



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Supplementary Budget Estimates)

THURSDAY, 21 OCTOBER 2010

CANBERRA

BY AUTHORITY OF THE SENATE

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SENATE ECONOMICS
LEGISLATION COMMITTEE
Thursday, 21 October 2010

Members: Senator Hurley (*Chair*), Senator Bushby (*Deputy Chair*) and Senators Cameron, Pratt, Williams and Xenophon

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

Senators in attendance: Senators Abetz, Mark Bishop, Boswell, Brandis, Bushby, Cameron, Coonan, Faulkner, Hurley, Pratt, Ronaldson, Ryan, Williams and Xenophon

Committee met at 9.00 am

TREASURY PORTFOLIO

In Attendance

Senator Wong, Minister for Finance and Deregulation

Senator Sherry, Minister for Deregulation, Minister for Small Business, Minister Assisting the Minister for Tourism

Department of the Treasury

Dr Ken Henry, Secretary

Fiscal Group

Mr Nigel Ray, Executive Director, Fiscal Group

Mr Tony Webster, Senior Advisor, Industry Environment and Defence Division

Industry, Environment and Defence Division

Mr Steve French, General Manager, Industry Environment and Defence Division

Mr Russ Campbell, Principal Advisor

Ms Natalie Horvat, Manager, Climate Change and Environment Unit

Mr Scott Rogers, Manager, Environment and Agriculture Team

Ms Jenny Allen, Manager, Industry Policy Unit

Mr Kurt Hockey, Manager, National Security Unit

Ms Meghan Quinn, General Manager, Macroeconomic Modelling Division

Budget Policy Division

Ms Luise McCulloch, General Manager, Sustainable Population Strategy Taskforce

Ms Jan Harris, General Manager, Budget Policy Division

Mr Jason Allford, Principal Adviser, Budget Policy Division

Commonwealth, State Relations Division

Ms Sue Vroombout, General Manager, Commonwealth State Relations Division

Social Policy Division

Ms Peta Furnell, General Manager, Social Policy Division

Mr Peter Robinson, Principal Adviser

Mr Chris Foster, Principal Adviser

Mr Damien White, Principal Adviser

Markets Group

Mr Jim Murphy, Executive Director, Markets Group

Mr Brad Archer, Acting General Manager, Infrastructure, Competition and Consumer Division

Mr Paul McBride, Principal Adviser

Mr Simon Writer, Manager

Mr Andrew Deitz, Manager

Mr Ian Laurance, Senior Adviser

Corporations and Financial Services Division

Mr Geoff Miller, General Manager

Ms Vicki Wilkinson, Principal Adviser

Ms Alix Gallo, Manager, Markets Integrity Unit

Mr Tim Beale, Manager, Investor Protection Unit

Mr Richard Sandlant, Manager, Financial Services Taskforce

Mr Mark Sewell, Corporate Reporting and Accountability Unit

Mr Christian Mikula, Manager, Consumer Credit Unit

Mr Daniel McAuliffe, Acting Manager, Governance and Insolvency Unit

Foreign Investment and Trade Policy Division

Mr Patrick Colmer, General Manager, Foreign Investment and Trade Policy Division

Mr Frank Di Giorgio, Principal Adviser

Financial System Division

Mr John Lonsdale, General Manager

Mr Justin Douglas, Principal Adviser, Banking Units

Ms Kanwaljit Kaur, Manager, Insurance Markets Unit

Mr Jonathan Rollings, Principal Adviser, Superannuation Unit

Australian Government Actuary

Mr Peter Martin

Mr Michael Burt

Standard Business Reporting

Mr Geoff Turner, Standard Business Reporting Management Group

Revenue Group

Mr David Parker, Executive Director, Revenue Group

Mr Paul McCullough, General Manager, Business Tax Division

Mr Geoff Francis, Principal Advisor, Business Tax Division

Mr Gerry Antioch, Adviser, Business Tax Division

Mr Mike Rawstron, General Manager, International Tax and Treaties Division

Indirect Tax Division

Ms Brenda Berkeley, General Manager, Indirect Tax Division

Mr Glen McCrea, Manager, Indirect Tax Unit

Tax System Division

Ms Christine Barron, General Manager, Tax System Division

Tax Analysis Division

Ms Maryanne Mrakovcic, General Manager, Tax Analysis Division

Mr Colin Brown, Manager, Costings and Quantitative Analysis Unit

Mr Phil Gallagher, Manager, Retirement and Intergenerational Modelling Unit

Mr Marty Robinson, Manager, Household Modelling and Analysis Unit

Mr Jyoti Rahman, Manager, Revenue Analysis Unit

Personal and Retirement Income Division

Mr Michael Willcock, General Manager

Mr Trevor Thomas, Principal Adviser (Superannuation)

Mr Tony Coles, Principal Adviser (Tax)

Indirect Tax Division

Mr Glen McCrae, Manager, Indirect Tax Unit

Board of Taxation Secretariat

Ms Brenda Berkeley, Secretary

Macroeconomic Group

Mr David Gruen, Executive Director, Macroeconomic Group (Domestic)

Mr Tony McDonald, General Manager, Macroeconomic Policy Division

Mr Steven Morling, General Manager, Domestic Economy Division

Mr Simon Duggan, Principal Adviser (Forecasting)

Mr Paul Flanagan, General Manager, International Finance and Development Division

Mr Bill Brummitt, General Manager, International and G20 Division

Australian Office of Financial Management

Mr Neil Hyden, Chief Executive Officer

Mr Michael Bath, Director Financial Risk

Mr Pat Raccosta, Chief Finance Officer

Mr Andrew Johnson, Head of Reporting

Mr Gerald Dodgson, Head of Treasury Services

Australian Taxation Office

Mr Michael D'Ascenzo, Commissioner of Taxation

Ms Jennie Granger, Second Commissioner

Mr David Butler, Second Commissioner

Mr Bruce Quigley, Second Commissioner

Mr Neil Olesen, Deputy Commissioner, Superannuation

Mr Shane Reardon, Deputy Commissioner, Indirect Taxes

Ms Frances Cawthra, Acting Chief Operating Officer

Australian Securities and Investments Commission

Mr Tony D'Aloisio, Chairman

Ms Belinda Gibson, Deputy Chairman

Mr Shane Tregillis, Commissioner

Mr Michael Dwyer, Commissioner

Productivity Commission

Dr Michael Kirby, Acting Head of Office

Dr Jenny Gordon, Principal Adviser Research

Dr Ralph Lattimore, Assistant Commissioner

Mr Ian Gibbs, Assistant Commissioner

Mr Alan Johnston, Assistant Commissioner

Inspector-General of Taxation

Mr Ali Noroozi, Inspector-General of Taxation

Mr Andrew McLoughlin, Deputy Inspector-General of Taxation

Australian Prudential Regulation Authority

Dr John Laker, Chairman

Mr Ross Jones, Deputy Chairman

Mr Ian Laughlin, Member

Mr Keith Chapman, Executive General Manager, Supervisory Support Division

Mr Charles Littrell, Executive General Manager, Policy Research and Statistics

Australian Bureau of Statistics

Mr Brian Pink, Australian Statistician

Mr Ian Ewing, Deputy Australian Statistician, Macroeconomics and Integration Group

Mr Garth Bode, Acting Deputy Australian Statistician, Social Statistics Group

Mr Denis Farrell, Acting Deputy Australian Statistician, Population, Labour, Industry and Environment Statistics Group

Mr Michael Belcher, Chief Financial Officer

Ms Gillian Nicoll, Assistant Statistician, Office of the Statistician

Mr Paul Lowe, Assistant Statistician, Population Census Branch

Mr Paul Williams, Acting First Assistant Statistician, Population, Labour, Industry, Environment Group

Australian Competition and Consumer Commission

Mr Graeme Samuel AC, Chairman

Mr Brian Cassidy, Chief Executive Officer

Mr Marcus Bezzi, Executive General Manager, Enforcement and Compliance Division

Mr Mark Pearson, Deputy Chief Executive Officer, Regulation

Ms Jo Schumann, Executive General Manager, Corporate Division

Mr Tim Grimwade, Executive General Manager, Mergers and Acquisitions Group

Ms Michelle Groves, Chief Executive Officer, Australian Energy Regulator

Mr Scott Gregson, Group General Manager, Enforcement Operations Group

Mr Nigel Ridgway, Group General Manager, Compliance Operations Group

Mr Michael Cosgrave, Group General Manager, Communications Group

Mr Adrian Brocklehurst, Chief Finance Officer

Dr Richard Chadwick, General Manager, Adjudication Branch

Ms Helen Lu, General Manager, People Services and Management Branch

Mr Sebastian Roberts, General Manager, Water Branch

Commonwealth Grants Commission

Mr John Spasojevic, Secretary Commonwealth Grants Commission

Mr Phillip Parkins, Director, Corporate Services, Commonwealth Grants Commission

CHAIR (Senator Hurley)—Good morning. 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 Innovation, Industry, Science and Research; Resources, Energy and Tourism; and Treasury portfolios. The committee has set Monday, 25 October as the date by which senators are to submit written questions on notice, and has set Friday, 10 December 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 document read as follows—

Public interest immunity claims

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)

[9.01 am]

Australian Competition and Consumer Commission

CHAIR—The committee will begin today's consideration of the Treasury portfolio with the Australian Competition and Consumer Commission and will then follow the order as set out on the circulated program. I welcome Senator Sherry, representing the Treasurer, and officers of the department. Minister or officers, would you like to make an opening statement?

Senator Sherry—I don't, Chair.

Mr Samuel— No, Chair.

CHAIR—Then we will go directly to questions.

Senator RYAN—Good morning, Senator Sherry and Mr Samuel. I want to turn to the issue of shopping centres and restrictive covenants. Are you aware of any restrictive covenants that still exist in shopping centres with respect to supermarkets?

Mr Samuel—To the best of our knowledge, there is one, and it relates to the Civic Centre in Canberra. Sorry, I should be a bit more accurate than that—I need to give you a bit of background. During the course of our grocery inquiry we established that there were, I think, something like 757 leases that included some of form of restrictive covenant, primarily in favour of Coles and Woolworths. They related to shopping centres and shopping malls around Australia. We negotiated an outcome with Coles and Woolworths whereby essentially the totality of those restrictive covenants were removed or to be removed. I say 'to be removed' in respect of those covenants that had been entered into within a five-year period of the agreement, and there was a five-year phase-out period of those covenants. So they all went.

Having dealt with the Coles and Woolworths restrictive covenants we then went to other supermarket and grocery outlets and said that we considered that the same thing needed to apply there, and we obtained undertakings from the Metcash group in respect of IGA, from

the Supa group, from Franklins, FoodWorks—right across the board—to remove all restrictive covenants, and they have all undergone similar undertakings. The only one we have not been able to have removed at this stage is that held by Supabarn in the Civic Centre in Canberra city, and that is a matter of ongoing investigations.

Senator RYAN—So your discussions with Supabarn are ongoing?

Mr Samuel—Yes, that is right.

Senator RYAN—With an aspiration to remove the covenant?

Mr Samuel—Let me simply say, as it is an ongoing investigation and it is not our practice to talk publicly about investigations, suffice to say that this is the only restrictive covenant that I am aware of where the covenant is still in force, and it would seem that the beneficiary of the covenant, which is the Supabarn group, has not indicated at this stage a willingness to release the covenant. That has some issues for us in terms of competition, but that is a matter that is part of an ongoing investigation.

Senator RYAN—The uniqueness of this situation is simply that it is the sole one left and you are still in process with the beneficiary?

Mr Samuel—That is correct, yes. It is the sole one left—aside from those that are still going through that transitional five-year phase, which is now getting to our last two years or thereabouts. They will gradually phase out completely.

Senator RYAN—Is it your view that such a restrictive covenant is of significant benefit to the beneficiary?

Mr Samuel—So far as the beneficiaries like to keep them in place, you would have to assume that they consider that they have a benefit. Any form of restrictive covenant has the potential for an anticompetitive consequence in that it restricts the ability of competitors to negotiate with landlords for entry into shopping malls and shopping centres and provide a competitive offering, which ultimately then is for the benefit of consumers.

Senator RYAN—Have you been approached by anyone who would be interested in opening a store in the area covered by this covenant?

Mr Samuel—You are testing my memory and knowledge on this a little bit. I understand that there have been approaches made to the landlord of that centre and/or adjacent areas where there might be some expansion for entry but that the restricted covenant has prevented the entry occurring.

Mr Gregson—It is certainly the case that we are aware of approaches having been made to the landlord in that matter.

Senator RYAN—If the operator sold the store, Supabarn, is the covenant transferable or does that purely depend on the terms of the sale? There is no law against it being transferable?

Mr Gregson—The leases in these matters are publicly available. They are on the register. My understanding of the transferability of terms and conditions would depend on the agreement as to how you transfer those matters.

Senator RYAN—I understand—and please correct me if I am wrong, because I have been briefed on this—in December last year, following proceedings undertaken by the ACCC, it

was found that Stores Online failed to comply with undertakings provided to the ACCC. I understand there have been media reports that Stores Online continued to trade in Australia following December 2009 and your finding that it failed to comply with undertakings it gave to you. Are you aware of that?

Mr Gregson—The nature of the ACCC's actions have actually been some interaction with Stores Online for a period of up to five years involving negotiation of various undertakings and indeed court proceedings. The court proceedings you refer to relate to, as you point out, allegations of failure to comply with earlier undertakings given to the ACCC. Those undertakings did not require a cessation of trading per se but required certain terms and conditions to be applied when trading—for example, when holding meetings to give advanced notice to the ACCC, to give various warnings at the start of those meetings and to refrain from certain representations. That was the nature of the court action that concluded in December 2009.

Senator RYAN—So Stores Online are still trading in Australia?

Mr Gregson—I am not aware. The nature of the trading of Stores Online has been one of entry and then departure from the country depending on the phase of it is marketing operations around the world. We are not aware of current meetings that are going on, at least I am not. I am not sure if my investigation team are aware.

Senator RYAN—There is a Stores Online refund scheme in operation at the moment, isn't there?

Mr Gregson—Ancillary to the resolution of the court proceedings in December 2009 was an arrangement whereby there would be an amount of money provided to the ACCC to contribute to refunds to the claimants.

Senator RYAN—That is currently in operation, isn't it?

Mr Gregson—That scheme is currently being administered, yes.

Senator RYAN—I understand that is being administered by Stantons International, which was charged by the ACCC with administering the scheme.

Mr Gregson—That is correct; we engaged Stantons.

Senator RYAN—Is it usual for the ACCC to engage an external consultant or provider to undertake these tasks?

Mr Gregson—Certainly it is not uncommon for us to use external providers for a number of reasons.

Senator RYAN—Is it on a case-by-case basis? When you said that it is not unusual that does not surprise me but do you have a set of criteria as to who you chose and whether you do it in house or choose an external provider?

Mr Gregson—It very much is on a case-by-case basis as to exactly how we may administer form of refunds, compensation or otherwise. Invariably there will be involvement by our lawyers where it has resulted from a cessation of a court matter or a formal resolution through undertakings. I note that we are required to comply with the FMA Act in terms of the

processes we go through for engagement. In this case we certainly sought tenders from another party.

Senator RYAN—So you sought tenders for the operation of this one?

Mr Gregson—Correct.

Senator RYAN—I have been informed of a particular person who approached Stanton for a refund under the Stores Online refund scheme. This person was notified by airmail on 23 September this year that the process will be completed by the end of September 2010. I understand Stanton has provided its final list of claims to the ACCC. I was just wondering when can claimants expect to be notified of the status and then paid?

Mr Cassidy—You have not named the particular party so neither will I but I would have to say to you that some of what that party is saying is factually wrong in terms of timing and what she has been told. You are correct that Stanton have provided us with the list of ‘refundees’, if I can call them that. Subject to us checking a few issues about that list, which Stanton have raised, we will provide the list to our lawyers in this case Corrs Chambers Westgarth, who are actually holding the funds. Corrs will be making the payments. I expect that will happen in the next few weeks.

Senator RYAN—I will just read the two sentences from the email that this person received from Stanton on 23 September:

Stanton International is currently processing all applications and supporting documentation and conducting follow-up queries. We anticipate that this process will be completed by the end of September 2010.

That is accurate.

Mr Cassidy—Yes, but that is the processing. That particular person, we are aware, is making claims that she was told payments would be made within a certain timeframe. Her initial claim was that she was told that they would be made within two weeks of mid-August. She has simply not been told that. There may be some misunderstanding but she has not been told a time for payments. There may be some misunderstanding of that email but Stanton are only doing the processing. They will not be doing the payments. The payments will be made by Corrs, our solicitors.

Senator RYAN—They will be done over the next few weeks, you said.

Mr Cassidy—Yes.

Senator RYAN—Are they being made on a pro rata basis? I am not as familiar with this case?

Mr Cassidy—Yes, they probably will be pro rata. We have a certain amount of money and we have a certain value of claims and, as I said, we are still assessing what we have got from Stanton. Then, of course, the money needs to match up with the value of the claims that are paid out.

Senator RYAN—Could ask you to take on notice how many claims were submitted?

Mr Cassidy—Yes. Let us take that on notice. You realise that it is a bit difficult, now, to provide the details—

Senator RYAN—I appreciate it.

Mr Cassidy—but certainly once we have it all resolved, which I suspect will be within the timeframe of responding to questions on notice, we will happily provide you with the details.

Senator XENOPHON—In relation to grocery prices, is the commission aware of media reports from a senior officer of the US supermarket retailer Costco who asserted that Coles and Woolworths are allegedly taking every opportunity to oppose the expansion of Costco?

Mr Samuel—Absolutely; yes.

Senator XENOPHON—Has the commission done any work on the possible competition impact of parcels of land or land banks held by different supermarket chains?

Mr Samuel—There are three elements to answer this in full, so let me just cover them. The first relates to the issues that Senator Ryan asked relating to restrictive covenants. In our grocery inquiry we indicated that, in terms of shopping malls and centres, the restrictive covenants were an impediment to competition and need to be removed. Let us put that to one side. We then have the issue of green field sites—that is, acquisition of green field sites for competitors to be able to open up stand-alone supermarkets and/or supermarkets that might be part of shopping parks rather than being in substantial shopping malls or centres. In the course of the grocery inquiry, Coles and Woolworths went on the record to say that they did oppose applications by competitors to open up, including by Coles or Woolworths themselves, green field sites. They did that in their commercial interests—they were quite open in so saying. Our recommendation in the grocery inquiry was that local and state planning laws and planning authorities needed to address this issue in the interest of competition, which was ultimately in the interests of the consumer, and to place competition issues as a paramount factor in dealing with planning applications. I am well aware of the Costco issue; in fact, I was asked to comment on it publicly.

Senator XENOPHON—Would it be fair to say that state planning authorities in some instances have been dragging their feet in relation to this very issue the commission is concerned about?

Mr Samuel—Certainly it is fair to say that there has not been encouraging response from state planning authorities following our grocery inquiry report, which was issued in July 2008. It is now two-and-a-quarter years since then. This is the issue—and I said this in public comments following the Cosco statement; along these lines: first of all, planning authorities, aside from dealing with issues of ambience, the environment and travel control, we have urged ought to be looking at competition and the interests of consumers as their paramount concern in looking at the development of land for potential competition, particularly in the supermarket grocery area. That is number 1. Number 2: you would expect that competitors would put in—either openly in their own name or by using alternative spokespersons—objections to developments that might be in competition to their existing outlets. But the real issue is for planning authorities to treat those objections with the lack of credibility that they may deserve, and that fundamentally goes back to the issue of putting competition and the interests of consumers foremost.

Senator XENOPHON—But in the absence of state planning authorities acting in the interests of consumers, would you agree that the Commonwealth does have the power to step

in cases like that. It could use, for instance, the corporations power with respect to such applications. Technically, the Commonwealth could get involved.

Mr Samuel—You are asking me constitutional questions—the last time I studied constitutional law was about 40 years ago at law school. So I am afraid I cannot give you an answer on that one.

Senator XENOPHON—It is about 30 since I did it, I think.

Mr Samuel—Yes, I have slightly less and more grey hair than you, Senator.

Senator XENOPHON—Can the commission update the committee on its review of the Metcash proposed acquisition of Franklins? Has it formed any preliminary views or concerns with respect to that proposed acquisition?

Mr Samuel—The public iteration on that is that we have a put out a statement of issues that raised some competition concerns. To this point in time we have not taken any further decisions on that matter or given it any further consideration at commission or at the merger review committee level. Mr Grimwade, who heads up the MA may want to elaborate.

Mr Grimwade—There is really not much more to say. The commission has indicated, in the statement of issues, preliminary concerns with the proposal, and in particular with the potential removal of a competitor to Metcash in the wholesale supply to independent retailers. We are in the midst of what we would identify as a second phase investigation. The decision date for the commission's final decision is 11 November. That date can always shift depending upon whether the parties delay providing the commission with information.

Senator XENOPHON—I want to rush on with a couple of other issues. I have written to the commission about this matter. In May 2010 Drake Supermarkets, which is a South Australian based company, opened a new store in Caboolture in Queensland. Within a week of opening Coles placed 10 per cent discount vouchers on the windscreens of the cars parked in the Drake supermarket car park. The offer was valid for three weeks, but only for the three Coles supermarkets in the immediate vicinity, as I understand it. We have corresponded with the ACCC and the ACCC's view was that there was not enough evidence to prove that this was an act of predatory pricing. Given that the voucher was only promoting discounts at stores in the immediate vicinity, it was not a state-wide discount, does the ACCC consider that that offer was done with the intent of taking away business from Drake, and in a sense to harm it because an across the board 10 per cent discount was not something that presumably would be sustainable across the whole state?

Mr Bezzi—I am not familiar with the particular matter you have raised—

Senator XENOPHON—There has been correspondence with the commission about it.

Mr Bezzi—Certainly, but speaking in general terms there are elements that we would need to satisfy in considering any predatory pricing issue. The amount of time the offer is open would certainly be a critical element. Let us assume that the 10 per cent meant that the offer involved the sale below cost by Coles—and that is a big assumption but let us assume that. The issue would be whether or not the month was a period that meant that they were in breach of the law, and I suspect that a month might be a bit too short.

Senator XENOPHON—I think Mr Drake probably would have been able to cop it if it was across the whole state, but it was just for those three supermarkets in his area. Perhaps the commission could get back to me in relation to that. The final line of questioning I have relates to a recent Supreme Court of New South Wales decision which I have been contacted on which involved Inak, Kay and Canli against the NAB. That was a case involving borrowings of about \$1 million in 2003 from the NAB. There were conditions fixed for that loan. The allegation in the Supreme Court was that there were issues of default interest and whether the parties were misled by the bank. The New South Wales Supreme Court recently found that the NAB was in breach of its contract, saying it was involved in false, misleading and deceptive conduct, according to the wording of the judgment as I understand it, and there was an award of \$280,000 in damages. As I understand it, the parties wrote to the ACCC asking what it would be doing about this in the context of a finding of false, misleading and deceptive conduct, and they received a response that the commission was not able to take this matter further. What are the protocols when there has been a Supreme Court decision saying that a bank has engaged in false, misleading and deceptive conduct? I would have thought that, itself, would have alerted the ACCC to a potential action against the bank.

