-two series?

Mr Farrell—Yes. Based on a combination of the assumptions.

Senator ABETZ—And how many assumptions?

Mr Farrell—Fertility—

Senator ABETZ—The three assumptions?

Mr Farrell—Well, four, yes.

Senator ABETZ—Four assumptions. What you put in determines what you might get out?

Mr Farrell—Yes.

Senator ABETZ—At the moment there is a forecast of 36 million people by 2050. Is that the figure or is that a figure from a parameter of, let us say, between 30 million and 45 million, for example, depending on what assumptions you make?

Mr Farrell—Yes, your set of assumptions and your model based on the population base that you start with. So we used the estimated resident population at a point in time. Then we applied the assumptions around fertility and mortality, life expectancy and migration.

Senator ABETZ—Does that give you a range, as opposed to the exact figure of 36 million?

Mr Farrell—Well, for each combination of variables, it gives you a number at each point in time. You are estimating annually through to a particular period of time—say, 2050. So you get a specific number. You start with a specific number. You use specific assumptions. You model them through the period year by year.

Mr Pink—So if you change the assumptions, you get a different number at the end of the period. It can vary quite significantly with relatively small changes in things like the fertility rate. Over a 40- or 50-year period it can have quite an impact on the total population.

Senator ABETZ—Yes. And especially, for example, the birth rate of migrants may well be higher, if I can use that, than the existing Australian population.

Mr Farrell—It can be, but it is done in gross terms. Using birth rates and age cohorts it is quite complicated.

Senator ABETZ—I accept that. Let us try to get us something a bit simpler. When you good people talk about persons, do you mean full-time equivalents for the purposes of the definition of a medium business and a big business?

Mr Farrell—That is not a population question.

Senator ABETZ—No. That is not a population question. I am moving on. I am sorry if I did not make that clear. What is your definition of ‘person’?

Mr Ewing—In business statistics, it would be full-time equivalent people.

Senator ABETZ—When you describe big business or large business as being more than 200 employees, you are talking full-time equivalents?

Mr Ewing—That is correct.

Senator ABETZ—Therefore, when you have the definition of small business as employing less than 20 persons, that is less than 20 full-time equivalent persons?

Mr Ewing—That is correct.

Senator ABETZ—I just wanted to clear that up. Thank you for that. Do you think that is the best definition of small business? Some people argue that it depends on the amount of turnover a business has. Why do we come up with a category based on employment as opposed to turnover, for example?

Mr Ewing—I think it is partly for reasons of international comparability, that employment tends to be more readily available and easier to measure across different countries with different administrative or survey arrangements, so it tends to be a standard that is easier to apply, though I think, as you rightly say, for certain sorts of businesses other measures of size may be more appropriate.

Mr Pink—Even in the context of the US, whilst they collect data that complies with that international approach, their own view of small businesses is 100 and less employees.

Senator ABETZ—Where have I heard that figure before? We will not go there. The ABS has a category of small business. Does it also have a category of micro business?

Mr Ewing—I would have to take that on notice. I am not sure.

Senator ABETZ—I think you do, and it is employing less than five full-time equivalents. But I would be interested if you could—

Senator Sherry—Senator, I certainly know the ATO does. I am not sure where the cut-in point is.

Senator ABETZ—In fact, you might be right.

Senator Sherry—I know they have got it, but I am not sure what the definition is.

Senator ABETZ—It was just at the back of my mind. That figure may well have been obtained by me from the ATO. Thanks for that, Minister. I turn to what is I assume your most recent publication, but correct me if I am wrong. It is entitled *Australian industry*, which was put out on Friday. Do you know the document I am talking about?

Mr Farrell—Yes.

Senator ABETZ—Excellent. Thank you very much. You gathered some very interesting data in that. The ABS is part of Treasury, is it not? Did Treasury or the Henry review have access to the workings and initial calculations or drafts of this document at any stage, to your knowledge?

Mr Farrell—That publication is the result of something called the annual integrated collections, which is an economy-wide survey. That release on Friday did not have a pre-release, so that edition of that publication was not released to anybody outside the ABS.

Senator ABETZ—That edition?

Mr Farrell—That edition. That publication is really—

Senator ABETZ—Well, that is not what I am asking. Was any of the information that was being gathered for the purposes of this publication at any stage shared with Treasury or the Henry review as the information was coming together?

Mr Farrell—No. What I meant by a previous edition was the survey is run annually, so it is released annually.

Senator ABETZ—Sorry. I thought you were trying to make a distinction between the draft and the final draft.

Mr Farrell—No.

Senator ABETZ—I accept that. Thank you for that. I do not know if you have the document in front of you or available to you.

Mr Farrell—No. I do not have it with me.

Senator ABETZ—Let us see how we go. On page 7 of that document we are told that the operating profit before tax of the mining sector in 2008-09 was \$63.636 billion. Is somebody able to confirm that or not?

Mr Farrell—Sorry. I do not have the publication with me. We produce a very large number of publications.

Senator ABETZ—Of course you do. I am not critical of that. I was just hoping to potentially obtain some assistance in relation to this document's interpretation.

Mr Farrell—All we can do is take it on notice.

Senator ABETZ—Does anybody recall the figure of \$63.636 billion as being the operating profit before tax for the mining sector?

Mr Farrell—I am sorry, no.

Senator ABETZ—All right. Fair enough. For the purposes of this document, what is meant by mining? It is not a trick question. Does it include oil and gas that is obtained offshore?

Mr Farrell—Well, firstly, the classification by industry is the ANZSIC, the Australian and New Zealand standard industrial classification. Mining is one of the industries that is defined within that classification. I also do not have a copy of that classification with me. I do not know whether Mr Ewing has.

Mr Ewing—No, I do not.

Mr Farrell—My memory is that oil and gas are part of it. The offshore component would depend on the circumstances.

Senator ABETZ—Looking at your website earlier this evening, that was my interpretation, but I did not want to jump to any conclusions without having that verified to me. But, in general terms, the categorisation of mining includes the oil and gas sector. It would include, would it not, the offshore? What is the difficulty there?

Mr Farrell—The difficulty is where offshore it is and what waters it is in.

Senator ABETZ—If it is in Australian waters? If it is within our economic zone?

Mr Farrell—My understanding is that if it is within our economic zone it is included, but that is not always absolutely clear.

Mr Ewing—There are some joint ventures or stuff that is part of a deal with East Timor and some of that oil and gas stuff is in an area where I understand there is an exception.

Senator ABETZ—Yes. I remember taking that legislation through the Senate. It is highly complicated.

Mr Ewing—I think that is the one area I am aware of where the general residence assumption is varied.

Senator ABETZ—Was it Sunrise?

Mr Ewing—Bayu-Undan.

Senator Sherry—Is there a shared revenue zone?

Senator ABETZ—Let us move on. This document tells me at page 7, if I am reading it correctly, that the operating profit before tax is \$63.636 billion, yet when I go to the document entitled *Stronger, fairer, simpler: a tax plan for our future: an overview* put out by Treasurer Swan, I have a bar graph for resource profits as coming in at about \$90 billion for 2008-09. I am just trying to get a handle as to what the difference between those figures might be and what it might be due to. As I go on, you can take some of the questions on notice if you are unable to answer them now.

Mr Farrell—Yes.

Senator ABETZ—Just remind me: do we date the global financial crisis to the collapse of Lehmann Brothers in September 2008?

Mr Farrell—Yes.

Senator ABETZ—So the profit figures for 2008-09 would be the financial year in which we would say the global financial crisis occurred?

Mr Farrell—Yes. In the company's report on this, we run the statistical collection in respect of that financial year, but you would be aware that many companies do not operate on a July to June financial year, and those companies that report on a different financial year may have reported on a different financial year based on their financial accounts. So it would vary from company to company.

Senator ABETZ—It would, but the totality of profit and income is still that \$63.636 billion, if that is the right—

Mr Farrell—Within the context of that collection, yes.

Senator ABETZ—figure that I have identified. What does the TAU—and please do not ask me to remember what it stands for, although it is in your glossary or definitions at the back—**Mr Farrell**—It stands for type-of-activity unit.

Senator ABETZ—That is right. Unfortunately you do not have the chart on page 43, where there is the heading, ‘contribution to sales and service income’ and then the left-hand column is the TAU. What does that tell us? Is it a case of the higher the percentage the better or the higher percentage the worse in relation to contribution to sales and service income?

Mr Farrell—Let me explain what a TAU is so that you get the context. The register of businesses we use for our collections comes from the Australian Business Register. At the very top end of the size of businesses, the structures of companies are much more complex, and the structures for organisational and other reporting purposes may or may not suit the reporting for statistical purposes, so we changed the structure of the businesses at the top end into type-of-activity units for the purposes of statistical reporting. So we are talking about the very large companies in Australia with very complex structures.