Mr Cassidy—There are two issues. Firstly, there is a double jeopardy point—

Senator XENOPHON—Is there, though? Does double jeopardy apply in a case such as this? Is there a formal issue of double jeopardy?

Mr Cassidy—I think there is, though I would need to look to the lawyers. Let me go to the second point, which will not have me looking to lawyers. The jurisdiction for that would actually be ASIC, because it would be a financial transaction—a potentially misleading and deceptive conduct in a financial transaction. It would be ASIC—there is a carve-up so that we do not deal with consumer protection in relation to financial matters.

Senator XENOPHON—So they should have sought advice or assistance from ASIC in that case?

Mr Cassidy—That is correct. I just go back to my first point—I am not sure how much comfort they would get from ASIC given there is a court-based outcome.

Senator XENOPHON—In terms of general principals, if there is a finding in a court of a potential breach of the Trade Practices Act, for instance, and there has been a determination made or damages awarded, so there is a civil remedy, are you saying that will preclude the ACCC from being involved in cases where the parties may have got remedy in damages, for instance, but there are other issues in terms of the behaviour of the entity that has been found to have breached, for instance, the Trade Practices Act?

Mr Bezzi—If the same relief is being sought as was sought in relation to the same conduct, it is very unlikely that we would also be able to seek relief. If there was a difference in the conduct or if we were not covering the same area as was dealt with in the earlier proceedings then there may well be some scope for us to take something on.

Senator XENOPHON—I do not want to labour this point because I know there are a lot of other questions to come, but if there is an issue where there is a civil remedy in terms of damages but there has been a breach of the act which indicates perhaps a systemic issue on the part of the entity that has breached the act then isn't there a clear distinction between in a

criminal prosecution if you like and a civil remedy that has been sought by individual parties in the civil courts?

Mr Bezzi—This is not an easy area to give you a quick response on. If you are talking criminal prosecutions then whether or not to launch a criminal prosecution is a matter for the DPP. They will look at whether it is in the public interest to do so. If there has been a finding by a court and relief given then that would be a factor that is taken into account in deciding whether or not there is a need to then take on a criminal prosecution. That is not something we would make a decision about.

Senator XENOPHON—Sure, and I appreciate what you have said about the complexity of this. Could I get something on notice from you in terms of: what are the protocols and criteria for determining whether you go further?

Mr Cassidy—You referred to systemic behaviour. I do not want to comment on a specific case—

Senator XENOPHON—I am not suggesting it is a systemic in this case.

Mr Cassidy—Let me say that in this sort of situation if there were indications that the behaviour had been going on for a while, and it may be behaviour by other entities as well, then we would not necessarily launch our own case to seek remedy. Nonetheless it is something that we may well take on in terms of keeping an eye or a watch on—

Senator XENOPHON—In due course, could you provide the committee with something on that. I think it is an interesting area about where do you intervene?

Mr Cassidy—We will take that on notice.

Mr Samuel—I think it is also worth noting that, until April this year, the launching by the ACCC of a separate action in respect of what has already been declared, for example, by another court to be misleading and deceptive conduct would have little consequence in terms of remedy because of course a civil action has never permitted the award of penalties by the court. So the most that the ACCC could achieve would be a similar declaration of misleading and deceptive conduct, an injunction that it should not occur in the future and maybe some corrective advertising and a compliance program to be installed in the corporation concerned. But the obtaining of a remedy of either further restitution in terms of damages and/or a penalty would not be available.

Senator XENOPHON—Compliance could be important though. If you could take that on notice, that would be appreciated.

Senator PRATT—I have a question in relation to the increased promotion of commercial technologies that purport to assess women for early signs of breast cancer. There are a number of technologies that have gained a particular foothold in the commercial breast-imaging market. These are things like electrical impedance, mechanical imaging and thermography. From what I have been told by experts, it does appear that there is no sound scientific evidence to demonstrate that these technologies detect breast cancer or reduce breast cancer deaths. But there are a number of people in Australia commercially advertising and marketing these products. I know that you have received at least a couple of complaints about commercial breast-imaging technologies and that there have been calls for the investigation of

commercial operators for misleading and deceptive conduct and the making a false representations in relation to these false diagnostic technologies. So I would like to ask you as my first question: what progress has been made on these complaints?

Mr Gregson—Yes, as you alluded to the ACCC has received an approach by a body in relation to certain operators engaging in practices that you have referred to. We are aware that certain remedial steps have been taken, perhaps in light of interest from other regulators in the field. We are continuing to look at that and to work with the persons who have raised it with us to get to the bottom of it.

At the same time we are also aware of media reports that I think you also alluded to about potentially other traders. The ACCC is interested in looking at that perhaps and further communication with the other regulators involved in this area, including the TGA, who have responsibility for a number of the specific health regulations in this space. If, senator, what you are after is a commitment as to our interest and that we are following those matters up then I can give that.

Senator PRATT—Does the ACCC consider that these issues have sufficient gravity to warrant a broad ACCC investigation into the industry? You could use part V, Consumer Protection, of the Trade Practices Act, for example.

Mr Gregson—Certainly. It is those sections and provisions of the act that are obviously the lenses through which we are looking at these matters. You might appreciate that they have come to us relatively recently, and we need to get the facts and information as to the conduct out there and the technical and health issues, together with discussions with other regulators on the best way to approach those issues.

Senator PRATT—How does the ACCC, in a general sense, deal with issues of misleading marketing? A range of health marketing takes place. It could be anything from fat reduction to hair removal. But in this instance we are talking about diagnostic tools for serious cancers and giving people false confidence that they might have a lump in their breast when indeed it is not likely to be a cancer, or they might have a cancer that goes undetected by these technologies. How does the ACCC structure its approach to these medical issues?

Mr Cassidy—Again, Mr Gregson might want to respond, but let me say that, as a general approach, we place a very high priority on what is alleged to be misleading and deceptive conduct based on health issues. We have taken several cases against people purporting to have cancer cures and cures for other serious illnesses. These people are basically preying on people who are very vulnerable, so we do accord those a very high priority in our enforcement activity. I do not know whether Mr Gregson wants to say any more.

Mr Gregson—Other than to note that we do have a compliance and enforcement policy that assists us in determining the types of matters which we do intervene in. I also note that a large number of consumer issues come to our attention. In relation to health matters and perhaps misrepresentations about health cures, we place significant weight on potential damage to consumers. The scenario which you referred to where consumers may be induced to cease traditional treatments or perhaps more contemporary medical treatments for those being promoted raises our antennae of concern. That has certainly been apparent in a number of recent actions, as Mr Cassidy referred to. I note, for example, in recent court actions

against allergy matters that we took to court, the court was particularly concerned about that particular issue. We have just recently instituted further proceedings in that space, including contempt proceedings in relation to an earlier allergy matter. That is a particular issue that we focus upon when we are deciding which matters to get involved in.

Senator PRATT—In the instance of commercial breast imaging, is it likely that the course of action that you might look to could include substantiation notices to interrogate advertising and marketing claims made by the industry, or could it include public warning notices to warn of the potential of widespread consumer detriment? And is there any likelihood in terms of investigating the potential for harm associated with commercially offered breast imaging devices for a recommendation specifically to recall such devices so that they are no longer in public use?

Mr Cassidy—It could include all of those and probably a few more things, depending on where we get to. You understand if we perhaps do not want to say too much about exactly where we are in looking at the issue or, indeed, what action we might take, because that takes us into a realm where we normally do not go in talking about ongoing matters which are yet to reach finality.

Senator PRATT—Thank you very much.

Senator BUSHBY—I thank the ACCC for coming along and helping us today. It is our understanding that the NBN Co. will submit an access undertaking to the ACCC outlining its price and non-price terms and conditions of access to its network. Can the ACCC outline how many staff it has dedicated to assess the NBN undertaking?

Mr Samuel—Mr Cosgrove will address that issue, Senator.

Mr Cosgrove—The ACCC has a dedicated team of about six to seven officers engaged, amongst other things, in the negotiations and discussions with NBN Co. around an access undertaking.

Senator BUSHBY—When you say ‘amongst other things’, they are also working on other matters as well, or are they solely focused on NBN Co., but other aspects of the NBN Co.?

Mr Cosgrove—The latter, Senator.

Senator BUSHBY—Okay. Given that the undertaking has not yet been submitted—that is correct isn’t it?—

Mr Cosgrove—That is correct.

Senator BUSHBY—what are they actually doing then?

Mr Cosgrove—The terms and conditions of an access undertaking involve negotiations and discussions around a wide range of factors that lead to the determination of what might be a reasonable access price. They would include discussions around approaches to such things as cost of capital, prudence measures for future investment and a range of other factors. As you would appreciate, with a substantial access undertaking such as this, there are very detailed discussions going on about possible approaches to those issues to assist NBN Co., as we do with any access provider in relation to what might be a red light for the ACCC. That is the nature of the discussions going on at this time.

Senator BUSHBY—With other access providers, you would also look at dedicating staff to assisting them in their preparatory work for putting in an undertaking?

Mr Cosgrove—Certainly. We have done that over the life of the current regime, principally with Telstra, for many years.

Senator BUSHBY—So, essentially, what you are saying is that they are doing preparatory work to assist the NBN Co. to put together its undertaking—

Mr Cosgrove—That is correct.

Senator BUSHBY—in a form that will comply, essentially?

Mr Cosgrove—In a form that we can assess as to whether it is reasonable in the terms of the act, yes.

Senator BUSHBY—The ACCC would be aware that the government has released an implementation study into the NBN? As the regulator of the NBN, is the ACCC of the view that the implementation study has sufficiently addressed regulatory concerns, especially in regard to third party access and regulatory gaming?

Mr Cosgrove—The ACCC has provided some advice to government in relation to the implementation study.

Senator BUSHBY—Has that advice been publicly released?

Mr Cosgrove—No. Those are matters that in the ordinary course we would provide some views on to government—

Senator BUSHBY—Who was the advice provided to?

Mr Cosgrove—The advice has been ongoing on a range of issues. The issues raised by the implementation study are broad. There has been ongoing advice primarily to the policy department of the Department of Broadband, Communications and the Digital Economy about the ACCC's views on a range of matters raised by the implementation study.

Mr Samuel—I think, Senator, your question was: 'Does the implementation study cover the field in respect of access issues?'

Senator BUSHBY—That is right.

Mr Samuel—And I think, as Mr Cosgrove explained, the SAU, the special access undertaking, is the area where the access issues will be dealt with. I do not think it has ever been our view that the implementation study was intended to cover the third party access issues. That will be dealt with under a much more detailed study which we will undertake in respect of the SAU.

Senator BUSHBY—Okay. What are the ACCC's views regarding the recommendation that NBN be permitted to increase its wholesale price in real terms each year? How would such an approach sit with the history of telecommunication pricing in Australia in the period since competition began in the early nineties?

Mr Cosgrove—Those are matters directly relevant to an undertaking that may be put to us.

Senator BUSHBY—The undertaking has not been put to you yet, so it is not a matter before you.

Mr Cosgrove—That is so, but it is a matter clearly on which we will have to make some judgment around the prices submitted by NBN.

Senator BUSHBY—Under section 152AH of the Trade Practices Act, the ACCC will be required to have regard to NBN Co's direct cost of providing broadband services in assessing NBN's access undertaking. Is the ACCC of the view that a proper economic costing of the NBN is required if an undertaking submitted by NBN Co is to pass the direct cost criteria of section 152AH of the Trade Practices Act?

Mr Cosgrove—It is not a matter to which we have given direct consideration in the course of any undertaking.

Senator BUSHBY—Is it something that you will be looking at?

Mr Cosgrove—Senator, you have correctly recited one of the elements of the reasonableness test under which we will have to assess the undertaking, that is correct.

Senator BUSHBY—In the normal course of events, you will look at proper economic costings of the NBN?

Mr Cosgrove—You would look at the direct costs of the access service provided by that access provider, yes.

Senator BUSHBY—Under the same section, the ACCC has routinely used a total service long-run incremental cost methodology to determine service costs in the telecommunications sector and a weighted average cost of capital in other capital intensive sectors. Does the ACCC accept that an internal rate of return is an appropriate methodology for assessing NBN Co's direct costs?

Mr Cosgrove—In relation to the total service long-run incremental costs, which is the costing approach we have adopted for fixed line telecommunications for some time, we have moved away from that approach in our latest assessment of indicative prices in that service for Telstra services.

Senator BUSHBY—What have you moved to?

Mr Cosgrove—We have moved more towards a regulated assess base and a building block approach, which is the same approach we take in the energy sector. It would be unlikely we would apply the total service long-run incremental cost approach.

Senator BUSHBY—But you have not moved to an internal rate of return approach either, have you?

Mr Cosgrove—No, we have not.

Senator BUSHBY—So the approach you have moved to is likely to be the approach you will take in assessing the NBN Co undertaking?

Mr Cosgrove—The approach we take on a regulatory task is a different task than assessing the internal rate of return of a company, that is correct.

Senator BUSHBY—Will the approach you just mentioned be the approach you would apply in this case?

Mr Cosgrove—It is certainly one of the approaches we are highly likely to consider given we have moved away from our previous approach of pricing fixed networks. So the answer is yes.

Senator BUSHBY—Is the ACCC's view that were it to adopt an internal rate of return methodology—and I understand you said that that is not where you are moving to—that it would satisfy the statutory obligations to assess NBN's costs under part excisee?

Mr Cosgrove—I think I said that it was a different task of assessing what is reasonable in terms of access pricing to determining the internal rate of return.

Senator BUSHBY—You have not actually said it but would you agree that an internal rate of return method is not the appropriate way or would not satisfy the requirements.

Mr Cosgrove—It is a different task.

Senator BUSHBY—Yes, it is a different task but in terms of what you were required to do under that section, that would not be sufficient.

Mr Cosgrove—No. I will say it again because it is the same answer: it is not the same task in assessing what are reasonable terms and conditions of access to determining what a company's internal rate of return should be.

Senator BUSHBY—So you would require a different assessment to be able to complete—

Mr Cosgrove—As we currently do with all access services in telecommunications.

Senator BUSHBY—Would you agree that an internal rate of methodology would not appropriately account for NBN's direct costs taking into account its debts and equity levels, risk profile and market risk premium?

Mr Cosgrove—It is not a matter we have considered.

Senator BUSHBY—Does the ACCC believe that a return of 6.3 per cent is likely to reflect NBN Co's capital and debt costs given that the ACCC's own modelling assessed Telstra's post tax weighted average cost of capital at 8.83 per cent and the Australian energy regulator adopts a market risk premium of 6.5 per cent?

Mr Cosgrave—It is not a matter currently before us, although—

Senator BUSHBY—Is it something that you will look at in the course of your assessment?

Mr Cosgrave—It is not absolutely clear that that would raise its head under our assessments of direct costs. It may do so. We would have to consider that at the time.

Senator BUSHBY—The NBN implementation study clearly indicated that 6.3 per cent is an appropriate rate of return for NBN Co. Was the ACCC consulted at all on the rate of return before the implementation study was released?

Mr Cosgrave—I do not believe so.

Senator BUSHBY—You do not believe so or are you sure of it?

Mr Cosgrave—I do not believe so.

Senator BUSHBY—Would you mind taking it on notice and checking?

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

Senator BUSHBY—Is the ACCC concerned that the government's financing of NBN Co., based on a rate of return that is at best only marginally above the long-term bond rate, will provide it with an unfair and potentially anti-competitive price advantage for some or all of its services in geographic markets?

Mr Cosgrave—Again, that is not a matter that we have directly considered. As I say, the government is still to respond to the implementation.

Senator BUSHBY—Is that something that you will look at?

Mr Cosgrave—Only if it becomes a matter of relevance to us in assessing an access undertaking by NBN Co. Otherwise it would not be a matter for us.

Senator BUSHBY—The issue of the government financing the NBN Co. at a low rate, potentially giving it a competitive advantage over competitors, is not something of relevance to the ACCC's responsibilities?

Mr Cosgrave—It is a matter that people may raise with us in the course of our assessment of the access undertaking.

Mr Pearson—Across the industries that we deal with—for example, in energy—there are a lot of state identities and government identities. We have ways of assessing on a benchmark basis. With NBN, questions will come up, such as: 'Who are the competitors?', 'Is there a competitive environment?' and 'Is it a natural monopoly?' But when you are looking at the internal rate of return, as Mr Cosgrave was saying, that is a different conceptual financial issue to the weighted average cost of capital. It is not against somebody. There is no rule that says somebody could not bring in an assessment and therefore an undertaking in any sector that we regulate using the internal rate of return. But when you assess an IRR you get positives and negatives. They can move up and down over the period when you are looking forward. With a weighted average cost of capital, we are actually making a determination to assess returns of and on capital given the risk profile of the business. It is a different conceptual process financially. It is very difficult, almost impossible, to compare or contrast to the two in the sense that you would use one rather than the other. I think that is what Mr Cosgrave was saying.

Senator BUSHBY—I do not disagree at all, but basically the only option the public has at the moment in terms of assessing the NBN Co. is through the internal rate of return and I would have thought that there are far more appropriate ways of actually assessing the cost benefit of a project such as this. I am interested in hearing the way that you will be approaching it. I do not disagree at all with what you have just said—that there are probably better ways of looking at it and that is how you will approach it when you do your assessment.

Mr Pearson—Of course, ours is not a cost benefit—

Senator BUSHBY—I know that. I am about to ask you questions about that. As my previous questions demonstrate, the work of the ACCC involves analysis of the NBN against financial criteria over a long period. Such an analysis would constitute a large part of a full social cost-benefit analysis, which would include other effects—for example, externalities like third-party effects, including environmental effects. Given you no doubt feel that the

ACCC can do its analysis—and I do not think anybody here would disagree with your ability to do that—why has Mr Samuel been reported as saying that the social cost-benefit analysis of the NBN is a ‘crystal ball gazing that cannot be done’? Do you feel that the ACCC’s analysis is crystal ball gazing?

Mr Samuel—I am pleased that you have raised that because the reporting of my comments in *Business Spectator* in an interview I gave there were, I must say, somewhat frustrating and almost bewildering. The report that came out and then started to gather currency in the days following the publication of the *Business Spectator* interview was that I did not think that a cost-benefit analysis was needed. Anyone that reads the *Business Spectator* will see that that clearly was not the case.

What I indicated was that I had a concern in the business community that there was confusion occurring between the need for the establishment of a business case, which is, as you have observed, a private cost-benefit analysis and, on the other hand, a social cost-benefit analysis. I am not going to take too much of the time of this committee to repeat verbatim what was in the *Business Spectator* article, but perhaps the excerpt of what I exactly said could be repeated and incorporated into *Hansard*, because I think that it is very important that the record be set straight.

I was endeavouring to establish the difference between a business case, which, as I observed, has been publicly stated by Mr Quigley CEO of NBN Co, is being prepared and will be submitted to government. Then it is a matter for government as to the extent to which that business case is made public, and I noted a comment by Mr Conroy the other day that elements of it will be subject to some issues of commercial in confidence.

A business case is of course different from a social cost-benefit analysis and, as you observed, a social cost-benefit analysis is a far more complex exercise. The use of the term ‘crystal ball gazing’ was in fact the words used by a particular journalist in the *Australian* newspaper, who wanted to try to get ‘crystal ball gazing’ into his story. That was the story headlined: that the ACCC chief, I think, does not consider a cost-benefit analysis is needed.

That is not what I said at all. What I said was that a cost-benefit analysis is very complex indeed, and I observed in the *Business Spectator* column that there are two elements of a social cost-benefit analysis which go beyond the business case. The business case assesses, of course, cash flows, revenues, capital cost, operating expenditure and return on investment—all the sorts of things that you have been discussing with Mr Pearson and Mr Cosgrave up until now. But a social cost-benefit analysis involves in this context two additional elements, amongst a whole range of others. One of them of course is the social investment that we have traditionally made in Australia, having regard to the enormous geographic spread of the country and the demographic dispersal of our population. Therefore we make significant investments that would not in the ordinary course satisfy a normal business case, in the business community sense of the word, for investment in rural and regional Australia. That is a recognition of the nature of our demographic spread in this country and the dispersal of our population and the recognition of a significant contribution that rural and regional Australia, and those that live in rural and regional Australia, make to the social and economic fabric of this country.

There is another element of it of course. When you do a social cost-benefit analysis you need to make a number of assumptions as to both the cost and, more importantly, the ultimate social benefits that will flow from a particular project. As I observed in the *Business Spectator* interview, when you are dealing with technology and the technological changes we are dealing with in the context of broadband and communications I defy anyone to be able to give you a prognosis as to the benefits that would flow from high-speed broadband networks and the installation of a new system. It is very difficult to go out five years, let alone the 50- to 60-year lifetime of the project concerned.

The other thing I would like to have incorporated into *Hansard* as part of my evidence—and I do not want to take too much of your time on this—is the note I have here on social cost-benefit analyses and what they are all about. One paragraph says:

Even if there is general agreement about how to define and measure the ‘with and without’ project scenarios, including the measurement and evaluation of intangible social costs and benefits, it may still be difficult to obtain suitable data with which to estimate social costs and benefits. If data are inadequate, assumptions or the use of proxies may be needed to ‘fill-in’ the data gaps. These assumptions and proxies may affect the findings of a social cost benefit analysis.

Then I continue as follows:

Social cost benefit analysis is a conceptually simple, theoretically sound technique that can be used to evaluate public projects. However, it can be difficult and costly to apply in practice. This is because adequate data is seldom available with which to value social costs and benefits. Furthermore, it will inevitably be necessary to make choices and assumptions which may affect the findings of a social cost benefit analysis.

Then I conclude with the following:

Given the likely disagreement and controversies about how to conduct the various steps of the social cost benefit analysis, it is very important that a social cost benefit analysis is tested to ensure that its results are not overly sensitive to the key assumptions and choices made. If the magnitude or sign of net social benefits changes significantly when different assumptions or discount rates are used, then the findings of a social cost benefit analysis will be treated with scepticism.

That was the point of the interview that was given to *Business Spectator* and you will find in that interview that I tried to make that very point.

Senator BUSHBY—Thank you, Mr Samuel.

Senator FAULKNER—Just on that point, before Senator Bushby continues, it is a matter for the committee whether they incorporate the material, Mr Samuel. I am not a member of the committee; I am just a visitor here. I would like to be clear on one thing: did you take steps to correct the record in relation to what you have outlined? By the way, welcome to our world. Could you very briefly give the committee an indication, before they consider the issue of incorporation, of what or any steps you took—and I assume you did—to make sure the record was correct?

Mr Samuel—The frustration of it all is that the only journalist that actually reporting on this in print was from the *Australian*. He rang me—this was the only interview I gave on the subject, beyond *Business Spectator*—and said, ‘I understand that you do not think there is any need for a cost-benefit analysis’ and I said: ‘No, that is not correct. Let me make it absolutely

clear that that is not what I said. Have you read the *Business Spectator* interview? In that it says that I detected confusion of the issues emerging in the business community between what is known as a private cost-benefit analysis and the social cost-benefit analysis.' Let me make absolutely clear: I did not say in the *Business Spectator* interview—

Senator FAULKNER—You are unhappy with the reportage in the *Australian* newspaper, is that right? Did you write a letter to the *Australian*?