We work with those companies to identify the best methods for reporting for statistical purposes for those organisations. We restructure them for statistical purposes, and the units that come out of that process are called type-of-activity units. Good examples might be a mine which has substantial construction activity or other businesses that cut across industries and would otherwise contribute very differently according to those types of activities.

Senator ABETZ—So what are you telling us on page 43, where you have a heading ‘Contribution to sales and service income’ and then list the various sectors, and down the left-hand side you have got the TAU percentage?

Mr Farrell—I really need to look at it, Senator.

Senator ABETZ—All right. If you can take that on notice, because in that chart mining is 89 per cent and, if I read the chart correctly—if the term is right—is making the highest, what, contribution?

Mr Farrell—Yes.

Senator ABETZ—Yes, the highest contribution?

Mr Farrell—Without seeing it, I suspect what you are talking about is specialisation and coverage, and what that means is, if you put all the mining companies together, what proportion of the total mining activity in Australia would that cover—that is, those companies that are predominantly involved in mining. It might end up being, say, 85 per cent, because some of the mining activity might be done by companies that are actually classified primarily to construction activity. Now, I am partly guessing because I cannot see the document, but I strongly suspect that is what we are talking about there.

Senator ABETZ—All right. If you could be so kind as to read the *Hansard* later and take it on notice for me, I will try to digest the written word when it comes back to me. Thanks for that. Do you keep any statistics on royalties paid to the various state governments in relation to mining?

Mr Ewing—In the government finance statistics we would collect that information.

Senator ABETZ—And I am sure you do not have in your back pocket the amount that may have been paid in 2008-09?

Mr Ewing—No, I would not have that.

Senator ABETZ—So it is in the government finance statistics?

Mr Ewing—Yes.

Senator ABETZ—All right. I will have a look there for that. The Commonwealth Grants Commission for whatever reason believes that, in 2008-09, \$8.3 billion was paid in royalties to the various states, which is an interesting figure. I have never been good at maths, but if you take the \$63.636 billion profit that is in your document and round that up to \$64 billion, and round down the \$8.3 billion to \$8 billion so it is easier to calculate, then the royalties represent about one-eighth of the profit before tax, which is around 13 per cent and, giving the averages, comes to about the 14 per cent figure which found its way into Mr Swan's pie chart. That would therefore seem to verify that top figure in Mr Swan's pie chart—when I say his 'pie chart' I am referring to the Treasurer's Economic Note from Sunday, 9 May 2010, just to identify the document—which I found of some passing interest. So, when we have in this document here the operating profit before tax, does that take into account profit before the payment of royalties or after the payment of royalties?

Mr Farrell—I will take it on notice.

Senator ABETZ—All right. Thank you. If I may go through this document, on page 5, for example, we are told that in 2008-09:

Mining recorded the largest percentage increase ... and the largest absolute increase—

in total income. All these statistics are outlined, such as the fact that mining recorded the largest absolute increase for EBITDA. It says:

Mining experienced a result counter to the decreasing trend in OPBT, showing substantial growth ...

It also says:

MINING this year has overtaken MANUFACTURING as the largest contributing industry ...

I can go through. It seems to me that in 2008-09, according to the Australian Bureau of Statistics, the mining sector still performed exceptionally well. Yet in this room I think it was a week ago in the morning we had Treasury telling us in that mining had let down the Australian economy during the global financial crisis.

Senator Sherry—Is there a question here, Senator Abetz?

Senator ABETZ—Yes. Yet the day after that evidence, the Australian Bureau of Statistics comes out with a whole array of statistics, and it does not matter what you look at, mining outperformed every other category of the Australian economy.

Senator CAMERON—They had 19 per cent unemployment.

Senator ABETZ—So, if it is not asking too much, could the ABS just verify for me their assertions in relation to chapter 1, Overview in relation to the mining sector, and also in chapter 2, Industry performance, which included on page 18:

Most industries have reported relatively stable profit margins over time. The main exceptions to this, which each recorded large decreases in their profit margins between 2007-08 and 2008-09, were Rental, hiring and real estate services (from 44.0% to 16.3%), Education and training (private) (from 24.5% to 9.8%) and Information, media and telecommunications (from 15.7% to 9.1%).

So they were all down substantially.

Mining returned the largest profit margin (37.1%), however this margin has been steady over time.

Senator Cameron interjecting—

So every single statistical analysis provided to the Australian people the day after Treasury gave us these statistics—

Senator Sherry—Chair, we are getting a lot of rhetoric. If you have a question, fine. It is getting late. We are getting interjections as well, which is not helpful, either, Senator Cameron. It is late at night. If we have a question, let's have the question.

CHAIR—Can you come to the question, Senator Abetz.

Senator ABETZ—I am requesting, please, of ABS to verify these statements, which seem to contradict the evidence provided by Treasury. I may well be misinterpreting all these statements and, if that be so, if I could be advised on notice as to what I am misreading in relation to that document.

Moving on, do you have any analysis of the total amount of company tax paid by the mining sector for the year 2008-09? I was told I would find the royalties in government finance statistics. Would that be the same place where I would find that analysis by the ABS?

Mr Ewing—No, it would not be.

Senator ABETZ—Where should I be looking, if at all?

Mr Ewing—I would have to take that on notice, but I suspect in the distribution of income accounts. But I am not sure they are broken down by industry. It would have the amount of tax paid in total within the economy, but I would have to look into whether it is broken down by industry. I could not guarantee that.

Senator ABETZ—If you could provide it to me in any event, but if it is not broken down, you must add, I would assume, all the various industry components to give you the total figure. Is that a fair assumption, if it is only a total figure?

Mr Ewing—Unless it is collected from an administrative source like the tax office's total tax. It may or may not be. I would have to take it on notice and let you know whether we can break it down by industry.

Senator ABETZ—I was going to ask if you could disaggregate the figure and advise me as to what the mining component was—that would be very helpful. Trying my luck even further, if you could try to differentiate between the oil and gas sector and the mineral sector, that would be of substantial benefit to me. That is the end of my questions, thank you very much.

Mr Ewing—Could I make a small point of clarification please?

Senator ABETZ—Yes.

Mr Ewing—I point out that a lot of the numbers the ABS compiles are compiled in the context of the system of national accounts on the basis of economic concepts rather than accounting concepts under which businesses report and are taxed, so there may be some variation between the numbers published by the ABS and those which might be relevant to considering what taxes and so on are paid or might be payable by companies under different circumstances.

Senator CAMERON—That is very interesting.

Senator ABETZ—So where is this information gleaned from then? For example, the wages and salaries paid by, let us say, the agriculture, forestry and fishing sector is determined to be \$6.122 billion?

Mr Ewing—Those figures would have been collected from the *Annual integrated collection* that Denis referred to before and they are probably collected on a business reporting basis. But I know that a number of the figures that are published in the national accounts, for example, that refer to gross operating surplus are adjusted to reflect national accounts and economic concepts that are somewhat different from accounting. In providing you with the answers to the questions you have asked, we will have to be careful to point out where those figures relate to economic concepts and where they relate to accounting concepts.

Senator ABETZ—All right. And the operating profit before tax?

Mr Ewing—That would have come from the same source. The publication you are referring to is based on the *Annual integrated collection*.

Senator ABETZ—So that is a collection of actual data?

Mr Ewing—Actual data from a survey of some 16,000 businesses across the economy.

Senator ABETZ—Whereas some of the other aspects that I have been asking about would relate to broader economic concepts?

Mr Ewing—In some instances some of the numbers you were referring to, such as distribution of tax and so on, within the income distribution account would be adjusted to a national accounts basis to be consistent with the rest of the SNA.

Senator ABETZ—So I get this clear, the figures in your document, *Australian industry*, released last Friday are from data collected?

Mr Ewing—They are from the *Annual integrated collection*, the data collection.

Senator ABETZ—So those figures can be relied upon without the caveat, but some of the figures that I might be supplied in relation to other matters that I have asked for will need that caveat. Is that correct?

Mr Ewing—Again, I do not have the publication with me, but I am saying that in supplying you with the data we will accompany them with appropriate definitions and caveats that will enable you to interpret them, in terms of their relationship to each other, in a coherent way.

Senator ABETZ—That would be very helpful. I apologise in advance to the poor people in the ABS who will have to undertake that task, but if they do undertake the task I can assure them it will be valued by me. Thank you.

CHAIR—As there no further questions for the ABS, I thank the minister and ABS for coming along. I conclude this estimates hearing by thanking the secretariat for their assistance during estimates this year, and of course Hansard and Broadcasting.

Senator Sherry—Thank you, Chair, ABS, H.

Committee adjourned at 10.19 pm