Mr Samuel—No, I did not. As you say, 'Welcome to the world.' You have been in the public life for some 20 or 30 years and if you spent all your time trying to correct reporting—

Senator FAULKNER—It depends on how aggrieved you are, of course. Anyway, I just wanted to get that clear. It is a matter for the committee as to how they deal with the incorporation of these matters. I will not proffer a view on that.

Senator BUSHBY—I take it from your statement that what you are trying to tell us is that you do support the need for a cost-benefit analysis for a project such as the NBN, but that the difficulties of accurately conducting a full social cost-benefit analysis make that a less worthwhile exercise?

Mr Samuel—Whether or not I support the undertaking of a cost-benefit analysis is not relevant. That is a matter ultimately for—

Senator BUSHBY—But you have made a statement that it is not the case that you think that a cost-benefit analysis is not needed. There are two negatives in there which make a positive. Does that mean that you—

Mr Samuel—Let me make it absolutely clear what I said, because I want to make exactly the same point that I tried to make to the reporter from the *Australian*. I did not say that a cost-benefit analysis is not needed. What I did not then go on to say is that one was needed. I was very clear in the *Business Spectator* interview when I said that if a cost-benefit analysis is undertaken it is a very complex exercise that involves a consideration of the social investment and benefits flowing to rural and regional Australia, and it also involves a consideration of the longer term social benefits flowing from a high speed broadband network—which are very complex indeed.

Senator BUSHBY—One way to clarify your position would have been to come and say that you were in favour of a cost-benefit analysis, rather than saying that it is not the case that the cost-benefit analysis is not needed.

Mr Samuel—I will let it to myself to clarify my own words, Senator, rather than you clarifying what you think you would like me to say.

Senator BUSHBY—But that would have helped clarify. I am trying to distil what you have said down into a few words. You are essentially saying that the size and the complexity of this project would render a full social cost-benefit analysis difficult to do and that the findings may be possibly fuzzy. But surely the size and complexity, and the exposure of \$43 billion of taxpayers' money, of such a project actually elevates the need to try to get it right?

Mr Samuel—I do not want to enter into the political debate on this, having been dragged into it, unfortunately, by trying to give a fairly innocent interview to *Business Spectator*, which was more directed to the business community than it was to those sitting up here on the

hill. I will not repeat the commentary I made before in this paper that I have got, but let me simply say that my observation to the business community was that you need to understand that a business case—which Mr Quigley has indicated that he is finalising and that NBN Co. is finalising; I think he indicated in evidence given before the communications committee the other day that it will be going before the board of NBN Co. for approval and then ultimately submission to government—is a separate issue from a social cost-benefit analysis. All I observed in the *Business Spectator* interview was that a social cost-benefit analysis for a project such as this is very complex indeed and then, as I observed in the comments I made just a few moments ago, if you play around with the assumptions you can end up with a high level of scepticism as to the ultimate conclusions of a social cost-benefit analysis.

Senator BUSHBY—So are you saying that a social cost-benefit analysis is never of any use?

Mr Samuel—No. I am not sure. What I simply observed was that there are some fundamental issues, complexities, associated with a social cost-benefit analysis. Social cost-benefit analyses have their value, but the value of—

Senator BUSHBY—But surely they must be even more valuable when the stakes are higher?

Mr Samuel—Yes, but the value of a social cost-benefit analysis can depend upon the underlying assumptions. As I observed before, if the assumptions in their own sense are capable of—

Senator BUSHBY—We have got a whole federal government bureaucracy to develop assumptions that are appropriate and will work. Surely we have got the expertise and skills to conduct a full social cost-benefit analysis of the NBN within government.

Mr Samuel—I am not sure I can add much more to what I have already indicated, but I would be very happy for this paper that I have here to be incorporated, because it would explain, I think, all the complexities of a social cost-benefit analysis.

Senator BUSHBY—I need to say to the chair that I am happy for it to be incorporated. I have one final question on NBN. In relation to bundled services, unconditional local loop service and line-sharing services, does the ACCC consider that unbundling has been a successful policy in fostering competition and innovation in the delivery of broadband services? What have been the consequences for price and innovation of bundling? If the NBN becomes a monopoly infrastructure owner, will retailers be able to acquire unbundled services from NBN?

Mr Cosgrave—The answer to the first part of your question would be yes. Those services were first regulated in 1999, and the use of those services by competitors—the insertion into Telstra exchanges of their DSLAM equipment and the provision of high-speed broadband—has led to product innovation in terms of higher speeds, particularly ADSL2+, which was first introduced by competitors, and price competition within the market. As to the second part of your question, I think NBN Co. is on record as saying that its initial access product will be a layer 2 bitstream product. My understanding of that product and the adequacy of that product to provide the same sort of price and service competition—and this understanding comes from discussions not only with NBN Co. but with a range of prospective users, those very

people who are using the unconditional local loop and line sharing—is that they are satisfied that that primary product set will provide them with the flexibility to continue to be able to compete on both price and product.

Senator BUSHBY—I have a number of other questions on other matters.

CHAIR—I will try to get back to you. Senator Cameron?

Senator CAMERON—Mr Samuel, I got the impression that the ACCC were monitoring estimates the other night when Minister Conroy was giving evidence. You quoted some of the—

Mr Samuel—I think it is fair to say that, while I was eating my dinner, I was watching the evidence being given as a matter of interest. I would not put it at as high a level as ‘monitoring’.

Senator CAMERON—Did you get indigestion?

Senator Sherry—That’s an outrageous reflection!

Mr Samuel—I have to say it was not Minister Conroy’s evidence that gave me indigestion; it was what I was trying to eat.

Senator CAMERON—Minister Conroy, during his answers to questions, talked about a number of overseas reports about not only the economic but also the social benefits of broadband. Has the ACCC had a look at any of those reports?

Mr Cosgrave—To the best of my understanding, no, but I will need to take it on notice because I am not quite sure of each of the reports that the senator was referring to in his evidence.

Senator CAMERON—Would the ACCC think, given that this is a new technology for Australia and given what you have tabled here this morning, that you would need to have a look at some of the international evidence of the social and economic benefits of broadband to make a proper judgment about issues under your jurisdiction that you may be faced with in the implementation of broadband?

Mr Samuel—If we go back to the evidence Mr Cosgrove gave a bit earlier, where he indicated that our primary focus will be on the special access undertaking and potentially the structural separation undertaking that we need to deal with, I am not sure that the social cost-benefit issues will come into consideration or account. We will be dealing with issues of access relating to competition, the long-term interests of end users and efficiency issues. I am not sure that the social cost-benefit analyses will be relevant to those sorts of considerations that we will be dealing with.

Senator CAMERON—All of those issues end up being social benefits. Issues such as access in rural areas are social issues as well as economic issues, aren’t they?

Mr Samuel—But our primary remit is to deal with issues of competition, the efficiency of access, the terms and conditions of access and the structural separation undertaking that will come before us in respect of Telstra. Those are issues that would not necessarily involve considerations of social costs and benefits, as I have described them in the paper which has been incorporated into *Hansard*.

Senator CAMERON—Even though that is your primary focus, given that there is evidence from overseas, you will look at that evidence, I assume?

Mr Cosgrove—It will depend upon the nature of the task before us and the nature of the criteria we have to consider in determining those tasks. Sometimes those tasks are defined purely in tests which are heavily influenced by economics; sometimes there is broader public interest or public benefit that we have to consider. The extent to which you might take in matters extraneous to the economic matters will depend upon the nature of the test. What Mr Samuel was saying was that, in relation to the consideration of an access undertaking by NBN Co., the test is the same as that we have been administering for many years, and that is an economic test. It may well be that with other tasks we are considering broader issues that are not yet clear. If that were so, it may well be that you would take other matters into account.

Senator XENOPHON—I have a supplementary question and I am happy for it to be taken on notice because of time constraints. Will NBN Co. be subject to section 46 of the Trade Practices Act regarding abuses of market power or any other sections in respect of predatory pricing? There is a concern that, if there is a private fibre-optic network, they could be unfairly disadvantaged depending on the pricing regime of NBN Co. I am happy for that to be taken on notice, along with whether any application has been made for NBN Co. to be exempt from the provisions of the Trade Practices Act.

Mr Samuel—We will take that on notice.

CHAIR—Before we leave the NBN, if there is no dissent I take it that we will accept the tabling of the documents that Mr Samuel alluded to. The committee has agreed. Senator Xenophon has some questioning about an issue Mr Samuel was speaking about: his experiences in the media. There was some media interest in the matter of conflict of interest and disclosure of your interests in private accounts. Just by way of setting the groundwork a bit, this is related purely to your obligations to the minister and the government. It does not seek to go into your private financial dealings at all. I understand you said that you had your interest in a blind trust. Could you explain what you regard as a blind trust and how that operated in your view.

Mr Samuel—When I was appointed to the ACCC, I was well conscious of and have always complied absolutely with the obligations imposed under section 17(3) of the Trade Practices Act to make disclosures on an annual basis, and periodically, as may be required, to the federal Treasurer or the relevant minister of my pecuniary interests. Those disclosures have been made and have been supplied to the federal Treasurer.

As some will recall, there was a degree of controversy about my initial appointment, and I decided voluntarily to separate myself from the day-to-day management of and involvement in the activities of those financial interests in which my family had a financial involvement. And so I set up what has been euphemistically described as a blind trust. I think it is appropriate to explain what a blind trust is and how it works because it has been misunderstood in many quarters and it is often used in a very loose sense. Blind trusts are generally used in relation to share portfolios. I suspect that senators sitting at this table, amongst a whole range of other parties, will have share portfolios that are managed by separate managers. In those circumstances the most that the parties who may have a potential

conflict of interest will receive are details of annual or quarterly or six-monthly valuations of the portfolio. They may even know about the broad asset allocation—that is, that parts of the portfolio are allocated to one fund manager and other parts are allocated to another fund manager—but beyond that they know no more. That is quite deliberate so that they have no idea as to what shares have been traded, what are being held, what are being sold et cetera. That is the nature of the way that those sorts of operations operate.

In the area of real estate, which is an unusual area before the so-called blind trust to be used, what happens is this: you would have to know the real estate holdings that are held. You would have to be deaf, dumb and blind not to know what real estate holdings are held. As I have indicated publicly, I took steps to separate myself and members of my family from day-to-day involvement in the activities of the DFO group. That was done very deliberately because I did not want to be in any position where my attention could be diverted to or it could be suggested in any way that I was involved in the day-to-day activities, the management of the activities of the DFO group.

The headline information—I use that word properly because it is information, it is what I have indicated publicly that I have received—that I received related primarily to knowledge of what the properties were worth, there were only five; knowledge on an annual basis of the taxable income that was attributable to my family's interest, because that was relevant to the preparation of tax returns; and I think once only was an estimate that given to me as to the potential value of my family's equity interest in the DFO enterprise. There was some very limited other information that was given to me. I had no knowledge of mortgages, mortgagees, lenders; all of those sorts of issues have never come across my desk, or dealings with tenants or any of the other day-to-day activities of the group, which was set up quite deliberately. It went beyond my obligations, but it was an endeavour to try to diminish any controversy that was around in early 2003 as to my appointment to the ACCC.

CHAIR—Thank you, Mr Samuel. Can you go into when you became aware of problems arising with the DFO group and when you excused yourself from any association with the NAB-AXA transaction since the NAB were, I understand, involved in those financing arrangements.

Mr Samuel—I became aware that there were some difficulties with the DFO group probably—look, I do not have an exact record, but it would have been sometime in June or July this year. As to NAB's involvement, again I do not have an exact recollection but I think that would have been sometime in July. I cannot give you an exact recollection of that.

Senator XENOPHON—But you would have documents or notes that would be able to pinpoint that time?

Mr Samuel—No, I do not have them because they were not the subject of communications with me as to when—the communications were on—I think I received—I am trying to recall, but there were no documents that advised me of that. It was an oral communication.

Senator XENOPHON—You would have made a note of a phone call or anything like that?

Mr Samuel—I did not make any notes. I received an oral communication that NAB were involved. The involvement of NAB was indicated to me as being a member of a syndicate of

a large number of lenders and related to the group in which my family had no involvement at all. The indication was that my family interests had no relevance at that point in time to any discussions or negotiations that were occurring with the syndicate in endeavouring to resolve some of the financial difficulties of the DFO group. Then I can bring you to the time when I became aware that my family interests might have had some relevance to those discussions, which is—

Senator XENOPHON—You would know that date though?

Mr Samuel—Yes, I have managed to establish that date. It was just prior to the weekend of 14 and 15 August. As soon as I became aware—and I became aware again through oral communications—that my family interests may be becoming relevant to the discussions that were occurring with the lenders, although they were not, as I understand it, directly involved in those discussions, that was the point in time at which I then communicated to Mr Cassidy my concerns about my continuing involvement in the NAB-AXA matter. He can perhaps take it on from there.

Senator XENOPHON—And then that went to the minister?

Mr Cassidy—No, there was a fair bit of press, particularly on Sunday, 15 August, that there were actually negotiations occurring between the DFO interests and the banks, including the National Australia Bank. So on the Monday morning the chairman suggested that perhaps I should speak with the chief executives of both the National Australia Bank and AXA, the two parties who were involved in the merger transaction, to ascertain their attitude to the chairman continuing to be involved. I did that during the course of Tuesday, 17 August. I spoke to Mr Cameron Clyne, the Managing Director of National Australia Bank, and Mr Andy Penn, who is the CEO of AXA.

I made notes on these discussions which I know have been released under FOI requests. When I spoke to Mr Clyne from the National Australia Bank he was not actually aware of the National Australia Bank's involvement in the DFO. When I explained to him my understanding from the press reports, his comments were, 'That would be a standard syndicated loan which we are probably a part of.' He indicated, as did Mr Penn, after checking with others at AXA, that they were both quite relaxed about the chairman continuing to be involved in consideration of the NAB-AXA matter. I relayed that to the chairman and, as I said, recorded it in notes that could be filed.

During the course of that day the chairman considered the matter further. On the morning of Wednesday the 18th—and the commission normally meets on a Wednesday—the chairman informed the commission at the outset of the meeting of what had happened. I informed them of my discussions with Mr Penn and Mr Clyne. The chairman indicated to the commission that, notwithstanding those discussions and what had been said, he thought it would be in the best interests of the commission and its consideration of the NAB-AXA matter, and indeed the best interests of the parties involved in the DFO negotiations, if he recused himself from any further involvement in the consideration of the NAB-AXA matter.

The chairman then excused himself from the commission meeting. Mr Kell, one of our two deputy chairs, assumed the chairmanship of the meeting. The commission considered the chairman's decision in his absence and decided that they agreed with the position that the

chairman had taken. Shortly after that the two entities involved, NAB and AXA, were informed that the chairman had decided to recuse himself from any further consideration of the matter and the commission issued a short press release indicating that that decision had been made by the chairman and that the commission supported that decision.

Senator XENOPHON—So the commission was advised and the minister was advised as well at that time?

Mr Cassidy—I did not personally speak to the minister. Given that the chairman had decided that he was recusing himself from the matter, we put out a press release to that effect. I think I took the view that everyone had therefore been informed that that was the case.

Senator XENOPHON—You understand that it has been an issue in the public domain and it would be remiss of us not to properly ask questions about this.

Mr Cassidy—Sure.

Senator XENOPHON—You have people such as David Yarrow, who is a Melbourne barrister and an expert in trusts, saying that blind trusts were a ‘North American invention’ that were not always accepted in Australia, and that they were ‘out of step with contemporary international best practice for management of conflicts of interest’. There is that view. Did you consider any other way of managing your affairs—a better mechanism than a blind trust?

Mr Samuel—Let me repeat that the obligations under section 17(3) of the Trade Practices Act are the normal obligations that would apply to public servants, which is: to make full disclosure of your pecuniary interests to the minister to ensure that conflicts do not arise. In the event that a potential conflict or a perception of a conflict arises, the obligation is to make that disclosure at a commission meeting or to your commissioners or to staff who might be involved and then to withdraw from consideration of that particular matter.

The blind trust was a voluntary step that I took. Let me make it absolutely clear that the voluntary step was taken to separate myself from day-to-day involvement in the activities and management of the DFO group. That was essential for two reasons. Firstly, the Treasurer at the time of my appointment said, ‘Mr Samuel, you must dedicate yourself to your role as ACCC chairman’; therefore, it was appropriate that I should separate myself from day-to-day activities and involvement. Secondly, you cannot be involved in the day-to-day management or activity or have intimate knowledge about what is occurring in relation to investments of this nature without raising questions on a continual basis and, therefore, it was better that I separated myself. So that was the process that was taken.

Senator XENOPHON—Peter Faris QC who was critical of the trust said that it was ‘partially sighted’, because you had a family member who was secretary of the trust.

Mr Samuel—I have to say to you, with great respect, we are relying upon the report of a single journalist in the *Australian* newspaper.

Senator XENOPHON—If that is inaccurate, could you correct that?

Mr Samuel—Yes, because, as the journalist well knows, the involvement of a member of my family was as a secretary of a company that was not involved with the DFO investments at all. It was a private company that sits at the top and manages my very small private investments. I think this has all been a bit of fairly loose reporting.

Senator XENOPHON—I am beginning to understand. You clarified that aspect of it.

CHAIR—I believe Senator Bushby has some a question.

Senator BUSHBY—Thank you. At the last estimates, it was noted by the ACCC that the publicity surrounding competitive issues and the Building the Education Revolution schools program had not gone unnoticed. Are you able to indicate today anything about the ACCC view on this, in general or specifically, in respect of any analysis or investigation you might have conducted or be conducting. Can you confirm whether you are currently conducting any investigations into any matters arising out of the Building the Education Revolution?

Mr Cassidy—At last estimates you asked about what were then press reports about some issues that had arisen in Queensland.

Senator BUSHBY—Yes, and you indicated that that had not gone unnoticed.

Mr Cassidy—I think I also said that basically the press reports were wrong. There was a uniform charge that was being built into the tender prices; and, of course, on the face of it, once you speak about uniform price you immediately think: ‘Hang on a moment. Is this collusive?’ But the particular uniform charge was actually a charge which was indicated by the Queensland authorities as being a charge that should be included. So there was no collusion in relation to that.

Since then, we have been proactive in relation to the program. We sent in excess of 300 letters to those who we understand are involved in the program, in building the facilities. Those letters explained the law—and of course we are looking at possible collusive activity—what is permissible and what is not. They also included copies of our immunity policy, in case any of the recipients thought to themselves, ‘Hang on a minute—I’ve been involved in something that maybe I shouldn’t have been.’ Again, at our initiative we have had and are still having meetings with a fairly large sample of project managers who we also understand are involved in the program, because it is really more at the project manager/subcontractor level that you would typically find collusive activity occurring. All that has yielded certain information that we are in the process of analysing and looking at. I would be loath to characterise that at this stage as being formal investigations.

Senator BUSHBY—But you would be having a pretty good look at it.

Mr Cassidy—We are looking at the information we have received. But, as I say, we have been fairly proactive in terms of being in touch with a large number of the participants in the program to remind them of their, if you like, legal obligations.

Senator BUSHBY—And the process of looking at that is not yet complete?

Mr Cassidy—No, it is still ongoing.

Senator BUSHBY—Thank you.

Senator BOSWELL—I am interested in the Metcash-Franklins merger. I note that you have said that you are concerned that, if the acquisition goes ahead, there may be a possibility of substantial lessening of competition in the wholesale supply of grocery products to independent grocers in New South Wales. Can you see any benefits that would flow from that acquisition, and do you consider there would be any benefits?

Mr Samuel—I think it would be pre-emptive of us to provide a response at this stage. As we indicated—and I am not sure whether you were here at the time—in response to an earlier question on this, that merger is currently the subject of analysis by the commission, the Mergers Review Committee and staff involved. We put out a statement of issues—which you have referred to, I think, in your comment about our concerns as to the wholesale supply in groceries—and we are considering responses to that at present. I think as Mr Grimwade indicated a bit earlier, currently our time line is that we will be making a final decision on those issues and on the merger itself on 11 November this year. But that time line may well change, depending on matters that are put before us. But to comment upon the concerns that we might have, and/or any benefits that might flow from the merger, I think would be pre-empting the consideration of the matter by the Mergers Review Committee and the commission, which will take place in the next two or three weeks.

Senator BOSWELL—You put out a statement of issues but no-one can comment on them or ask a question on them.

Mr Samuel—No—certainly the purpose of the statement of issues is for people to submit to us all their comments and observations, information and evidence that they may want to provide to us to help us to further consider the issues that are raised in the statement of issues. That is the whole purpose of a statement of issues, which is to evoke comments from interested parties. The only thing I cannot too, though, is to provide our own comments because it is still in, as Mr Grimwade described it before, a phase 2 assessment, and that phase 2 assessment is being undertaken at the current time, having regard to the submissions that are being put before us in respect of the matters raised in the statement of issues and it would be pre-empting consideration of this matter by our staff, by the Mergers Review Committee and by the commission to be providing comments on that at this point in time. But certainly our views on those issues, including any benefits that might flow from the merger and any competition concerns that might flow from it, will become evident when we make our final decision—which is, as I think Mr Grimwade indicated before, currently scheduled to be made in the first couple of weeks in November.

Senator BOSWELL—Mr Samuels, Pick n Pay are leaving the country. They have said they are going. They are getting a hiding in the market. That is a commercial decision in the interests of their shareholders. Are you concerned that, if they go, the majors will cherry-pick their sites and there will be a further lessening of competition in the market?

Mr Samuel—We need to remember not only that the acquisition of the Franklins operation by Metcash is the subject of scrutiny by the ACCC under section 50 of the Trade Practices Act but that, as you would be aware, every acquisition of every existing supermarket outlet and/or greenfield site by the majors, as you have described them—that is, Coles and Woolworths—is also subject to scrutiny by the ACCC under section 50 of the Trade Practices Act. In each and every case we consider whether or not the acquisition would have a likelihood of substantially lessening competition in a market. Those are matters that have been well canvassed, for this committee and publicly. We also, I might say, examine acquisitions by other parties in the supermarket and liquor area under similar considerations. So cherry-picking, as you have described it, would necessarily have to be subject to the application of section 50 of the Trade Practices Act and the scrutiny of the ACCC under the terms of that legislation.

CHAIR—Thank you, senators. We are now at morning tea break. Can I just advise senators that we will have a short private meeting at the beginning of the morning tea break. I have a final question for you, Mr Samuel, going back to that conflict of interest situation. Do you still regard yourself as having a blind trust now, and have you informed the minister of any change in that arrangement?

Mr Samuel—With the so-called blind trust, as you have described it, there has been a change in the directors of the trustee companies that are involved in the various trusts. There were two directors until last evening. One of those directors, Mr Guy Jalland, who is an associate of Mr James Packer, advised me last evening that confirmation had been provided to the Ten Network of private interests associated with Mr Packer having acquired shares in the Ten Network. As a consequence—effective last evening—Mr Jalland resigned from his offices in the various trustee companies, so as to avoid any difficulties that might arise there. So Mr Jalland is no longer an officer of those companies. There is now a sole director of those companies involved, and that director gives rise to no issues concerning a conflict of interest. But, yes, the same arrangements are in place to separate me from the day-to-day activities of the trusts that are involved in my family's financial interests.

CHAIR—Thank you, Mr Samuel.

Senator Sherry—Sorry, Chair. When we come back, are you anticipating that we will go straight onto ASIC?

CHAIR—Yes, indeed.

Senator BOSWELL—Chair, I have been sitting here for an hour and you have given me about 30 seconds to ask three questions. Is there any chance of being able to direct one or two questions to Mr Samuel?

CHAIR—If you want to consult with your colleague and we come back later with ASIC, that would be—

Senator BUSHBY—Could we come back a few minutes early?

CHAIR—I have a private meeting already. I do not think we will be able to do that.

Senator Sherry—Sorry, I have a meeting for 15 minutes during the tea break. We are certainly relaxed about what you do in terms of the ACCC and ASIC.

Senator ABETZ—The ACCC will have to stay for a cup of tea.

CHAIR—Thank you, then, to the ACCC for coming in this morning. Thank you for your assistance.

Proceedings suspended from 10.33 am to 10.45 am

Australian Securities and Investments Commission

CHAIR—Before I welcome the Australian Securities and Investments Commission, I will just read a motion passed in the break by the committee. It is: 'That filming and photography of today's hearings be permitted insofar as it does not hinder or distract from the proceedings of the committee. Media representatives should not harass or distract witnesses, and filming or photography of senators' or witnesses' documents is prohibited.'

I welcome here this morning the Australian Securities and Investments Commission. Mr D'Aloisio, do you have an opening statement that you would like to make?

Mr D'Aloisio—Thank you, Chair. I will very briefly mention a couple of things of note for ASIC since we last met in June this year. Firstly, we took over the national credit regime from 1 July. I am pleased to report that the registration and licensing of that and the changeover are going very well.

Secondly, on 1 August we took over the transfer of surveillance from the ASX. Again, I am pleased to report that that changeover has gone very well. In terms of how that activity is going, it is early days for us to give figures about that surveillance and how it is working, but I thought it was useful just to give some initial figures to the committee. ASIC has commenced inquiries into some 57 separate market related matters since the transfer. Of those, nine matters have proceeded to formal investigations as at today. That is a rough average of about three a month, in contrast to comparable periods with ASX of around 1.7 to two a month. It is early days on those numbers, but we are comforted by the fact that the transfer is going over in a seamless way. These matters have, we believe, proceeded to an investigation stage probably in a shorter time than may have been the case, although the two agencies—that is, ASX and us—did work very well together. We have also been very active in that period in raising unusual trading with relevant market participants, very much being mindful that the supervision function is very much about being close to the market and working with the market.

The final matter to mention is that, in terms of our other work, our business-as-usual work, in that period since we last met, in enforcement ASIC in that period has had 41 outcomes: 19 in the civil area, 14 in criminal and eight in administrative. We have also provided extensive guidance to the market on a number of issues including contracts for differences. I think I will close there. I thought it would be useful for the committee just to get a little bit of an update on the key issues that have been occupying our minds since we last met. Thank you, Chair, for letting me make an opening statement.

CHAIR—Thank you for that.

Senator BUSHBY—Thank you to ASIC for coming along today to give us assistance. In the June estimates, you stated that ASIC would discharge its responsibilities within budget for the 2009-10 year. Did you actually do that?

Mr D'Aloisio—In the final numbers that will be in our annual report, we ended up with a deficit of, I think, 4.9. There was a software write-down that accounted for a significant part of that, and we also made provision if we needed to do restructuring in the 2010-11 year, so we ended up, I think, with a 4.9 deficit which we funded from the carry-forward from previous years. This will be all in the annual report shortly.

Senator BUSHBY—So you funded that by carry-forward. Were there any additional matters added to your allocation by the government during that financial year that were not shown originally in the budget?

Mr D'Aloisio—Not in that financial year, but shortly after, in the new financial year, the government approved an additional \$10 million of unclaimed moneys funds for ASIC for the 2010-11 year, for the current financial year.

Senator BUSHBY—On what basis was that provided?

Mr D'Aloisio—That was provided on the basis of projects that fell within that form of funding.

Senator BUSHBY—So that was for a specific project?

Mr D'Aloisio—A number of specific projects

Senator BUSHBY—But there was no money provided to cover the shortfall or any perceived shortfall in operations in any of your areas?

Mr D'Aloisio—No, we did not ask to cover the \$4.9 million shortfall.

Senator BUSHBY—There were no other shortfalls in any other area?

Mr D'Aloisio—We have budgeted, roughly, on a breakeven basis for the 2010-11 year and at this stage we are obviously involved with Treasury and government in relation to funding beyond the 2010-11 year, which we are progressing. That will take its course through government.

Senator BUSHBY—You have had a lot of new responsibilities allocated to ASIC, most of which have come with increased allocations. In the June estimates, in terms of the actual costs of running those new responsibilities, you indicated that effectively time would tell whether that was sufficient. And you indicated you would approach Treasury if you felt that those allocations were inadequate. You also noted that in three to six months you would have a better feel to assess things and talk to government as to whether you need additional resourcing. We are about four months later—so we are within that three-to-six-month period. Are you in a better position to make the assessment as to whether the additional allocations that have been provided to you are sufficient?

Mr D'Aloisio—We are working on that, as I indicated. And clearly, as I indicated, we are talking to Treasury and I have a task force that is reviewing our funding beyond 2010-11. As part of that the commission is considering those issues. I do not have anything to state publicly at this stage but our intention is to be looking at the ASIC funding well beyond the 2011-12 year and picking up. As I said at the last meeting, and you quite rightly point out, it is one thing to plan in the sense of supervision et cetera; it is quite another when you get into working it through. The commission is comfortable that our funding is right for this financial year and that in relation to going beyond that this is a matter that we are discussing with government and going into detail. Hopefully we will be able to report better on that in the next Senate estimates meeting.

Senator BUSHBY—I will just move onto something different—short selling. I understand that ASIC is now publishing new short selling data on its website. What trends are you establishing?

Ms Gibson—I do not believe we are finding troublesome trends. We get monthly reports with highlight issues and the most recent one I read said nothing out of the ordinary.

Senator BUSHBY—Has short selling returned to its pre-crisis levels?

Mr D'Aloisio—No.

Ms Gibson—Short selling in that period in September 2008 was at extreme levels—

Senator BUSHBY—I am talking more about the longer-term average.

Ms Gibson—until we introduced the ban. No, I do not believe so. I could check the figures but I do not believe so.

Mr D'Aloisio—We can check and do some analysis. One of the difficulties is that we do not have comparative numbers, in the sense that the disclosure requirements were not there. The issue of disclosure really assumed significance from September 2008 on, when we had the Lehman Brothers and the issues around short selling. So we can look at that. Certainly, we are not detecting from the market, as Ms Gibson has said, that there are concerns being raised with us that companies have been heavily short sold, and what is ASIC doing about it?

Senator BUSHBY—Have you performed any analysis of how the impact of the ban on short selling actually impacted on the volume of short selling in Australia. Was the ban effective while it was in place?

Mr D'Aloisio—I think we have reported on this in previous meetings. I need to refresh my mind. You will recall that the ban went in in three tranches. There was the initial complete ban of naked short selling and covered short selling. That went, I think, for about two or three months in the September through to the December-January period of 2008 and early 2009, when the GFC was probably at its height. Then we reopened the market, other than the financials. Then we opened the financials as well. So in that period short-selling did have the impact that was needed, we felt, given the potential systemic issues that could have occurred for the financial sector and for the REIT sector of the Australian market.

These were matters of judgment, and no doubt historians and others with the benefit of hindsight will look at them, but certainly at the time we felt that that was the right call and certainly since then there has not been any material given to us saying that the ban was not effective and did not achieve the sorts of purposes that were needed essentially to restore confidence in the market when buyers had vacated the market.

Senator BUSHBY—Back in June you noted on the day of the estimates that the new short-selling system had just started on that day. You noted that it was open to receive reports but the industry was not fully ready to interact with it at that point and you had provided a period of grace of some weeks. I presume that that period of grace has ceased.

Ms Gibson—Yes—it has, substantially. My understanding is that the main players are now all operating through the system—that the IT people who were developing the interface privately have extended that to other clients. I would need to check whether all short sellers are now on the system.

Senator BUSHBY—Okay. Could you take that on notice, please? At the time you indicated that you were looking at a period of about three weeks to allow people to get up to speed and you were confident that you would be able to make that. But we are four months later now, and if industry is not fully compliant I would be interested in knowing about that.

Mr D'Aloisio—We will take that on notice and confirm it in a written answer.

Senator BUSHBY—I would like to ask some questions about coercive powers. Last estimates I asked you some questions about your use of legislatively granted corrosive powers and the internal policies you have surrounding their use, and I note that answers to how often

some of those powers have been exercised have now been provided. But I do not recall seeing anything in those answers about your thoughts in response to the question on whether you need to extend the record keeping and the transparency around the use of those powers. Do you have any thoughts on that now?

Mr D'Aloisio—We take the use of coercive powers seriously, because you are balancing public interest and individual rights, and we need to balance the use of those powers in the range of investigations that we have. In the last three years, I think we have had something like 792 investigations on foot, so we have quite a wide remit. The powers, as you know, fall under two key headings: the power to examine individuals and the power to require production of documents and so on. We are hearing the debate and the issues that are being raised, and, as part of that, quite clearly I would like to talk more fully to the Rule of Law Association and also to the law councils that are raising some issues about seeing where they are, because we do not believe the powers have been abused. We believe the powers are needed.

ASIC has itself asked our staff to prepare papers for review for us to re-examine the processes we follow and to examine whether we need to be more transparent in reporting in the way that the powers are used. So from a public interest point of view we recognise the seriousness of this issue and the need to reassure the community that there is no abuse, that we use the powers properly, that there are checks and balances in place when powers are used and that individuals have the right to claim certain privileges when they answer questions. So we see it initially as an exercise in just redoing a fresh stock take on powers that have been given to ASIC over many years since the Corporations Act has been in its current form.

Senator BUSHBY—I am pleased to hear that you are—

Mr D'Aloisio—So that is what where we are at, and we will be very pleased to report further to you in future meetings about what we have done and what the outcome of those discussions has been. In providing the figures to you that we provide, we are well aware of the fact that when you see those sorts of numbers you say 'that is a lot of notices', but when we go into the complexity of the cases, the number of people we need to see, the evidence that is needed in running a case and the actual probity of that evidence that is needed to stand up to cross examination, the use of these powers is very important for ASIC discharge its functions.

Senator BUSHBY—I am pleased to hear that you are looking at the processes around it. I think the last time I asked you sort of a surprise question that did not appear—and I apologise if I am putting words in your mouth—to be something that you had thought of in terms of a process of oversight, and I am pleased to hear that ASIC is looking at that.

CHAIR—Are you still on coercive powers.

Senator BUSHBY—Yes, it will be a while before I finish on this. Currently are there any policies and procedures within ASIC to ensure internal compliance with the law and that coercive powers are only used to further the legitimate objectives of the organisation?

Mr D'Aloisio—Before an officer of ASIC can issue a notice or use a coercive power there are internal processes that have to be followed that are document in our enforcement—

Senator BUSHBY—This is for the use of all coercive powers, even the most—

Mr D'Aloisio—Yes—

Senator BUSHBY—We went through this last time, what you needed to do and I think the most commonly used one was up to the discretion of the investigator to some extent.

Mr D'Aloisio—The investigator has to make a judgement about what they need from an individual or in terms of material that has to be produced. What we say is that you make that judgement and then you have to go through a process of a form of document that is then used and needs to be settled. That becomes the request, if you like—the document of demand. In the processes leading up to that the investigator makes a judgement, a lawyer in the team generally will review that, the document will be settled, it will then be signed by the appropriate delegate and then it will be served. You cannot sort of get a bit of paper and write out, 'Please give me this'; you have to go through these processes.

Senator BUSHBY—I understand. You have these processes you need to go through.

Mr D'Aloisio—And then what comes in and how it is recorded is there as well. I am more than happy, if you like, to take it on notice and for us to outline to you just what that process is both in respect to calling individuals to come before us and calling for material. The notice needs to be used for proper investigation, but also in a lot of cases does need to be used to override possible confidentiality obligations that may exist between parties that are responding to those. So as a matter of law they are required to provide information they may regard as confidential but we do not think is confidential and it is in the public interest of the investigation that it be given to us. There are a range of reasons. As I say, we can outline those.

Senator BUSHBY—I would appreciate it if you would do that. Thank you.

Mr D'Aloisio—Okay.

Senator BUSHBY—In general, are the coercive powers available to you sufficient and appropriate to ASIC's role in ensuring compliance with the law?

Mr D'Aloisio—Subject to one comment. We do not have within the commission a view that we need more coercive powers. The one qualification relates to—again, we have discussed it in the past—the issue of access to information from telephone interception that is carried out by the Australian Federal Police. There is a bill currently before the parliament, which I think has been reintroduced following the election and is in committee. We have said to government that we felt that it was important for ASIC to be able to share information through telephone intercept that was carried out by an intercept agency.

Senator BUSHBY—That is the Corporations Amendment (No. 1) Bill 2010?

Mr D'Aloisio—Yes. My team is indicating that it relates to market offences above five years. Where we were particularly interested in it was in relation to insider trading and market manipulation.

Senator BUSHBY—I imagine on 3 November we will have the opportunity to ask you a few more questions about that at the Senate inquiry into the bill.

Mr D'Aloisio—Yes.

Senator BUSHBY—In applying the coercive powers that you have, what regard does ASIC or your investigators have to the potential impact of their use on business efficiency?

Mr D'Aloisio—Business efficiency is a factor. We can do some investigation. When these investigations are on foot, in a lot of cases the investigations are in relation to companies that have got into difficulties and we are looking at wrongdoing.

Senator BUSHBY—But not all of your financial services or surveys that you send out. I suspect there is a lot of paperwork there.

Mr D'Aloisio—I agree. I think we try to use judgment in that way, but there have been instances where we have been criticised for having an impact on business efficiency by issuing notices when business would probably say, 'They weren't needed. We would have provided you with the information.' So there are judgments that are made. We are conscious of the issue and we accept that from time to time there will be criticism that we might have used a power when we could have got the information anyway. But the judgment has to be made, whatever we are doing, whether it is surveillance or an industry review or an investigation. The officers need to make a judgment on what they need and how quickly. So, yes, they will look at business efficiency, but we will not always get that judgment right and business will say, 'We could have provided that in any event.'

Senator BUSHBY—Are you aware of the Australian Government Investigation Standards?

Mr D'Aloisio—In terms of the model litigant and the way we do things? Yes.

Senator BUSHBY—The Australian Government Investigation Standards are a set of best practice standards for all investigations of offences under Commonwealth legislation.

Mr D'Aloisio—Yes, we are aware of those and they are incorporated into our manuals. I am personally not able to answer questions specifically on those standards, but they are covered in our enforcement manuals.

Senator BUSHBY—So the standards that they contain would be complied with and followed by ASIC?

Mr D'Aloisio—I think they would, but I am happy to take that on notice and check it more specifically for you.

Senator BUSHBY—I do not know that it is necessary a requirement, but it is a set of best practice standards. So could you take on notice the extent to which you enforce the use of and train investigators in the use of the AGIS.

Mr D'Aloisio—I am happy to do that.

Senator BUSHBY—Are you aware that the ANAO recently audited Centrelink and, amongst other things, found the in the context of those standards that evidence re investigations was not collected in an appropriate manner. Ineffective intelligence processes led to the unnecessary collection of information on persons. There was unauthorised or inappropriate use of coercive notices to extract information from persons. There was a finding of a 100 per cent failure rate in a sample of 113 cases for the 2009 financial year and a lack of training to ensure knowledgeable and appropriate conduct by investigations staff. How do you

think ASIC would fare in a similar audit by the ANAO into the use of its investigatory and coercive powers?

Mr D'Aloisio—I was not aware of the results of that audit. I am not really in a position to give you a judgment on that, off the cuff.

Senator BUSHBY—But clearly the ANAO is looking at these issues in agencies. It may not yet have brought its focus to bear on ASIC, but it may well do so. Those Centrelink investigations are similar activities to those undertaken by ASIC. I would hope that ASIC's internal procedures would mean that you would not fail, but I am just highlighting that it is something of interest—rightly—to the ANAO and parliament. That is why I am asking questions about it, for the people of Australia. I have asked you about AGIS, and you have undertaken to take that on notice.

Mr D'Aloisio—And the last issue as well, because I am not in a position to answer. I think we will do very well, but I need to look at the information.

Senator BUSHBY—Are you aware that the US government has regulated intelligence-gathering processes, through the federal codes, to prevent unnecessary intrusion into the affairs of individuals and businesses in its investigatory activities?

Mr D'Aloisio—I am not personally aware of that. What is the extent of the protection there? Is it the sort of protection we have already?

Senator BUSHBY—No. I think it extends further.

Mr D'Aloisio—It has gone beyond what we have?

Senator BUSHBY—It goes beyond what we currently have in Australia. So you might have a look at that—

Mr D'Aloisio—Okay.

Senator BUSHBY—as part of looking at your internal processes. As you do not have an internal policy on the use of your coercive investigative powers as such—other than to the extent which you outlined previously—how do you ensure that unnecessary intrusion into the affairs of individuals and businesses does not occur?

Mr D'Aloisio—This is what I was saying about the strict procedures we have in our enforcement manual. As I said in answer to the previous question, I am prepared to look at that and at whether we need to improve. Probably the next step is for us to discuss those internal enforcement manuals and procedures that we follow with groups out there—lawyers and so on—to try and home in on where the problem areas may be and to review them. But certainly we do have those procedures and policies in our manual. The issue is: are they adequate; should there be some change? As I say, we do not see it, from the way we are working, but we are happy to look at it.

Senator BUSHBY—I understand. My questions are not intended to imply that there are any inappropriate uses of your coercive powers either, for the record.

Mr D'Aloisio—Thank you.

Senator BUSHBY—I think it is important that you have coercive powers, but it is also important that the Australian public has confidence that those powers are used appropriately.

My question is more to do with ensuring that there are appropriate transparencies, procedures and rules that are followed in the use of these powers, to ensure that the Australian public can have confidence that they are used appropriately and not in situations where they are not needed, particularly when they cause burdens on those who have to comply with them. In that respect, given that you rely to a significant extent on your investigators to exercise their own judgment and the extremely high level of utilisation of the coercive powers as outlined in answer BET-25, what evidence do you have that investigators are only using those powers in appropriate circumstances?

Mr D'Aloisio—I think because of the process of responsibility in the delegation of the powers, their use and the teams that are put in place, the leaders that are in place, in running investigations and supervision—we work on a pyramid structure—there is accountability. There is review. There are performance assessments. There are a range of things that we would expect our leaders to be examining. Certainly, had they picked up and should they pick up potential abuse of that power, that would be referred to us or to our internal unit that would look at these issues. We have within ASIC a complaints unit that would look at issues where there are complaints from the public about the way we are exercising our powers. That unit would examine that and provide a report to me or to the commission or to a senior leader. If they come from the outside, they would be examined.

Senator BUSHBY—There are checks and balances.

Mr D'Aloisio—There is that check and balance. There is the check and balance that comes through the leadership structure.

Senator BUSHBY—There are varying levels of potential abuses, though. The most glaring one, which would I think get caught out by those checks and balances, is where the coercive powers are used for nefarious purposes. But there are much lower level but still important abuses, where they might be used to pepper particular industries or businesses with requirements to comply with notices or other things which might seem on the face of it reasonable but, standing back objectively, might not be reasonable in all circumstances.

Mr D'Aloisio—As I said at the beginning, I think we need to home in on what those are. Through this round of discussion that I mentioned earlier, I think we can get a better feel on that and then make that assessment. At the moment, with the information from what we have seen and the way we operate, I am not seeing that within ASIC. I am not dismissing it. We are conscious of the need to be perceived by the community to be responsible in this area and not just to be responsible.

Senator BUSHBY—Absolutely. It is important that the community has confidence in ASIC, and the business community in particular. Part of ensuring that confidence is ensuring that your use of your coercive powers is seen to be transparent and appropriate.

Mr D'Aloisio—I think the next step, importantly, in taking on a lot of the comments you have made this morning and brought to the market, is for us now to actually try to home in more specifically on the issues that have concerned business and concerned people and then for us to make a judgment. Clearly if it is an issue of efficiency and the use of a notice that should not be used, if it is a simple 'disgruntled because we're getting information you didn't want to give us', that is different. We have got to analyse the pressures and then make a

judgment as to whether we need to introduce additional protections. We want to be perceived as a responsible regulator that is respected in the way it uses its powers.

Senator BUSHBY—I have one final question on coercive powers. Of the matters in which your powers have been used—and you have outlined those in the answers to questions on notice, particularly those ones in respect of investigations of potential breaches—what percentage have actually resulted in action being taken against those investigated? You might want to take that on notice.

Mr D'Aloisio—I would have to take that on notice.

Senator COONAN—I have a very brief point that I want to raise with you about the corporations law amendment enhancing asset search warrant capacity without first issuing a notice to produce and also enabling an interception agencies such as the AFP to apply for interception warrants in the course of a joint investigation relating to insider trading. The point I am about to make will no doubt come up in the scrutiny of bills examination of the legislation and possibly in debate, but I just wanted to flag it here. It might require some thought in the meantime, unless I have not understood something about the bill.

ASIC's powers in division 3 to apply for a search warrant provide in effect that it should be exercisable for 'proper purposes' in connection with ASIC's statutory functions. Yet it does not seem that in the current bill that we will shortly be considering that the exercise of the powers will be subject to specified safeguards with reference to the purpose for which the power is being exercised. In other words, there is no reference to particular seriousness. I heard Ms Gibson's point earlier about indictable offences, which might be the answer, but it certainly is not very clear. Do you have any comment about that?

Ms Gibson—I think the term 'proper purpose' appears in many pieces of legislation. It intones in common law motions of the right intent and so on. I cannot comment specifically on the legislation but I think 'proper purpose' brings with it a lot of common law as to what that is, which is perhaps the protection that would otherwise be built in.

Senator COONAN—I just wonder about that because, for example, I had a look at the New South Wales Law Enforcement (Powers and Responsibilities) Act where it actually defines 'searchable offences' in relation to a warrant to mean an indictable offence and various other things. But there is certainly a definition that it must be serious. This appears to just be at-large. I think there is a real issue as to whether that is potentially an infringement on personal liberties et cetera that will be raised as part of the scrutiny of the legislation. I think it would be certainly worth limiting ASIC's powers or specifying that the powers be confined to seeking a search warrant for investigations of particular seriousness. Perhaps there should be some collaboration about that, because it is potentially very coercive.

Ms Gibson—I think I will leave that for government.

Senator Sherry—The detail of the legislation is a policy matter. I think I can anticipate a letter—not to me but to my colleague, who I think is Mr Bradbury in this case.

Senator COONAN—This constant changing means there are a lot of people to write to.

Senator Sherry—It is a consequence of being re-elected—which is a nice place to be I might say. I will take it on notice and let—

Senator COONAN—I thought it was worth alerting you to it, particularly given the generic discussion we have just had on coercive powers. This is a particular legislative case in point where I think it does arise.

Senator Sherry—Okay, thanks.

Senator PRATT—The government has given ASIC powers to act on unfair mortgage exit fees. I am interested to know how your custodianship of this is going. I know it has been fairly recent and relates to a range of consumer law changes and consumer credit changes that we have seen come into play, but have any examples of this come before you or are banks simply changing their practices?

Mr D'Aloisio—As you know, as part of taking over the responsibility on 1 July for consumer credit, we have the responsibility for enforcing the unfair contract terms legislation as it applies, including to mortgage exit fees, early termination fees, break fees et cetera. Under that we have been given the power to be able to go to court and look at unconscionability and so on. We have not at this stage commenced any cases. The position we have taken is to put out a consultation paper on how we think these issues should be approached by industry, by the lenders and so on. We are working to finalise that consultation and issue guidelines. We will then typically probably give the market a little bit of time to digest it. That will then be followed by proper surveillance and techniques to look at whether or not it has been complied with. Clearly in the meantime if we get complaints we will act on those as well. So we do see these as important protections, but in the first instance it is really about consulting with industry and to get it clearer when there could be issues and how they should approach it.

Senator PRATT—Is there any clarity then on the extent to which consumers might be just assuming that the mortgage exit fee in their home loan is just part of their contract and they are just continuing to wear it because they will not be aware—

Mr D'Aloisio—That is a very good point. I think our approach on that is very much through our FIDO website and our consumer advice that we put out. As part of that and as part of this consultation we are making people more aware. Interestingly, since we have had the credit legislation we have received some 600 complaints in relation to various aspects of consumer credit. So I think the community is getting to the point of understanding that there is ASIC and there is a new regulator. Our FIDO website provides guidance about what rights are. Once we have completed the consultation I am sure our people will put very clear guidelines on the FIDO website about what to do when you have an exit fee—how can you challenge it; are you comfortable that it is reasonable in the circumstances; what are the sort of questions you should ask your lender to satisfy yourself about that. So those are the sorts of issues we will be promoting. Our FIDO website, which is a very direct means of getting to financial consumers, has had this year over two million hits. So it is a serious form of education to get the messages out on what the right questions are to be asking.

Senator PRATT—I appreciate that you are probably doing as much as you can at this point—although I would suggest that your average consumer out there finds their mortgage paperwork hard enough to understand; let alone the idea that they might be shopping around what are in their view obscure government departments. What would you suggest in terms of

a role for parliamentarians in communicating with their constituents and talking to consumer advocates about raising awareness of people's rights under these new arrangements?

Mr D'Aloisio—As you know, ASIC has a consumer advisory panel that it works with. So we are in that part of our business very close to a number of consumer groups. Again, as with FIDO, we will work through them. The key issue here is that because you are talking about reasonableness and reasonableness in certain circumstances there is not a 'one answer fits all' approach or a 'one or two answers fits all' approach. It is really about informed choice and asking questions. I think it is about working through these sorts of initiatives, and from time to time ASIC doing a full investigation and taking action where it feels it needs to. So that again becomes another way of getting the message across as to what is the right thing to do. I think the more we encourage people to visit the FIDO website or to consult the sort of material ASIC can provide and to ask the questions we can provide the more it will assist.

Senator PRATT—You mentioned a range of complaints that you are receiving as a result of having these new powers looking at unfair terms in contracts. Are you able to tell us the nature of some of those complaints?

Mr D'Aloisio—No, I would have to take that on notice and give you a bit of a breakdown. They will range from credit cards to mortgages and fees. We could probably look at that and give you a bit of a breakdown of what is coming through.

Senator PRATT—Is telecommunications credit still featuring highly in there?

Mr D'Aloisio—I cannot answer that.

Senator PRATT—I know it has been a significant problem historically.

Mr D'Aloisio—This is phone bills, is it, basically?

Senator PRATT—Usually mobile phone bills which are in effect.

Mr D'Aloisio—I know that people have been looking at that and are involved in the issue. I will have to get some more specifics for you.

Senator PRATT—It is when people have gone over their caps and have got a line of credit for something that they were not really aware of consuming. I know that many companies have changed their practices in response to that, but I would be interested in where ASIC thinks that is up to. Also related to credit is the status of margin lending currently. I know that margin lenders are now being licensed, in line with other credit licensing that is taking place. I want to know where that is up to and the extent to which people consuming these financial products are now less vulnerable to loss.

Mr D'Aloisio—The changes that the government made, I think it was when Senator Sherry was the minister, have been introduced and are working. Of course you have had the situation where the market itself has not been at the sort of market level that encouraged margin lending back in 2007-08, so it is hard to measure. But, certainly, the changes have introduced an element of responsible lending and also the broader education that ASIC has done, again through FIDO, about the questions people should ask and the pitfalls. We have certainly added a lot more information about the pitfalls of margin lending for the retail investor. I think all those factors are indicating to us that it probably is not a problem out there at the moment, but there is going to be a relationship between the market—

Senator PRATT—Moving again—

Mr D'Aloisio—which is related to the degree of risk that people are prepared to take in relation to shares. I think, with the benefit of the problems that occurred, people understand that if you are going to go into margin lending products you have to not borrow to actually have your equity; and, if you do you have the equity, it means you have got to be prepared to lose it because of the volatility of the markets. We are trying to get those messages out. Essentially, what we are saying to retail investors is that the bottom line is: this may not really be a product for you and you have got to be really, really careful and get proper advice.

Senator PRATT—Yes. Indeed, we had some discussion at the last estimates about the fact that it did not appear to be that much of an issue because of the change in market conditions and it may only be once things hot up again. Given what you have said and the new powers in relation to consumer credit, it seems that there are some planks in place to mitigate those kinds of risks for people who should not be taking them.

Mr D'Aloisio—We think, for margin loans for the retail investor-financial consumer, the degree of take-up, the knowledge of those products now and the disclosure that is required when you use it with a retail investor will add quite a good degree of protection for the investors. The consumer finance credit legislation again adds another level of protection in relation to consumer loans and so on. So at the moment we are not seeing it as an area that is going to explode and be a problem. I think there are things that are working their way through, and the indications are that people understand the pitfalls of margin lending more clearly today than they did in the last market movement upwards.

Senator PRATT—So, when the market does next move upwards, the provisions in the new act that require things like advisers providing advice that is appropriate to a client's circumstances will all be in place; is that correct?

Mr D'Aloisio—In so far as responsible lending and it coming in for financial consumers, we have got that guide; that is Reg. Guide 209. We are in the process of issuing another guide in relation to the disclosure of margin loan products over the next few weeks. Again, that will complement that further disclosure around the margin lending products.

Senator PRATT—And are the dispute resolution services in place now as well?

Mr D'Aloisio—Yes, I believe so. Where you are a financial services licensee, you have to have alternative dispute resolution methods, both internal and external, and those would be in place.

Senator Sherry—I will just mention that, from a policy point of view, the government identified the regulation, supervision and oversight of what is known broadly as consumer credit, which included margin lending. That is—or was—done by state governments, because it was a state supervised area. Some three years ago, we took a policy decision to seek to have the states transfer those responsibilities to the Commonwealth, and I will not go into the detail. Obviously the transfer has only just occurred and there are a range of supervisory guidance notes and consumer protections. Until that time, there was little if any supervision of margin lending in Australia. That is not a criticism of the states. I just think that the sector has grown dramatically, although it has significantly contracted as a consequence of the GFC. But certainly, up until the GFC, margin lending had grown very significantly in terms of the

individuals engaging in that activity. It is not a criticism of the states, but I do not think they were particularly well equipped to supervise this area of significantly growing financial activity. So, for a number of reasons, we took a policy decision to transfer regulatory and supervisory responsibility. Mr D'Aloisio and I have indicated this. I will take it on notice. I am sure we can get you some figures on the level of margin lending either through ASIC or through the department.

Mr D'Aloisio—Yes, we can.

Senator Sherry—Suffice it to say in summary that, from a policy perspective, those individuals who are engaging in margin lending, or may move into engaging in margin lending in coming years as the market becomes more active, will have a higher level of protection than that which existed three years ago.

Senator PRATT—Thank you for that exploration, Minister. I appreciate that.

Senator XENOPHON—Mr D'Aloisio, in relation to consumer issues, I wrote to you very recently on the issue of the Bank of Queensland's 'Save to Win' accounts, whereby, if you would forgo interest, you could have a punt on winning a prize in a lottery by virtue of having more than \$250 in the bank. What is ASIC's response to that and what role does ASIC have to regulate that sort of product? Many have expressed concerns about it, including Choice—Christopher Zinn said that it sets a pretty bad example to consumers, and I think it does to young savers as well.

Mr D'Aloisio—Senator, I did receive your letter of 19 October—thank you—and I will respond in more detail. In response to the question that you have asked, our understanding is that the product was announced, I think, last week by the financial institution concerned, the Bank of Queensland, and it has not as yet put out all the detail. As I understand it—

Senator XENOPHON—You know enough of it to—

Mr D'Aloisio—Yes. As I understand it, it is on the basis that you have a deposit and it has low interest—

Senator XENOPHON—Or no interest.

Mr D'Aloisio—or no interest—and you participate in monthly or weekly draws. As you know, the starting point of the Corporations Act is really that it is self-executing; it is for corporations to make their own judgments about complying with the law and putting out new products and innovations. Our role is to look at this from three key perspectives. We need to be satisfied that what is being put out is not misleading or deceptive, that it does not involve issues of unconscionable conduct, and that it does not involve unfair contract terms, as we were discussing a bit earlier, and that there is proper and adequate disclosure if it is a particular form of deposit that is regulated as a financial product. Our position at this stage is that clearly we want to talk to the institutions and work through those issues. We are concerned that it is the sort of product that could mislead, and we want to ensure that, if the institution is going to release it, it will comply with the law. So, at this stage, this is an interim report to you, if you like. Thank you for making us aware of it. We are looking at it and we will look at it closely. We will talk to the institution and then we will report back to you in reply to your letter.

Senator XENOPHON—So at this stage the time frame is within the next month?

Mr D'Aloisio—It is going on right now. It is important because the institution has indicated it wants to release it fairly quickly.

Senator XENOPHON—It is basically asking people to have a gamble on their interest. That is what it is. You can get zero interest or you can get a \$20,000 prize or whatever it is. You are having a punt.

Mr D'Aloisio—We are not a gaming authority.

Senator XENOPHON—You are being asked to be, in a sense, aren't you?

Mr D'Aloisio—No, I think there are a number of aspects to this. There is the deposit aspect, which no doubt APRA is looking at, and there is the gaming aspect.

Senator XENOPHON—APRA told me to talk to you guys.

Mr D'Aloisio—ACCC will no doubt be looking at it and ASIC's function is around the areas that I have spoken about. I think we are on to it; we are looking at those issues and we will respond to your letter.

Senator XENOPHON—Thank you. I have two or three other issues. Briefly in relation to the Brien Cornwell saga and the investors that are being stung by Brien Cornwell. As I understand it, on 30 August the Supreme Court in New South Wales ordered Cornwell to repay investors within 28 days and, unsurprisingly, he has not done so. What role does ASIC have in relation to this whole issue with Brien Cornwell and the number of people that have been hurt quite badly by his activities?

Mr D'Aloisio—As you know following last Senate estimates, where the issue was raised, we looked at it again. We are satisfied that we had been doing what was required in relation to what the investors were doing in relation to this group over a period of time, but we took the view that the enforceable undertaking should be enforced in court. We took those court proceedings. The orders were made. We are now waiting on the companies to respond. If we do not receive satisfactory answers then we will go back to the court. Our options after that would be winding up and seeing what happened to the money and following it through to those involved or seeking other court orders in relation to where that money may be, and so we are proceeding. The next step, if we do not get a satisfactory response to the demands that have been made, is that we will go back to court.

Senator XENOPHON—But you can understand the distress and the frustration of investors who have lost a lot of money.

Mr D'Aloisio—Yes, we do, but in the way this unfolded, the amount of money involved and how it came together, the orders ASIC got at the time and the EU, we have tried to recover the money.

Senator XENOPHON—Can I move on to a story on the front page of the *Financial Review* today headed 'ASIC faces sharemarket query' by David Crowe and Matthew Drummond.

Senator ABETZ—I have got some questions on this as well.

Senator XENOPHON—I might be a bit truncated then, given that Senator Abetz, I am sure, will ask more perceptive questions than I will.

Senator ABETZ—I will just try and clean them up.

Senator Sherry—It did not name them in the article. I wondered which senator was going to ask the questions and pose the queries.

Senator XENOPHON—Can I tell you, Minister, that it was a happy coincidence. I actually saw this this morning and I am not misleading the committee. The stat dec is on its way!

Senator Sherry—I will accept in relation to the *Fin*. I am not sure I would if it was the *Australian*.

Senator XENOPHON—You can accept it in relation to any publication, even the *Gawler Bunyip*.

Senator Sherry—Of course, in respect to you.

Senator XENOPHON—Mr D'Aloisio, essentially there is a concern that there has been a change of surveillance from the ASX to ASIC as of 1 August—that is correct?

Mr D'Aloisio—That is correct.

Senator XENOPHON—Concerns have been reported in relation to the software that there have been some configuration or other issues. Can you tell the committee where we are at with that? In other words, has the changeover meant that there is in some way any lessening of scrutiny, any transitional blips, that could affect the level of scrutiny of irregular trades, for instance?

Mr D'Aloisio—I will ask Commissioner Tregillis to comment as well, but certainly, as I said in the opening statement, we think that the transfer of surveillance from ASX to ASIC has gone extremely well. It has been quite seamless. From the market related matters that we are referring to formal investigations, which I mentioned earlier, there is nothing to indicate that we are not detecting the issues that we should be detecting. In any settling in of a new system, particularly where you are looking at where you set your warnings and what comes up, there is going to be a settling-in period. We have obviously read that article as well. I was a little bit surprised that it was raised, because I felt at my level that things were and are going very well. I will ask Commissioner Tregillis to talk a little bit more about how we will address that issue to make sure that we assure the market.

Senator XENOPHON—Before you do that, insofar as you have acknowledged that there is a settling-in period, does that mean that the settling-in period could mean a slightly lesser or a lesser level of scrutiny or surveillance?

Mr D'Aloisio—No, not from our point of view. The preparation and the transfer across to us was always on the basis of it continuing and the market not being put in a position where it felt that it could gain or do things because we were getting up to speed. The staff, the systems and everything else we have put in place assure us that it is working well and, indeed, the results themselves are coming through already in that regard.

Senator XENOPHON—Mr Tregillis, one of the sources quoted in the *Financial Review* article says:

ASIC decided that they would be able to set up their own calibrations. It has not been able to set the calibrations effectively enough to be able to effectively monitor the stockmarket.

That is the assertion.

Mr Tregillis—I would say that that is not correct. As the chairman has indicated, through the surveillance over the last month some 57 matters have been identified for further detailed review. Nine of those matters have been referred off to deterrents. That is the outcome of the surveillance. In terms of the real time market activity, the team does monitor that on a real time basis. The number of alerts that we are generating, as we understand it, are broadly in line with the types of alerts that had been previously generated by the ASX. If I could explain the process a little bit, just to provide a bit of context, we are using the SMARTS system, which the ASX and a number of other jurisdictions use. When we are talking about trading alerts, we are really talking about alerts that are generated in relation to unusual volumes compared with previous patterns. We have alerts that look for market manipulation—for example, there may be some layering of trades to try and give a false sense of supply and demand—or we look for excessive volumes of trades. They are the types of alerts. We have a range of parameters that are designed to pick up those. Typically, in any one day, there would be generated something like 300 alerts. Part of the calibration process is to make sure that when we are getting alerts we are picking up suspicious activities rather than just the types of activities that are the normal volatility in the market.

Senator XENOPHON—In terms of what the ASX was doing and what ASIC is now doing, is there an apples for apples comparison? For instance, how many alerts have you had for irregular trades since August compared with a similar period last year? Can we get a fair comparison between the sorts of alerts that were issued when the ASX was doing it and those now that ASIC is doing it?

Mr Tregillis—I do not have the precise figures. I am told that the numbers are broadly comparable. Again, the use of the system by ASIC is slightly different. We have a newer version of the system than ASX has, so that creates some differences. In terms of the use by ASX of its system, it was monitoring not only for trading but also for continuous disclosing. So the comparison of apples for apples is not precise, but I think the number of alerts we are generating is around the same.

The numbers is not the only thing. You can set the parameters so wide that you can generate a very large number of alerts. The real aim of this exercise is to generate alerts that enable you to follow up suspicious activity of the type that I have identified, such as unusual volumes, price and volume alerts, suspicious activity that leads you to inquire about whether there is some market manipulation, or excessive volumes that may be the result of algorithms.

Senator XENOPHON—I am conscious that Senator Abetz wants to ask questions on this, but can you, on notice, provide details to the committee of the extent to which the parameters have been changed so that at least an attempt at a comparison can be made with what the ASX was doing, and also, for instance, on the issue of irregular trades. I think it would be useful

information on the number of irregular trades that have been reported and there may be factors, if there is a difference, such as that the market is quite different than it was a year ago.

Mr Tregillis—I will take the question on notice in terms of the numbers of trades and the number of alerts. I can give you those figures. Again, I do put a caveat that the parameters are not exactly the same because we are using a slightly different system and we are using it for different purposes. As the chairman has said, for us the key issue is: are these alerts leading us to matters that are subject to further inquiries? The answer is yes, the 57 matters and the nine. That is, in fact, more than comparable to the types of issues being identified previously.

Senator XENOPHON—And you can tell us how the parameters have changed—that will not be a problem, will it?

Mr Tregillis—I would have to take that on notice. I do not have that detail. We have configured the system because it is a new system, and it is slightly different, so I am not sure that I will have exactly the information on how the parameters have changed. In terms of the numbers of trades and the number of alerts being generated as a percentage of trades, I can provide those figures.

Mr D'Aloisio—We will take that on notice, Senator, and be helpful. At the end of the day, we also need to be careful that how we set our parameters and how we vary our algorithms to what we look at and what alerts come up is quite important, sensitive information for the market. So I will just take it on board and we will see how we can help you.

Senator XENOPHON—Yes, sure. I, for one, would not want the release of any information in the public domain which would make your job more difficult. I make that clear.

Mr D'Aloisio—I was not suggesting you would. But, in the background of all this, for people to know a lot more about how ASIC sets its parameters, how it works, how it sets its algorithms and what it looks at and what it does not look at and how it makes those judgments, is quite important investigative information.

Senator XENOPHON—Yes.

Mr Tregillis—Senator, I think the relevant information is, in general, the type of parameters, the things we are looking for, the number of alerts that are being generated, some comparison with the number of trades—that is information that we can provide. The process of alerts is something we continue to refine because what we are trying to do is make sure we do not get too many false positives. A high number is not necessarily a good thing. What you want is a number that allows you to identify those that are most suspicious and able to be followed up for further inquiries. So a high number, by itself, of alerts is not something that we would seek to target; it is actually alerts that lead you to make further inquiries and give you a lead-in to making sure that you can identify suspicious activity.

Senator ABETZ—What do we mean by a settling-in period that this new program? I think you mentioned that.

Mr D'Aloisio—All I was referring to is that in any changeover arrangements you do all the preparation, and I think we are going through seamlessly, but it is going to take a period of time to do all your testing. At the moment we have had roughly two months—August and

September and a bit of October. We are continually looking at that information, and we will continue looking at it very closely for probably at least the next six months to make sure that the comment that the changeover has been seamless is substantiated. We feel it is at the moment and we will continue to monitor its closely. That is all I meant.

Senator ABETZ—Right. There was no acknowledgement, if I recall correctly, of that in your opening statement. All we were told, I think, was that the changeover has gone very well or extremely well—words to that effect.

Mr D'Aloisio—That still is my position.

Senator ABETZ—You say that there have been 300 alerts. How does that compare to the ASX alerts?

Mr Tregillis—I do not have those figures. As I said, that is an average figure, just to give you an indication of the type of numbers of alerts that we would get on a daily basis. I would have to take on notice the question of a comparison with ASX alerts.

Senator ABETZ—Can you give us a breakdown for these first few months of the daily number of alerts. Because, if you tell me there is an average of 300, it might be that for the first month you had none and for the second month you had 600 on each day. So, if we can have the exact figures on that—on a daily basis just for the first two months—that would be very helpful. As I understand it, the software that is being used by ASIC is the SMARTS system. That was also used by ASX. Over a number of years, as I understand it, the ASX had invested its own intellectual property into finetuning the SMARTS system to ensure that it was highly attuned to the needs of monitoring the market. Is that a fair assessment?

Mr D'Aloisio—I do not know. You would have to ask ASX, I think. There is an issue of whether it invested or whether SMARTS invested and whether, in us acquiring the SMARTS system, we have the benefit of that.

Senator ABETZ—Thank you very much. You are leading me to exactly where I was going. I have been advised that ASIC deemed it inappropriate or not necessary to purchase the intellectual property from the ASX, is that correct?

Mr D'Aloisio—I am not sure. I will have to take that on notice. As I understand it—and perhaps my colleagues assist here—our contract is with SMARTS in terms of the software and the program it is needing. SMARTS is the industry leader in this area and certainly we have sought to get the full benefit of what is needed for us to be comfortable that we can run a system. That has meant some transfer of know-how through people and otherwise with ASX through the agreement in relation to that transfer.

Senator ABETZ—I would have thought you would be full bottle on this as to whether or not you had fully taken benefit of everything that ASX had been able to add to the SMARTS system over its many years of experience in this area.

Mr D'Aloisio—Let me check that and come back to you. We certainly formed the view that we had what was needed to do what I have outlined. How we acquired that is the issue you are getting to. Let me look at that and come back to you specifically about what we acquired from ASX and what we acquired from the software houses.

Senator ABETZ—Because the information I have been provided with is that ASIC did not purchase the intellectual property from the ASX, which had been built up over a number of years and provided calibrations from the SMARTS system to be able to monitor the market and detect irregular trading activity. I understand that ASIC decided that they would be able to set up their own calibrations and not get the benefit of the learnings and experience of the ASX. So that is the issue and I would have thought—

Mr D'Aloisio—Well that is new to me.

Senator ABETZ—What about Mr Tregillis?

Mr Tregillis—I think we would have to take that question on notice.

Senator ABETZ—So you do not know either?

Mr D'Aloisio—It is not that we do not know. The assertion that we do not have what was needed to calibrate SMARTS proceeds on the assumption that we have not acquired that from ASX and we have not acquired it from SMARTS. What I am saying is that I would like to look at that because I am not sure what the source of your information is.

Senator ABETZ—But surely you must know whether you bought the intellectual property from the ASX. You must know that?

Mr D'Aloisio—We would have acquired from ASX what we needed, our team would have assessed on what was needed to run the surveillance system. We would have acquired from other software houses and SMARTS what was needed. It is the aggregate of that that gives us as the commission the assurance that we have the wherewithal to do the surveillance of the market. How we acquired that, who we paid and how it was put together, I am happy to look at that in more detail and answer that question for you, but the overriding issue for us as a commission is that we are satisfied that we have the wherewithal to conduct surveillance, and we have.

Senator ABETZ—I am sure you are self-satisfied in relation to this, but can I assure you that there are a number of people about who are not satisfied that you are necessarily able to detect the irregular trading activity and monitor the market at this stage as well as the ASX did in the past. In relation to the numbers that we were given, were they started off completely fresh—they are the 57 market matters—were they all as of 1 August or were they hangovers, if I can use that term, inherited from the ASX when matters were handed over to you?

Mr Tregillis—My understanding is that they are matters we have identified, but I would want to check precisely.

Senator ABETZ—In relation to the nine that had moved to a formal investigation, were they matters that had already come to the attention of the ASX before being transferred to you or were they as a result of your investigations as of 1 August?

Mr Tregillis—Again, my understanding is that eight of the nine are matters that we identified and one is a transfer. But let me reconfirm that figure for you.

Senator ABETZ—If that is the case and, sure, it is only one number—it does not make much difference—but why have we been told that the system is working well and you now have nine going to formal investigation, when you cannot really take responsibility for one of

them? Sure, it is small, but it potentially creates the impression that all is well. You are painting a picture that may be a little bit better than it actually is, and I accept that this is only one formal investigation that, with respect, you cannot lay claim to, given that it was initiated by the ASX.

CHAIR—The officers have said that they will take it on notice and get back to us. Your colleagues, I would remind you, are waiting to come on.

Senator ABETZ—Senator Xenophon has already asked you about the difference in the calibrations between the ASX system and the system that you are operating under. If you could provide me with the details of the differences there because that is very important. You are saying that, currently, there is no effect on the Australian Stock Exchange with the changeover?

Mr D'Aloisio—We think that the changeover, as I said earlier, has gone seamlessly. We think that in fact the speed at which we are able to look into issues is probably starting to indicate that it will be faster because we do not have to deal with two agencies or the ASX. We have said that it is still early days, as I said a moment ago. Also, one of the other indicators is that the market itself is not saying to us that there has been a big change here or that there is a problem. So, as we see it, it is going well. I take on board the questions you have asked. They are all important questions and we will do our best to answer. As we move further towards probably December and early next year I am hopeful that the evidence will build much more clearly that will support what I said to you this morning.

Senator ABETZ—Concern has been expressed that insider trading and market manipulation may be undetected in the Australian market as a result of this changeover, but it is not as rigorous. The figures will ultimately bear you out or the source that I am relying on. We will undoubtedly revisit this matter at next estimates.

Mr D'Aloisio—If I can say so, one of the other key things in terms of investigation on insider trading market manipulation is that, even well before the transfer of market surveillance from ASX to ASIC, we had increased resources in their area. We are continuing to do that. As these cases come through, we will take action. We have made it clear to the market that one of our key priorities is to stamp out 'insider trading'. When you look at the results now that are coming through on the work we are doing on insider trading, we think, again, that it is starting to have a general deterrent effect and that that, together with our supervision of the markets, is going to be what is important in maintaining confidence in the integrity of the markets. We do not think you will ever eradicate the perception that markets will have insider trading, but we are certainly working hard at keeping that as the key priority in the confidence in the integrity of Australia's share markets.

Senator WILLIAMS—Welcome, Mr D'Aloisio and your team. Can I commence by thanking you for meeting last week in relation to the Provic Group. I think it was a very prosperous meeting. Mr D'Aloisio, you would agree that there is a need for change in the regulatory guides as far as the secured investment companies go, would you?

Mr D'Aloisio—The discussion we had, Senator, was that I indicated that we would take on board two issues. One was the issue of whether, in the nomenclature, or naming, of

debentures, unsecured notes or secured notes, there needs to be a category of secured notes, which at the moment is missing. We said we would look at that issue further.

On the second issue: you raised and Provic raised with us the potential disadvantage of needing to say in an advertisement for debentures or secured notes or unsecured notes that the lender could lose their principal, could lose their money. We explained to you that those requirements had emerged at a time when we felt that investors had not fully appreciated that with some of these products they could lose the principal, and therefore our changes going back two or three years were designed to get that level of knowledge up. We recognised the thrust of the argument that you and Provic put in relation to whether or not that may now be disadvantaging the market or certain of the players in the market, and I indicated to you that we would take that on board and revisit our regulatory guide on that issue to see how we could deal with the issue that was raised with us. That work is in progress.

Senator WILLIAMS—Good. Just on that issue about the work in progress, I know that some of those companies have to issue prospectuses in the near future. Would you be able to give me any indication of the time when perhaps we may have a result on this very issue?

Mr D'Aloisio—The team, Senator, after the meeting went away to do that work, and they have not as yet indicated to me what the timing would be on that, but I think we indicated at the meeting that we would get back to Provic fairly quickly about at least what the program would be and how long it would take. I did make the point at that meeting that any change of this nature does involve ASIC in a consultation process with the broader industry, and we have Christmas coming up, so there is going to be a little bit of time, I think, in getting the issue resolved.

Senator WILLIAMS—But you are aware of those companies that do have to issue new prospectuses and hence their—I suppose—urgency?

Mr D'Aloisio—Yes.

Senator WILLIAMS—You are aware of that; thank you. Moving on to Storm Financial, can you give me an update on where your inquiry into Storm is, please?

Mr D'Aloisio—Yes. We put out a statement last Friday updating the Storm investors. As you know, we have a website for Storm investors, and we use that website to communicate with them. Also they have a private page on that website, each with their own login arrangements, so that they can keep track of what is occurring. We put on that website that we have continued our commercial confidential discussions with key parties and we have extended that consultation until 24 November. We have indicated that the commission will then consider, if there has not been agreement in principle on those commercial discussions, and the commission will then make its decision about commencing legal proceedings. That is where we are.

Senator WILLIAMS—Legal proceedings against?

Mr D'Aloisio—It will be against a number of parties involved in relation to Storm. We will identify those and indicate who they are at that point in time.

Senator WILLIAMS—So, in short, you have completed your investigation into Storm?

Mr D'Aloisio—Yes is the answer—not in the sense of being able to launch proceedings; that is subject to further consideration by the commission. But, certainly in terms of the material facts and what occurred and so on, yes we have.

Senator WILLIAMS—So are you encouraging financial institutions to perhaps come to settlements with some of their clients?

Mr D'Aloisio—I have said that the approach by institutions on seeking commercial resolutions is desirable. The Commonwealth Bank has done that and ANZ has also announced that. We have said, in relation to those resolution schemes, that there needs to be a carve-out so that, if ASIC is able to then recover money over and above that, the investors get the benefit of that. So we are encouraging commercial resolution. We ourselves believe that confidential commercial resolution of this matter remains in the interests of the investors and those involved, not because we are against taking legal proceedings—clearly we will if the commission so decides—but simply: given the time that is required to do that, given the position of the investors, we do believe that a commercial resolution is the better outcome here.

Senator WILLIAMS—So you agree with me: the more they stay out of court, the better off they are!

Mr D'Aloisio—Well, I think we are bona fide—we have said to the parties: we are bona fide in seeking to pursue commercial resolutions and are not using the legal process in any sort of aggressive way or anything of that nature; we are simply saying, 'Let's see if we can get this resolved commercially; if we can't—that happens—we'll then look at the legal option.' We are not suggesting that we will not pursue the legal option if we need to.

Senator WILLIAMS—Do you have grounds to pursue the legal option?

Mr D'Aloisio—We have indicated in one of our earlier releases that we are looking at a range of potential claims. Any litigation, as you know, is fraught with issues. You can never be certain. But certainly ASIC will launch those proceedings if it so decides, with the intention of seeing them through and recovering money for the investors.

Senator WILLIAMS—I understand you have been contacted in writing twice by solicitor Stewart Levitt, who is acting on behalf of a group of investors. Is it true that ASIC representatives have told people to be careful and Stewart Levitt is working on the other side of the Storm Financial issue? Were any words like that issued by ASIC?

Mr D'Aloisio—We have written to Mr Levitt explaining—my recollection of that is that we have not done that, and we have written to him. In terms of his approach in commencing actions and seeking to recover money—and Slater & Gordon and others are involved—we are all on the same side. There are no issues here. ASIC is the regulator. It has to clearly look at it across the whole range. It cannot take sides with Slater & Gordon or with Levitt's or other class actions. ASIC has to make its own judgments. What we are encouraging people to do is, if they go into resolution arrangements and enter into arrangements that are commercially settled, to have a carve-out so that, in the event that ASIC can recover more, they get the benefit of that.

Subject to that, with the class-action law firms and other law firms we have no issue. I do not see that we are at different ends of the spectrum here. We are all trying to do the right thing by a group of investors. In ASIC's case, its ability to do that has to be independent; it has to be across the range of interests it is seeking to protect. We are doing that job and, in the approach we are taking to commercial resolution, we are very mindful that, at the end of the day, in any resolution that is achieved, our own actions and how we conducted that will be subject to scrutiny by the investors, so we are very mindful of being careful in the way we are running these proceedings.

Senator WILLIAMS—It is a big mess to clean up. Have you had many negotiations or discussions with Emmanuel Cassimatis from Storm Financial?

Mr D'Aloisio—I have not personally, no.

Senator WILLIAMS—I suppose your representatives have.

Mr D'Aloisio—You can assume that we would have over a range of time been talking to all those involved and, clearly, he was involved.

Senator WILLIAMS—I have spoken to a Sergeant Sean McCardle who is a senior forensic examiner with Queensland Police. Have ASIC had any contact with Sergeant McCardle?

Mr D'Aloisio—I would prefer not to be going into the specifics. Perhaps I could take it on notice, but it is not going to be productive. This thing is difficult and we are trying to balance all interests, and I think going in to what people allege to be evidence and not evidence and responding to that is not going to be helpful. We are aware of issues that have been raised with us. When they are raised we look at them; we look at them carefully. We assess them. But our people, at the end of the day, have got to make judgments about the probity value of evidence that is put before us.

Senator WILLIAMS—Time is very limited so moving on from Storm Financial I have this. In relation to questions relating to Corporations Law, a lady constituent by the name of Christine Bowen contacted me. She has been involved with a company called Allco Finance Group. Are you familiar with the group?

Mr D'Aloisio—We are certainly aware of the Allco group.

Senator WILLIAMS—I know it is at a stalemate at the moment. The liquidators Ferrier Hodgson have taken her to court. I think their claim is that there are 50 employees who were not actually employed by the Allco group and hence they have not received their entitlements and they have not received any GEERS as well. It is concerning that this may be dragged on while these 50 employees do not get their proper entitlements, the long service leave, holiday leave et cetera that they are entitled to. It is in deadlock. I know that on 3 February 2009 Christine Bowen contacted ASIC and she received a formal response on 5 February 2009 but has not heard anything from you since. Mr D'Aloisio, this is one of the common complaints we got during the Senate inquiry into liquidators, administrators and the role of ASIC, where people lodge complaints with ASIC but they do not get any feedback; they might get a generic email. Can you add something as to that? Has ASIC been more responsive to those complaints now?

Mr D'Aloisio—The advice I received when we got your question is that there were a group of these complaints which included Ms Bowen's and that our people in fact did respond and did respond subsequent to the acknowledgement. But I am advised that in fact in her case she did not get the letter that the others got. Our people have got on to that and are looking at it now as to why that occurred. I am not taking away anything from the point you have made. It does look like it is inadvertent, and we are following it through at the moment.

Senator WILLIAMS—I will take you to another situation which was brought to my attention: a liquidator from Armstrong Wily and Co. which was actually suspended for four months some time back. I have here a letter from ASIC, from the media centre actually, saying that on Thursday, 4 December 2003 Mr Wily was suspended for four months for various activities—without going into too much detail. Are you familiar with the collapse of a company called BACF?

Mr D'Aloisio—I am.

Senator WILLIAMS—Did you appoint Mr Wily as liquidator for that company?

Mr D'Aloisio—I didn't.

Senator WILLIAMS—ASIC, I should say—not you personally.

Mr D'Aloisio—My understanding of that was that he was appointed because he had already been appointed to three other companies in that group, and it was the feeling at the time that it would probably make sense. He was not suspended, obviously; that was in the past. It made sense, because he had the other companies, to appoint him to this one.

Senator WILLIAMS—You are aware of some controversy with that BACF group and the liquidation of that, of course?

Mr D'Aloisio—Senator, in relation to that, I would prefer to take any further questions you have on this on notice, because this is an operational matter, it is on foot and I think, again, it is one of those situations where as ASIC we do need to let this run its course. You have made clear, and you have given me material that makes clear, the seriousness of this, and I can assure you that it is an operational matter at ASIC that is on foot.

Senator WILLIAMS—Good. Briefly, I will go to the infamous Stuart Ariff. When Mr Ariff initially applied for registration as a liquidator, was he—

Mr D'Aloisio—Senator, sorry to interrupt, but this is an important point. Mr Stuart Ariff has been arrested on ASIC charges. That was on 23 August 2010. He is on 19 criminal charges following investigation by ASIC. The alleged offences relate to his conduct in relation to HR Cook Investments between 9 June 2006 and 29 March 2009. He has been charged with 13 counts under section 176A of the Crimes Act and also six counts under section 1308(2) of the Corporations Act. This is a matter that is before the courts, and the advice that I have received is that I should not answer questions or go into details concerning Mr Ariff. I recognise that there is a balance between that and what you need to know. The best I can do, on the advice I have, Senator, is to take your questions on notice. As and when the court proceedings or information becomes public or gets to a form where we are advised that we can release it to you, we will do that. I recognise that some of the questions you have asked do not specifically relate to the charges, but the advice to me still is that it would not be proper

for ASIC to be engaged in a discussion on these issues at this time, balancing up his interests and ASIC's interests.

Senator WILLIAMS—No, I am comfortable with that, Mr D'Aloisio. That is fine. Chair, I am going to hand over to you.

CHAIR—Excellent. Thank you, Senator Williams. Senator Cameron.

Senator CAMERON—Mr D'Aloisio, can you advise me who represents Australia on IOSCO?

Mr D'Aloisio—Yes. ASIC is the relevant member of the International Organisation of Security Commissions. We are on two committees—the technical committee of IOSCO and the executive committee. As Chairman of ASIC I would generally represent ASIC at those meetings.

Senator CAMERON—I ask because in your answers to my questions on notice you raise IOSCO a couple of times. I do not have a lot of time so I am not going to go to the issues I did want to raise about the answers to my questions; I might put them in writing to you on notice.

Mr D'Aloisio—Sure.

Senator CAMERON—Are you aware of a speech that was given by Jane Diplock, the chair of IOSCO, in Colombo, Sri Lanka, on 28 September?

Mr D'Aloisio—No. I know Ms Diplock; she is the current chairman of the executive committee of IOSCO. I do from time to time read her speeches but I am not aware of that one specifically.

Senator CAMERON—Can I just put some issues to you from the speech. Obviously you will want to consider it more carefully by looking at the speech. In it Ms Diplock raises the issue of the lessons of the global financial crisis. She says there are three lessons: the interconnectedness of global markets, that markets matter and that governance matters. Do you believe that governments also matter, or is this a position for IOSCO? Why wouldn't they have a role for governments who were absolutely essential in dealing with the financial crisis—not just from a governance point of view, but from a fiscal policy point of view?

Mr D'Aloisio—I have not read the speech but I can talk about ASIC and its approach. It is very clear in the work that we do with IOSCO in representing that we work closely with Treasury. Treasury, as the policy adviser to government, comes with us to those meetings. We take the view that, as the regulator, our function in this forum is to identify the issues. The actual decision about what governments then do are policy decisions for governments, and we worked closely with Treasury on, for example, the implementation of the reforms on credit ratings and the implementation of the reforms on short selling. These were issues that arose out of the financial crisis. These were issues that were discussed widely at IOSCO and that we inputted. These issues were then brought back and the Australian government—and Senator Sherry, who is here—made decisions, as I recall, on short selling with us that were then implemented by government. On the broader issue, the global issue of where IOSCO fits in with the responsibility of governance, the IOSCO agenda, the Financial Stability Board agenda and the Joint Forum agenda are all primarily being driven by the G20 governance. All

the work that IOSCO and FSB has done is coming to a head next month in Seoul, with the G20—

Senator CAMERON—I am happy, Mr D'Aloisio, if you want to give me some further information on how you see our organisation working within IOSCO, but I really want to come to some of the detailed issues. The speech goes on to say that the crisis also overcame the traditional belief that, so long as we regulated institutions such as banks and markets, they would look after themselves:

We thought that the self-interest that drove markets meant markets would discipline and take care of themselves—

while continuing to deliver sustained economic growth and welfare—

The crisis demonstrated that this belief was woefully wrong-headed.

Do you agree with that?

Mr D'Aloisio—I have also given speeches on some of these issues, so I might stay with my own views and what we have said. When you are looking at the global context—and this speech is—and you look at the so-called misaligned incentives, particularly in the United States between executive remuneration commissions and so on and what occurred, and conflict of interest, I think that is what we are referring to—that probably some of the assumptions around so-called efficient market hypotheses that markets will regulate themselves with a minimum of interference have been called into question. But how they have been called into question depends on the particular jurisdiction. They have probably been called into question more in the United States and parts of Europe than in Australia. We did not see in Australia that sort of degree of problem around incentives and what the investment banks may have been doing.

Senator CAMERON—But the government had to intervene to keep the economy running, so I do not think you can downplay the effect of the global financial crisis in Australia by saying that everything was okay regulatorily; there are issues. What I want to come to is that in her speech Ms Diplock goes on to talk about reporting on environment, social and governance aspects, and argues that the public is increasingly expecting companies to report on environmental, social and corporate governance. It is called ESG, and we will probably see a bit more on ESG. Ms Diplock then moves on to talk about how you deal with that: you do this in integrated reporting. Are you across what is being proposed in this new approach on integrated reporting? What this does is takes the arguments I have heard from you about how we were well placed, jumps over that and says that there are new ideas and new issues that need to be dealt with. So I am surprised that you are not—

Mr D'Aloisio—I am happy to reflect further on the questions you are putting, but essentially we are not a policy arm. We are there to advise government. These are very significant policy issues that government—

Senator CAMERON—But this is the chair of your international body—

Mr D'Aloisio—Well, no—

Senator CAMERON—who is raising these issues.

Mr D'Aloisio—What I do not know is the capacity in which she is giving the speech. Is she giving the speech as the chair of IOSCO?

Senator CAMERON—Yes, she is.

Mr D'Aloisio—Then those issues are still at an early stage in the working groups of IOSCO, and if they get to such a form within IOSCO that we feel that we should discuss them with the government here and take them up, we will do that. At the moment, they are not on the specific agenda that IOSCO has. This may be something that the president of that committee may want to bring forward and discuss with IOSCO. It is something to look at.

Senator CAMERON—So if I were to ask you in the future about a governance issue, I would have to go and talk to the minister before I could even—

Mr D'Aloisio—No.

Senator CAMERON—What are you telling me?

Mr D'Aloisio—To the extent to which we are regulating governance in Australia, we would obviously talk about the regulatory regime. To the extent that you were asking me questions about whether we think there should be changes to those laws, we would take those up with government. To the extent that you are asking me if I have a view on where we should be on some of these issues, if it is in a policy area then ASIC probably will not have a view because it is a government matter.

Senator CAMERON—Can I get your view—

Mr D'Aloisio—I may be misunderstanding your question. I am trying to help.

Senator CAMERON—No. I am just interested that your international body has raised these issues and you say, 'I cannot have a view on this.' On the integrated reporting, in her speech Ms Diplock quotes a key international auditing firm, KPMG, as identifying three features of integrated reporting: one, reporting that covers not just financials but also economic, social, environmental and governance factors; two, performance that follows a company's strategies and targets; and, three, reporting that serves a wide range of stakeholders. Is there any advice or discussion that you are looking at that could take us to this level, which seems to be the emerging level of corporate governance as distinct from where we are at that moment, where it does not have that integrated approach?

Mr D'Aloisio—Not within IOSCO, no.

Senator CAMERON—I am talking about within your organisation.

Mr D'Aloisio—Within our organisation we are clearly trying to keep abreast of changes that go on and discussion that occurs. But we are not at the point of putting a proposal to government or a change to government.

Senator CAMERON—What I am concerned about is that we have this position put continually that, 'We were great; our governance was good.' But now we have an international body that you are involved in saying that that old approach was not good enough. I might ask more questions on it in future.

Senator Sherry—Senator, I think you are being a little unfair about what Mr D'Aloisio has been touching on. Perhaps there is a misunderstanding. Neither Mr D'Aloisio nor indeed

the government have claimed that the Australian financial system operated perfectly during the financial crisis. There are a range of issues that Mr D'Aloisio, both publicly and privately to government, has discussed. Indeed, we have discussed those very issues or referred to them this morning: short selling; the licensing and supervision of credit rating agencies; the consumer credit area; margin lending, which we saw with Storm Financial; the supervision of the ASX; and a whole range of corporate governance issues such as executive pay. So, whilst Australia did comparatively very well, certainly the government has never claimed—and I certainly do not believe that Mr D'Aloisio has claimed—that the Australian financial system sailed through with perfection.

Senator CAMERON—I may have read it in the *Australian*!

Senator BUSHBY—I am willing to take those questions further, if the senator wishes. During the North Atlantic financial crisis and driven at least in part by the government's deposit guarantee, which was put in place suddenly in late 2008, many investors whose savings were not protected by the guarantee were frozen. I understand from ASIC press releases from late May this year and from other sources that many of those funds remain frozen. How many funds are still frozen and what is the total value of those frozen funds?

Mr D'Aloisio—The advice I have is that around 63 schemes representing \$16.8 billion of mortgage payments are frozen. There are \$3.7 billion in property funds, about half a billion of hedge funds and about \$2 billion in cash-enhanced funds that remain frozen. As you will recall, freezing occurs because the liquid asset position of being able to redeem the units is such that the trustee forms the view that they should freeze because they cannot meet—

Senator BUSHBY—There would potentially be a run on the bank.

Mr D'Aloisio—There would be a run, yes. So what they do is then trade out of it. As money comes in, they then pro rata and give distributions back. We have given a range of relief around hardship and around rolling withdrawals and so on to enable people to withdraw funds. Some 81 schemes have sought approval from ASIC for hardship relief, some 5,387 applications have been considered and about 4,228 of those applications have received payment under the hardship provisions of about \$93 to \$94 million.

CHAIR—Senator Bushby, I am afraid we are past the lunch break time, so we will need to thank ASIC for their appearance here today.

Mr D'Aloisio—Thank you, and I note that there are a number of questions that have been foreshadowed to be given to us on notice. We will answer those as quickly as we can.

Senator BUSHBY—Hopefully quicker than last time.

Mr D'Aloisio—There was an election in that process, Senator.

Senator ABETZ—With the questions that were placed on notice, if any information can be brought back today, or indeed as soon as possible, that would be very much appreciated.

Senator Sherry—That is assuming, of course, it is not at the ministerial level.

Senator ABETZ—Of course.

Senator Sherry—In terms of the later questions, I will get my office to check with the other responsible office or officers to see whether they are at a ministerial point.

Senator BUSHBY—I may have unfairly accused APRA last night, but I am fairly confident that ASIC's answers were not within the timeline.

CHAIR—Thank you, ASIC, for coming in today and answering questions in person.

Proceedings suspended from 12.32 pm to 1.31 pm

Productivity Commission

CHAIR—I welcome the officers from the Productivity Commission. Thank you for coming in this afternoon. Dr Kirby, would you like to make an opening statement?

Dr Kirby—I would like to bring you up to speed with where the commission is at the moment in terms of its work program. Since we last met, several reports and reviews have been finalised. The latest instalment of our annual review of regulatory burdens on business was released last week in fact. Prior to that, we have released the final report on gambling and also our trade and assistance review, which is one of our annual report series of products. We have also finished our inquiry into wheat export marketing. That report has been given to government and is awaiting tabling.

In addition to that, we have many projects still underway. In fact, nine commissioned projects at the moment are underway. Three of those have actually commenced since we last met—one on the urban water sector and reform there, the early childhood development component of our education and training workforce study, and also our estimation of the COAG reform benefits. In addition to those new ones which have started, major projects still underway include an inquiry on disabilities and on aged care. We are due soon to put out a draft report on the vocational education and training component of the education workforce project. A draft report has been released of the rural research and development corporations inquiry. A final report will be delivered next year. We have also released a draft report on the study into bilateral and regional trade agreements. Again, that project will be finalised towards the end of this year. Currently we have underway the latest instalment of our benchmarking work. This time it is on planning, zoning and development assessments. That project, because of data issues, has actually had to be extended. So a draft report for that will now be expected in February.

In addition to that suite of government commissioned projects, our other major block of ongoing work relates to our work as a secretariat to the COAG Steering Committee for the Review of Government Service Provision. So the report of our major annual review of government service provision will be released in late January. Also, in the middle of next year will come the next instalment of our biannual *Overcoming Indigenous disadvantage* report. In addition, we have been doing a lot of work for the COAG Reform Council in terms of reporting on national agreements and national partnerships as well as work on Indigenous expenditure reporting. The final thing to note is that before the end of this month our annual report is due for release as well. So it is quite a full and varied work program, and it is quite a wide range of meaty policy issues which the government and COAG have entrusted to us.

CHAIR—Thank you, Dr Kirby. Senator Bushby has some questions.

Senator BUSHBY—I thank the Productivity Commission for assisting us today, and congratulations on what sounds like a very busy workload that you appear to be delivering

very well. In the view of the commission, what is the biggest contribution that this government has made to increasing Australia's long-term productivity?

Dr Kirby—I do not think we have actually made an assessment of this government's particular contribution to delivering productivity. From time to time we have undertaken studies relating to productivity growth and productivity potential for the Australian economy. We have certainly highlighted the broad sorts of policy issues which are relevant to enhanced performance in that area. Some years ago we did a major study on the potential for reform and what that may contribute. In the broad, we would emphasise things like having good regulations and good regulatory processes. We emphasised good industry policy and also we have emphasised the need for or the potential in terms of the human capital agenda.

Senator BUSHBY—Dr Kirby, you have outlined a lot of things that should happen in terms of the advice that you have provided. Can you point to anything that has happened in the term of this government that would substantially have added to the productivity of the nation?

Dr Kirby—We have not done such a stocktake. However, a government commissioned project which we have on our books at the moment, which is to estimate the economic impacts and benefits of the COAG reform agenda, will provide an opportunity for us to address the issue which you are alluding to.

Senator BUSHBY—But at this stage you have not?

Dr Kirby—The first instalment of that work is actually due pre-Christmas, but that report will be very much a sort of framework and methodology report and then we will be analysing progress and what has happened in particular areas in the subsequent reports.

Senator BUSHBY—So there is a formal framework that may well identify changes in productivity, but nothing comes to mind sitting here in front of us today?

Dr Kirby—That project is still ahead of us.

Senator BUSHBY—But in terms of what the government may have done over its first term of government to add to the improved productivity of the nation, nothing comes to mind at this point?

Dr Kirby—We have not analysed that question.

Senator BUSHBY—Okay, that is fine. I will leave it at that. I guess on that basis you would not care to venture an opinion on what might be the least good contribution to productivity.

Dr Kirby—Probably not.

Senator BUSHBY—Why has Australia's productivity been declining in recent years?

Dr Kirby—I think there are several issues at work, and in fact one of my colleagues may be able to help me out here as well. There are some very specific factors which have been going on. In fact, we recently made a submission to a House of Representatives committee on this issue and will be discussing it perhaps more fully or in a more up-to-date fashion in our annual report, which will be coming out in coming weeks.

Senator BUSHBY—Unfortunately not in time for today.

Dr Kirby—That is correct.

Senator Sherry—That is reasonably standard, I have to say.

Senator BUSHBY—It is reasonably standard.

Senator Sherry—For all portfolios of all governments.

Senator BUSHBY—Not all of them. Tonight we will have the AOFM and I have had the benefit of seeing their annual report, which came out this week. That is no criticism of you, but it is possible.

Dr Kirby—Yes. In the analysis we have done we have also looked at the contribution to Australia's productivity performance of different industry sectors and it seems clear that there are some special events—I guess you would call them—which have been taking place. For example, a lot of the productivity performance in recent times can be attributed to what has been going on in the mining sector, in the agricultural sector and in some of the utilities sector as well. We have published research on the mining sector specifically already. The main things which are going on there seem to be the very strong investment surge which has taken place in that industry, and the reality is that there is a fairly lengthy lag between investment and increases in output when it comes to large investments in the mining sector.

The other issue in the mining sector, too, is that over time the quality of our ore bodies just tends to decrease because the high-quality, readily accessible ones tend to be used first. I guess the other thing which has been going on in the mining sector in recent times, as you would be aware, is that mineral commodity prices have been very strong which means that the set of potentially profitable projects has expanded. That means that what were previously relatively low productivity projects are now profitable.

Senator BUSHBY—So they do not have to try as hard to—

Dr Kirby—So even though productivity may be declining, profitability has been expanding and Australian incomes have risen as well.

Senator BUSHBY—But is that just masking a problem because of the high prices maintaining profitability when those prices are no longer there? If we have not made gains in productivity, then that will be exposed, will it not?

Dr Kirby—In fact it is a good news story, because what it means is that ore bodies which previously were unprofitable, which previously were low productivity—

Senator BUSHBY—Certainly at that micro level it is a good news story, but in terms of the more macro aspect of Australia's economy it could potentially leave us exposed if as a nation, so to speak, we relax because the profits are still coming but they are coming for a specific reason and in the meantime we are not making productivity gains. When that reason no longer exists we could be exposed.

Dr Kirby—I think that is a separate issue. The reality is that it is a great time of opportunity in that we can utilise those ores where previously we could not and we can raise the income of the Australian economy whereas previously we could not.

Senator BUSHBY—You mentioned earlier a number of recommendations, and publications that you have put out talk about where we could go to improve Australia's future

productivity. What stands out to you as the main changes that a government could make or parliament should focus on in order to achieve some of those?

Dr Kirby—Again, when we did our analysis of the potential areas of reform for our report on the national reform agenda a few years ago, it was clear that there were several areas of potential activity or benefit. One was the traditional area of regulatory reform and industry policy. The other big, perhaps untapped, area was the area of human capital development, and that went to the heart of education and health type issues, although, in the case of that, we were cognisant of the fact that those sorts of gains do not necessarily come costlessly. So the costs of increasing educational standards et cetera really needed to be taken into account as well.

Senator BUSHBY—So those are the things that stand out from your perspective as to where parliament could go, looking forward?

Dr Kirby—Regulations or characteristics of the workforce which were inhibiting participation in the labour market and which were inhibiting the productivity of individual workers.

Senator BUSHBY—Okay. So in that sense you are talking about education rather than government regulation that might be inhibiting the workforce to adapt to the demands?

Dr Kirby—Certainly in the case of education, for instance, yesterday we released a staff working paper, which is not a formal commissioned product but is a research product by some of our staff, on the impact of literacy and numeracy on labour market outcomes. That research strongly indicates that enhanced literacy and numeracy skills really do contribute to the potential for participation in the workforce and the potential for higher wages as well.

Senator BUSHBY—In terms of regulation, which you mentioned, the Department of Finance and Deregulation is obviously tasked with deregulation. In your view, what progress has been made on deregulation in the last three years?

Dr Kirby—Again, I think the department could probably better answer that question. We have not undertaken a stocktake of deregulatory—

Senator BUSHBY—So you have not done any formal analysis, but nothing comes to mind once again? You cannot think of any major strides that have been made by that department in achieving deregulation in government?

Dr Kirby—I think the department could better answer that question.

Senator Sherry—Senator, as I think I indicated yesterday when we got into this area, I am more than happy to talk extensively about that issue here and now, but it is not the appropriate place. But, as has been mentioned, the PC has been charged with carrying out the COAG agenda of deregulation and an assessment of that—

Senator BUSHBY—Delivery of government services—

Senator Sherry—And the impact, and that is to come, of course.

Senator BUSHBY—You mentioned before that you had not done a stocktake on it, but through that body—you are the secretariat, I believe—

Dr Kirby—Yes.

Senator BUSHBY—Through that body you will be looking at this in the future?

Dr Kirby—We will be looking at the COAG reform agenda and the impact and the benefits.

Senator BUSHBY—So that is for all state and federal governments' approaches to the issues of service delivery and how regulation may impact on productivity?

Dr Kirby—Yes.

Senator BUSHBY—I presume you would agree that it is a given that there is scope for further deregulation in terms of achieving productivity improvements?

Dr Kirby—I think there is scope for continual improvement in the regulations in the Australian economy.

Senator BUSHBY—Okay.

Dr Kirby—It is a matter, I guess, of picking the priority areas and working out which are the best ones.

Senator BUSHBY—Which was very much my next question. Where would you think the priorities should be?

Dr Kirby—We will be examining what the achievements have been and hence what the residual priorities are.

Senator BUSHBY—So the Productivity Commission has not put out any papers or Mr Banks has not given any speeches where he indicates where some priorities could be?

Dr Kirby—We have over recent years been undertaking studies of the regulatory burdens imposed on business by Commonwealth legislation and we have been undertaking studies which benchmark the different regulations in specific areas across the various jurisdictions in Australia. So that information perhaps will be useful to policymakers to make an assessment of where things may change.

Senator BUSHBY—That is fine, but in any of those fora have you actually identified areas where you think there would be significant benefit to Australia if certain things were tackled?

Dr Kirby—Those reports identify differences and areas of imposition of costs and I guess by implication a reader may be able to make conclusions as to how they might want to respond.

Dr Gordon—It is worth saying that the not-for-profit sector report made a number of recommendations with regard to regulation that effectively got embedded in contracts. So through the contracts a whole bunch of requirements added significantly to the costs of operating not-for-profit services, many of them funded by government. There were explicit recommendations about actions that could be taken to reduce those costs.

Senator BUSHBY—That is a good example. How big a job would it be to identify the types of issues that you might have put together over the last three years in various reports, speeches or papers—without the detail, just the headline; this is what it was?

Dr Kirby—We could go back and look at our—

Senator BUSHBY—If you could take that on notice and, without placing an unreasonable requirement on you, that would be appreciated.

Dr Kirby—Sure. That information would be available through our website, where there is a complete listing of all the projects and inquiries that we have done. That is fairly straightforward.

Senator BUSHBY—As a general principle, do you think it is advisable that large public infrastructure projects are preceded by a cost-benefit analysis?

Dr Kirby—I think the commission has always been a supporter of strong policymaking procedures. Some of the key steps in terms of good policymaking involve considering the objectives that one is seeking to achieve, considering the full range of options which may be conducive to those objectives, considering the impacts, the costs and the benefits of the various alternatives and making a selection based on the policy option which leads to the greatest net benefit to the Australian community. At the end of the day, having a fairly strong post-evaluation process in train to check and finetune policies after the event in terms of what impact is actually achieved is supported.

Senator BUSHBY—So in summary the answer is yes? You are not Robinson Crusoe in that respect. Dr Henry is also of that opinion. The red book advised the incoming government that it is a valuable thing to do and it should be done, particularly for large projects—infrastructure and so forth. Tell me if I am putting words in your mouth, but in general you are saying yes?

Dr Kirby—Strong consideration of all the alternatives, the costs and benefits and careful selection is the way to go.

Senator BUSHBY—Is it a reasonable argument to say that some projects are so big or so visionary that they cannot be assessed by a cost-benefit analysis? Could you foresee that a job could be too big or too visionary to actually conduct an analysis of it?

Senator CAMERON—I think this is really a hypothetical. If there is a question about a project or a type of project I think that is fine, but to ask in a general way like that just leaves—

CHAIR—I will leave it up to Dr Kirby to answer it.

Senator BUSHBY—I can rephrase it and ask him if he was asked to do the cost-benefit analysis on the NBN, for example.

Senator CAMERON—But why would you?

CHAIR—I think Dr Kirby is quite capable of responding.

Dr Kirby—If we were given by the government of the day the job of doing a cost-benefit analysis of any particular project then basically we would do the best job we could of that. We would examine the characteristics of the project. We would examine the information which was available relating to the impacts and the costs and benefits. We would address the government's terms of reference as best we could.

Senator BUSHBY—And ultimately, regardless of whether some impacts or potential benefits may be known or not, you would come up with a result which said, 'Well, on the

basis of the information that we can ascertain, this is our consideration of the costs and the benefits,' and a conclusion.

Dr Kirby—Oftentimes what one finds is that one has good information on a subset of the costs and benefits—information which is readily available. So in principle we would document that. But then there may well be a broader range of issues which cannot be so readily calculated, so to speak. We would tend to mention them qualitatively, and I guess there would be an element of judgment involved on the part of readers of the analysis as to what decisions they come up with.

Senator BUSHBY—Nonetheless, you could have a crack at it and come to conclusions based on that level of information that you had available to you?

Dr Kirby—We would undertake whatever projects the government of the day requested us to do.

Senator BUSHBY—What do you think about the proposition or the argument that because a government policy has already been decided upon there is no point in doing a cost-benefit analysis?

Dr Kirby—Well, again, the Productivity Commission is happy to do tasks which the government asks us to do.

Senator BUSHBY—Regardless of whether it is a policy already or not, you would take it on because that is your job?

Dr Kirby—Yes, that would be an issue of government prioritising of our work program.

Senator BUSHBY—I will move on to a slightly different topic. In your most recent annual review of regulatory burdens, one of the recommendations is to increase the monthly income threshold for superannuation, which is still at \$450. Why do you think the threshold was set at \$450 in 1992?

Dr Kirby—I understand that that threshold was set at \$450 in 1992. It was essentially, I think, at the time a question of balancing the need to ensure superannuation was received by workers versus the costs of administration and compliance. So essentially it involved balancing those two issues and that is what led to the \$450 threshold.

Senator BUSHBY—Do you know how many workers were excluded from the guarantee in 1992 because of that threshold?

Dr Kirby—I could not tell you that.

Senator BUSHBY—You would probably have that information, though, as part of your examination of this issue somewhere in the commission?

Dr Kirby—We could take that question on notice and see if we do have that information.

Senator BUSHBY—Thank you. In real terms, how much has that threshold fallen?

Dr Kirby—Again, I cannot give you the exact number but, clearly, because of inflation, because of increases in wages, that threshold now captures more workers than it previously did. So to an extent there has been regulatory creep through the nonindexation or nonincrease of the threshold. I think that was part of the rationale in our most recent report, which

suggested that that threshold really needed to be looked at, needed to be increased and maybe should be subject to regular review in order to maintain the original policy intent.

Senator BUSHBY—That balance that you spoke of is no longer necessarily there in the same way it was when it was introduced?

Dr Kirby—Correct.

Senator BUSHBY—What impact would this dramatically lower threshold have on employees' wages and business costs?

Dr Kirby—I cannot give you a specific quantitative answer, but clearly it is capturing more workers. Clearly there is a cost there. There are probably also increased administrative and compliance costs.

Senator BUSHBY—Okay. In your recent trade and assistance review you write:

While tariff assistance has declined significantly in recent years, budgetary assistance to industry has been increasing.

Can you elaborate on the budgetary assistance you are referring to?

Dr Kirby—The budgetary assistance—and, again, maybe my colleagues can help me a little bit on this one—relates to direct expenditures and also relates to the various tax concessions. In the report there are various areas of expenditures, various tax concessions, which are documented and costed.

Senator BUSHBY—What is the impact of this assistance on the Australian economy, in your view?

Dr Kirby—Obviously the direct impact of assistance is to enhance or to favour those particular areas of activity. The broader impacts of it through the economy would need to be examined.

Senator BUSHBY—What are the potential broader effects?

Dr Kirby—In the case of budgetary assistance, the most obvious one is that taxpayer revenue has to be raised in order to finance it.

Senator BUSHBY—Yes, or diverted from other programs.

Dr Kirby—Yes.

Senator BUSHBY—What about distortionary effects in the economy?

Dr Kirby—To the extent that one area of activity in an economy is favoured through regulation, through protectionist measures, through subsidies and through a range of possible assistance measures, that area benefits. That area attracts resources of labour and capital. Those resources come from other areas of the Australian economy.

Senator BUSHBY—This is my final question on this particular point. Did you come up with the total value of the assistance that the federal government is providing to industry in Australia?

Dr Kirby—I have not got that number off the top of my head.

Senator BUSHBY—I think it was \$17-point-something billion. I do not have it in front of me either, but I quoted it yesterday before the industry department and I think the industry minister made some comment about how they might calculate assistance to industry different to what the Productivity Commission does. Could you just confirm what that figure is and provide a break-up of how it is comprised and from which departments? Is that possible? Where it is sourced?

Dr Kirby—Certainly where it is sourced or where it goes to. Whatever is in the report we will get to you.

Senator BUSHBY—Okay. As much detail as you can in terms of the break-up of that figure. Thank you.

Senator RONALDSON—Dr Kirby, I am pleased that you made reference to the staff report yesterday about the links between literacy and numeracy skills and labour market outcomes, because I suspect that the staff and I are the only ones who have probably read this at this stage. But there were some very interesting outcomes from it. Just for the benefit of others in the room, what the staff report found was that it was estimated that an improvement in literacy and numeracy skills from level 1 to level 3 would increase the likelihood of labour force participation by about 15 percentage points for women and about five percentage points for men and increase hourly wage rates by about 25 per cent and 30 per cent for women and men respectively, which was a very significant improvement clearly. What I found of great interest was the next part of this report, and I will quote from it:

Improving educational attainment was also estimated to have a positive statistically significant effect on labour force participation and on wages.

If improving the opportunities for educational attainment has that positive effect on labour force participation or wages, I would assume that reducing the opportunities for educational opportunities would have a negative effect potentially on labour force participation and on wages.

Dr Kirby—The analysis I think is specifically in terms of educational attainment, so I am not quite sure how that relates to opportunity, per se. The interesting thing about this research is that it did try to disentangle the effects of educational attainment—for instance, year 12 or degrees or whatever—from the specific skills which individuals have in terms of their literacy and their numeracy.

Senator RONALDSON—That is right, so overall it was educational attainment that was being looked at in the global sense. Indeed, presumably cost is a trigger factor in people's decision to improve their educational attainment. Would it make sense that that would be a trigger?

Dr Kirby—Costs but also I guess the expected return on their investment.

Senator RONALDSON—Yes, but costs would certainly be one of them you just said?

Dr Kirby—Yes. One of the obvious costs in terms of future educational attainment is the income which is forgone in the time in which you study. So for many of us who have done three or four years of university study, we were not earning income in that time period and that is probably a major element of the cost involved in that decision.

Senator RONALDSON—Or the cost of living away, or the cost of transport—all of those sorts of things.

Dr Kirby—Yes.

Senator RONALDSON—On the back of that, are you aware that last year the current government made some very dramatic changes to the independent youth allowance?

Dr Kirby—I am aware of some media comments on it.

Senator RONALDSON—Are you also aware that these changes effectively allowed the government to discriminate against students from areas classified as ‘inner regional’?

Dr Kirby—The commission has not looked at that issue specifically.

Senator RONALDSON—Are you also aware that this new policy divides regions and electorates with arbitrary lines or maps determining student eligibility for independent status? Are you aware that two towns in the same area on different sides of the line will have potentially different educational outcomes and that students may come from the same class in the same school but be discriminated against based on which side of the line their home sits?

Dr Kirby—I personally am not aware of the specific details of the policy or its implementation.

Senator RONALDSON—Are you aware that in the House of Representatives—on Monday, I think it was—there was a motion moved by Ms Marino, the member for Forrest, who moved:

That this House:

(1) requires the Government:

(a) urgently to introduce legislation to reinstate the former workplace participation criteria for independent youth allowance, to apply to students whose family home is located in inner regional areas as defined by the Australian Bureau of Statistics instrument Australian Standard Geographical Classification;

Senator CAMERON—Point of order. First of all, there does not seem to be a question coming. Secondly, Dr Kirby has indicated that he is not aware of the issues that Senator Ronaldson is raising. Yet Senator Ronaldson is continuing on as if Dr Kirby can respond to these issues, even though he has indicated that he does not have a detailed capacity to respond.

CHAIR—Yes, that did occur to me as well, Senator Ronaldson, but I will allow Dr Kirby to make that decision himself.

Senator RONALDSON—Just on the point of order, Dr Kirby—

CHAIR—The point of order has gone. I am allowing you to continue, Senator Ronaldson. I do not see any point in dwelling on the point of order.

Senator RONALDSON—I was hoping that you might let me elaborate on the point of order.

CHAIR—No.

Senator RONALDSON—To avoid me asking another question. I will leave it there. I thank you for the answers that you have given me, Dr Kirby.

CHAIR—Thank you.

Senator CAMERON—Dr Kirby, you are aware that Professor Stiglitz did a series of seminars in Australia?

Dr Kirby—Yes.

Senator CAMERON—One for the Productivity Commission.

Dr Kirby—Yes, I think it was a joint Productivity Commission and the Economics Society of Australia lecture.

Senator CAMERON—What issues did the professor raise in the seminar that interested the Productivity Commission?

Dr Kirby—One of my colleagues can help me out a little bit on that, but the main issue which I heard him talking about was the issue of wellbeing in an economy and measuring wellbeing in an economy.

Dr Gordon—The talk was on the work that Stiglitz, Sen and Fitoussi did with the commission that had been put together by President Sarkozy and he was reporting on the measurement framework that they had been developing to try to develop other measures of wellbeing that go beyond some of our current economic measures. We have always known that the economic measures are very limited—partial measures of wellbeing. There is an OECD-led international program to try to expand some of those measures. The commission has been talking to the ABS and watching that space very closely.

Senator CAMERON—So were there, firstly, any lessons for the Productivity Commission in this seminar and, secondly, for government?

Dr Gordon—What was interesting is the extent to which we do not have good general national level measures, we do not have good longitudinal data on a lot of the sorts of things that matter for wellbeing. So we are very interested in assisting to get the sorts of information that we would like when we do our inquiries so that we have a better database to work with because, as was mentioned earlier in response to a question on how you can try to measure some things that are very hard to measure, often we find that we can measure economic things well but we really struggle to find good measures of social outcomes and often environmental outcomes. So we are very supportive of any program that tries to build better databases for future analysis.

Senator CAMERON—In relation to your current inquiry into productivity, would you be taking any of the lessons or ideas from Stiglitz and applying them in that analysis?

Dr Gordon—If an inquiry is into productivity, measuring multifactor productivity, we are actually talking about outputs. So the concept of productivity as measured currently is very well defined. But, when we do our analysis in a cost-benefit framework, we do look at a much broader set of benefits and costs. In many ways the commission uses our inquiry process and calls for submissions to identify what those are and to ask people for evidence on those kinds of things.

Senator CAMERON—So the wellbeing of the community could be a factor in this inquiry?

Dr Gordon—In any inquiry that we do we are actually tasked with looking at the community wellbeing. Sometimes we are asked to specifically look at the economic ramifications, and other times, particularly inquiries like parental leave and aged care, we do have to look at those broader wellbeing issues.

Senator CAMERON—You might want to take this on notice, but maybe at the next estimates you will be able to advise us how you use the Stiglitz analysis in your inquiry, if you use it at all. I will be seeking some answers on that.

Dr Gordon—I think it is a very useful piece of work.

Senator XENOPHON—I have a question that follows on from what Senator Cameron was asking on these broader issues and from what Senator Bushby was asking in relation to the NBN and the cost-benefit analysis. Does the commission have the capacity to undertake a social cost-benefit analysis of something like the NBN in terms of the economy-wide effects and the issues of, for instance, what some would perceive as a market failure with respect to broadband in regional Australia? There is an element with broadband of the blue-sky type issues in terms of we do not know what the technology will bring, although I suggest that you can extrapolate from what has occurred in the last few years. Is that the sort of thing the commission could usefully do—not just a strict cost-benefit analysis, as I think Senator Bushby was referring to, but broadening it to the social impacts of broadband?

Dr Kirby—I think the commission is well placed to do such work. It has the expertise to do it. It has had plenty of experience in applying such an approach—for instance, the work that we have done on gambling, on non-profit organisations, on disabilities, on aged care. These are important social issues which do have that social dimension. So we have plenty of experience at doing it. Also, I think the commission's public hearing processes are very suited to bringing those issues to the fore in the discussion, in the debate, in the analysis. That information is certainly taken into account in putting together the final analysis of the issues.

Senator XENOPHON—Would that include issues or perceptions of market failure?

Dr Kirby—Certainly we examine market failure issues.

Senator CAMERON—Given this productivity inquiry that is taking place, when I was the secretary of the union I had some work done by a Dr Jim Stanford, a Canadian economist. He outlined a number of failures in the Australian economy in the decade from 1996 to 2006. He said that there was a failure of using ABS statistics and OECD analysis, that there been had been a failure of investment, a failure of innovation, a failure of productivity, a failure of development, a failure of competitiveness, a failure of balance in the economy and a failure to deal with the issue of sustainability. Does that correlate with any of the issues that you have looked at over the last decade?

Dr Kirby—I am not familiar with the piece of work, but it sounds like a fairly gloomy assessment of the Australian economy.

Senator CAMERON—It is actually an analysis of ABS data and OECD data in terms of where we are, because it is not gloom; it is facts.

Senator BRANDIS—Not opinion, Senator?

Senator CAMERON—No, factual. I can take you to it. And it is not a Brandis to Brandis.

Senator BRANDIS—Economists do have different opinions, you know, Senator Cameron.

CHAIR—We really only have a couple of minutes, so Dr Kirby might like to respond. Please go ahead, Dr Kirby.

Dr Kirby—Well, I guess what I am hearing from the question is a fairly gloomy assessment of the status and the progress of the Australian economy in that particular time period. I guess my experience suggests that it has not been quite as gloomy as that, so I am surprised at the depth of the gloom there. I think the Australian economy internationally has not been doing too bad in a relative sense either. I think undoubtedly some of the broader studies and some of the specific studies that we have done indicate that there is plenty of scope for improvement. That is what we are about as a commission—trying to find those areas for improvement.

Senator CAMERON—On the international tables over that period, we were at the bottom of the tables for research and development. We were at the bottom for investment. That is the facts as they are laid out in the OECD and in ABS statistics.

Dr Kirby—Well, on the research and development, perhaps I can turn to my colleague to my right who, in fact, was involved with our major study on innovation.

Dr Lattimore—We did look very closely at Australia's innovation system in a report several years back. It is very difficult to make these comparisons of R&D across countries and it is quite easy to get the impression that Australia is a low performer. However, we have a particular industry structure. When you adjust for that industry structure our position is not at the bottom of that.

Senator CAMERON—I am not saying the bottom; we are below average.

Dr Lattimore—Okay, and some people turn it around and say we are above average in R&D productivity, if you like, too. But we looked at a whole broad range of aspects of our innovation system at that time, which encompasses the public sector as well as the private sector, and we did identify some issues, but there were also some very positive features of the Australian system. We had very positive words to say about, for example, the role of the public sector in R&D.

Senator CAMERON—Does the Productivity Commission say that it is not a gloomy picture when you look at the failure of investment in public facilities and infrastructure? PEO and ABS statistics from 1990; it reduces from six per cent of public fixed investment as a percentage of GDP down to under four per cent. Is that a great achievement for this economy?

Dr Kirby—I think when it comes to public sector investment or investment generally there is no magic number. There is no magic per cent of GDP which is the right number. Essentially what you want is to make sure that your investment makes sense in that it makes a decent return to the community either in terms of a profitable investment if it is a private sector undertaking, or the other returns, the other social and economic and community returns which come from major infrastructure investments.

Senator CAMERON—But Dr Kirby—

CHAIR—Sorry, Senator Cameron, we are at time now. If you want to put questions on notice please go ahead. I would like to thank the Productivity Commission for coming in again this afternoon.

[2.19 pm]

Inspector-General of Taxation

CHAIR—Welcome. Do you have an opening statement that you would like to make?

Mr Noroozi—Just briefly. As you know, the office was set up in 2003. It has been going for seven years. I have been in the job for about two. I started on 6 November. This is the first time I have appeared in this capacity before you. In terms of what we have been doing, in the last financial year the minister released five of my completed reports, including the so-called U-turn review which dealt with adverse impacts of alleged delayed or changed views of the tax office.

There are three other reports that are with the minister awaiting public release. Those are to do with a super guarantee charge, the administration of private binding rulings and also a follow-up review to see how the tax office has implemented the recommendations that it had agreed to in a number of earlier reviews.

We are also in the midst of four other reviews. One of them is the audit of large business. Another one is the administration of past rulings. Another one is SME and audits of high-wealth individuals. The last one is the review of the tax office change program, which I was directed to do by the minister after concern had been raised by taxpayers and tax practitioners about delayed or incorrect returns as well as problems with refunds. I will commence work on a new work program towards the end of this calendar year. That is by way of introduction.

Senator XENOPHON—It may not surprise you to know that my primary concern is in relation to the review of the change program. Could you give an indication of the time frame of when you think that review will be provided to the government?

Mr Noroozi—Sure. I might, if I may, paint a bit of a picture first.

Senator XENOPHON—I was going to ask about the number of submissions and the like.

Mr Noroozi—We have received over 90 submissions. It is an enormous program. It was not just the tax office personnel involved; there was the contractor Accenture and two independent assurers involved and subsequent to that there was a further contractor involved. It has been a process of going through over 90 submissions, verifying the contents of those as well as further investigation work and also trying to develop worthy recommendations as to how some of the issues may be overcome if this were to happen in future. So it has been a very—

Senator XENOPHON—But it is still a current problem though, is it not? It is a current issue—that is, the transition or the change program?

Mr Noroozi—I am aware that the Senate was keen for this process to be quick. The approach that I have taken is to have a staged approach to deal with the most immediate issues upfront which is what has affected taxpayers and tax agents. As regards that first stage,

we are in the process of completing our first draft of that report which we will be sharing with the tax office soon, as I am required to under my act and under the protocol between us and the tax office. Following that period of consultation with the tax office on the draft itself, it will then be provided to the minister. As you know, it will then be released by the minister at the time of his choosing but within 25 sitting days. So that is where we are at. We are in the process of finalising our first draft of the report upon which we will then be engaged in consultation with the tax office before releasing to the minister.

Senator XENOPHON—In terms of the tax office response, that may be a month or so? What would you normally expect in your experience of these things?

Mr Noroozi—There are arrangements under the protocol. As you would appreciate, first of all we need to make sure that everything in that first draft is absolutely correct and they have the right to have a look at that. They also have the right to respond to any criticism in that report, and they have a period of time to do that. So there may be some iterations involved. We will do it as soon as we can. I am hoping that in the next few months we would be in a position to finalise that report and submit it to the minister.

Senator XENOPHON—Is there an ongoing review? Obviously into the new tax year there are some suggestions that in order for the tax office to cope with the problems there were a lot more staff than probably were anticipated to continue working on it. That is something we will ask the ATO later on today, but is that one of the issues that you are monitoring or looking at in the context of this change program?

Mr Noroozi—As you know, under the Inspector-General of Taxation legislation I am not authorised to discuss the reviews until such time as they are publicly released by the minister.

Senator XENOPHON—I just have to be patient I think. Thank you.

Senator BUSHBY—Thank you to the officers of the Inspector-General of Taxation for coming along. Mr Noroozi, you said it is your first time before us. I presume that is because we have failed to call you before since you have—

Mr Noroozi—I have appeared before you in a different capacity.

Senator BUSHBY—That is right. I do recall that, but as Inspector-General of Taxation.

Mr Noroozi—Yes, it is.

Senator BUSHBY—I am glad that we have called you along today. You do a lot of important work. In your view how much scrutiny are the ATO's decisions subject to? Is it adequate in your view?

Mr Noroozi—That is a difficult question. There are certainly a number of scrutineers on the tax office. There is the Ombudsman who deals with single cases for individual taxpayers or, should I say, single taxpayers, be it corporate or an individual. They raise their issues with the Ombudsman and they have a scrutineer function. I have a scrutineer function with respect to systemic issues. In addition to that, there is the ANAO that carries out performance audit and so on. There is also the Joint Committee of Public Accounts and Audits, so there are a number of scrutineers. This starts getting into a policy area and something that perhaps the government could consider, but at the moment there are certainly a number of bodies looking

at what the tax office does. I guess it is for others to determine whether all of those different bodies are doing their scrutineering function adequately. I have no reason to doubt it.

Senator BUSHBY—Does the ATO have any publicly available policies on how it deals with its objections and complaints?

Mr Noroozi—Yes, it does have procedures for objection handling. We have done a review into tax office handling of objections, for example. We did that and it was released by the minister in the last financial year.

Senator BUSHBY—Do you monitor the number of disclosures of taxpayer information made to other government agencies or law enforcement agencies?

Mr Noroozi—No.

Senator BUSHBY—Is that outside the scope of your act or something that you have not directed the attention of the office to?

Mr Noroozi—The level of disclosure is not something that we have turned our mind to, but I would have to look at the legislation to see whether that is actually authorised or not.

Senator BUSHBY—As far as I know, there are not any records of these disclosures. I would think that it is probably in the public interest if there were records of the level of disclosures to other government agencies. That may be something of interest to you, if it falls within the scope of your act. Have you read the Denley case, which was decided recently by the appeal court in Queensland, which was critical of the ATO's litigation tactics? Are you aware of that?

Mr Noroozi—Yes, we are aware of that. A number of years ago there was a review done by my predecessor into the litigation matters that the tax office gets involved in. But, again, as you know, we engage in a very wide consultation process before we release our work program. I am about to embark on a new work program towards the end of this year. At this stage of course we will take input from everybody as well as doing our own research as to what the work program should be. Currently I am completing a work program that was set in March 2009. I am required under my act to advise well in advance as to what that work program is and then work through it.

Senator BUSHBY—In terms of the issues that are raised by the appeal court in Queensland in that case, those issues may well be things that you will consider as part of your work program.

Mr Noroozi—Potentially, yes.

Senator BUSHBY—Similarly, no doubt you would be aware of the ATO material in relation to the departure prohibition order which was imposed on Paul Hogan and how that was approached. I presume that would also be the ATO's approach to departure prohibition orders and similar powers. Will they also be on the possible list of work order?

Mr Noroozi—Certainly the wider issue of Project Wickenby will be and also the serious noncompliance unit within the tax office. We have already received a number of submissions. Again, that is one of the potential reviews that we will be looking at when we develop our work program.

Senator BUSHBY—I note that in issue No. 38 at paragraph 1460 of the Thomson Reuters *Weekly Tax Bulletin* you are actually reported as considering a review of Project Wickenby.

Mr Noroozi—Yes, that is right. I think what I have said publicly is that we have received a number of complaints. We have received a number of submissions. We are considering it and we will make a decision about it when we complete our work program—sorry, we complete the actual future work program.

Senator BUSHBY—Yes, what is going to be in that work program—I understand. Are you satisfied with the ATO's response to your report on your review into the implications of any delayed or changed ATO advice on significant issues?

Mr Noroozi—That was the one that has been shortened to the U-turn review. The report is obviously on our website. The tax office agreed to all of the recommendations we made in that report. The first recommendation talks about a potential course of action the government might want to take in terms of the advice framework that the tax office operates within. Then it goes on to say, 'But we have come to some administrative agreement with the tax office into what they should do in the meantime.' The tax office is supposed to develop a practice statement from 12 months of the release of that report that captures in what circumstances they would seek to apply their advice retrospectively or prospectively, and we are engaged with them in development of that practice statement. So the issue is, yes, we are happy about the fact that they agreed to the recommendations but much depends on its implementation. As I said, the practice statement will come out. We will then see how the tax office applies that in practice before saying whether we are completely happy with the tax office response.

Senator BUSHBY—Okay. Your work program—and you are currently developing the next one—how long a period will that work program cover?

Mr Noroozi—It will depend on the type of reviews that come up because, again, the legislation requires me to consult widely and really much of it comes from the grassroots. So it will depend on the type of reviews and how many reviews we select to do. Traditionally, both my predecessor and I have not necessarily sat down saying, 'This work program is going to last for this long.' For example, in the last work program we set out initially eight reviews we would do and, given my current level of staffing, that was always going to take a couple of years to do, roughly.

Senator BUSHBY—What is your current level of staff, just as a matter of interest?

Mr Noroozi—Including myself, seven.

Senator BUSHBY—Okay. Having adopted a work program—so you identify seven or eight areas that you are going to look into—if you become aware of another systemic issue in the ATO early on in that work program, one that appears like it could need some urgent attention, do you have the flexibility to be able to change a work program to include that?

Mr Noroozi—Indeed. In fact, that is what we did, for example, when I was directed to do the Change Program. We had just starting doing the review into tax office audits of SMEs and high-wealth individuals. So that has been put on hold until we complete the Change Program.

Senator BUSHBY—Okay. I have one final question. In 2009 the inspector-general—who I presume was you then; I am not sure—wrote in a report dated 15 April 2009:

Clearly, the stakeholder feedback to date does not suggest that current management and handling of objections—

by the ATO—

is perceived as being independent or impartial.

In the same report:

... the Inspector-General believes that the Tax Office has to take further steps... to reinforce the role of objections in tax administration and to promote its independent character.

Has this perception changed, in your view, since early 2009?

Mr Noroozi—That was the review that I alluded to earlier.

Senator BUSHBY—Yes.

Mr Noroozi—What we do with these reviews is after some time has passed we go and do a follow-up review to see to what extent the recommendations we made, and to which the tax office has agreed, have actually been implemented. We will shortly be starting that follow-up review process on the objection review.

Senator BUSHBY—Okay.

Mr Noroozi—It is probably more appropriate to speak about it at that time.

Senator BUSHBY—We will have to call you back again.

Mr Noroozi—Correct.

Senator BUSHBY—Okay. Thank you.

Senator CAMERON—I am just not sure whether this is the appropriate place to be asking this question but, given that you deal with serious noncompliance and systemic issues, is sham contracting an issue that you would be involved with?

Mr Noroozi—Sorry, let me go back a step. I do not deal with serious noncompliance. The review that I may do would be looking at the tax office's handling of serious noncompliance. For example, the complaint that has been made to me is that no matter who you are, you always deserve due process. Some of the complaints are around people who are accused or who are potentially serious noncompliers and who have not been afforded due process. That is the allegation. So I do not deal with serious noncompliance per se; that is the job of the tax office and I think they are appearing after me.

Senator CAMERON—That is what I wanted to know. Thank you.

CHAIR—Thank you. As there are no more questions for the Inspector-General of Taxation we will conclude at that point and look forward to seeing you back at a future date to follow up on those issues. I call the Treasury next, and I will ask the Revenue Group and the Australian Taxation Office, outcome 1 groups, to come to the table. These groups will be heard together.

[2.44 pm]

**Department of the Treasury
Australian Taxation Office**

CHAIR—We are asking Revenue to come to the table and we will make a start. The Australian tax office are delayed. Senator Sherry, my understanding is that there are many questions for Revenue Group and it would make it difficult if we were to be delayed much longer, so I would prefer to start.

Senator Sherry—Can you start with something else?

CHAIR—That is a question for the committee

Senator BRANDIS—Senator Sherry, I do not need Dr Henry for my questions.

Senator Sherry—You do not, but the government does want Dr Henry here.

Senator BRANDIS—Well, that is the government's problem.

Senator Sherry—No, it is not.

Senator BRANDIS—This is a Senate committee, not a government committee.

Senator Sherry—It is also the committee's problem because—and this goes back to the point I was making earlier, Chair—you have come in and asked to go straight to mining tax. That was not our understanding.

Senator BUSHBY—It might not have been your understanding but there has been no decision of the committee in that respect.

Senator BRANDIS—Senator Sherry, my questions are going to be directed to a number of officers, not necessarily Dr Henry.

Senator Sherry—I understand that. I have already raised it twice. Chair, I do not want to be in this position again. It is embarrassing for everyone concerned.

Senator BRANDIS—Senator Sherry, I propose to start now. We have been delayed now by three minutes beyond the time at which this bracket of evidence was scheduled and I propose to start now.

CHAIR—I think we should call a private meeting on this issue and resolve it in that way.

Senator Sherry—That would be appreciated, Chair, thank you.

CHAIR—I will adjourn the committee for five minutes for a private meeting.

Senator Sherry—Chair, look at your own program. Reading your program—

CHAIR—Yes, I understand that.

Senator Sherry—I think it is important. The program itself says this.

CHAIR—What I said is the committee has always operated flexibly. I do understand that we said that retirement income, superannuation and tax administration should be considered before afternoon tea. We will need a private meeting to adjust that, but we are not bound by that and never have been.

Senator BRANDIS—Chair, before you convene the private meeting, can I just indicate that my first questions will not be to Dr Henry. They will be to another officer.

CHAIR—I think we understand that as well, but I think we do need a private meeting.

Senator BRANDIS—They will be to Mr Parker, who was sitting right at your left shoulder, Senator Sherry.

Proceedings suspended from 2.49 pm to 3.00 pm

CHAIR—The committee will now recommence. Thank you for your patience, everyone. We will commence with questions in other areas and when Dr Henry is here we will have that questioning.

Senator BUSHBY—How much did the Cooper review cost?

Senator Sherry—That is related to the Markets Group. I will take that on notice.

Senator BUSHBY—The government has produced a \$40,000 savings figure for the benefit of its My Super superannuation policy announced during the election. Has the likely increased usage of passive management been taken into account in the Treasury estimate?

Senator Sherry—That is the Markets Group again. I will have to take that on notice.

Senator BUSHBY—What aspects of retirement income and superannuation can be asked about?

Senator Sherry—Do you want me to take that on notice as well?

Senator BUSHBY—No, I would like an answer to that now.

Mr Willcock—Just to assist the committee, in relation to the Cooper issues the Revenue Group deals with issues that have a tax policy implication. That includes, for example, regulation of the SMSF sector, which is largely regulated through the ATO. We also handle super-stream-type issues. Most of the rest of the Cooper issues are covered by the Markets Group. Outside the Cooper-type issues we, of course, deal generally with the taxation of super.

Senator BUSHBY—I will come to questions about self-managed super funds in a minute, but I think we will probably be moving to Senator Brandis now.

Senator BRANDIS—Madam Chair, can I simply record that the committee has been delayed in coming to this topic by the refusal of the government to proceed in the absence of Dr Henry. Dr Henry has now arrived. It is not your fault, Dr Henry.

Senator CAMERON—Point of order.

Senator BRANDIS—It is not your fault, Dr Henry, but the committee should not have been imposed upon by the government in this manner.

CHAIR—Senator Cameron has a point of order.

Senator CAMERON—My point of order is that there was an agreement reached on this issue and I am unsure whether, when you reach agreements now in the committee, the issue then continues. I do not know why you would come here making these statements when an agreement was reached.

CHAIR—I do not think that is a point of order.

Senator Sherry—I was not going to comment, but Senator Brandis has. It was certainly our understanding and, in fact, it is printed on the agenda—

Senator BUSHBY—Not on the one handed out today.

Senator Sherry—that the preferred approach would be retirement incomes and tax issues first. I certainly respect Senator Brandis wanting to ask his questions but, in view of the understanding reached, Dr Henry was not here for the proposed retirement incomes area. Senator Brandis wanted to go to the mining tax—fine. We just needed a time to ensure that Dr Henry could be here for that area. That is what has occurred.

Senator BRANDIS—That is what has occurred but it is not the position that the government can pick and choose when to respond to questions which are within the schedule because particular public servants wish to be here.

Senator Sherry—The position of the government is that we believe there was an understanding about what areas questions would be posed to, and as evidence I point to the agenda of the committee. That was our understanding. We respect—and welcome, indeed—that you want to come in at short notice to vary that arrangement and that understanding. We accept that but, given that notice in order for Dr Henry to be here, it has now taken us 16 minutes to organise that.

Senator BRANDIS—Madam Chair, my questions are to Mr Parker. Is it Mr Parker or Dr Parker?

Mr Parker—Mr Parker.

Senator BRANDIS—We are not all doctors. Mr Parker, you are the Executive Director of Revenue Group.

Mr Parker—Yes, that is right.

Senator BRANDIS—The development of what was the RSPT and is now the MRRT, from a Treasury point of view, is undertaken by your division and under your supervision?

Mr Parker—Yes, that is right—with the overriding supervision of Dr Henry, of course.

Senator BRANDIS—I understand that. I have a series of questions that I am going to direct to you, Mr Parker, in relation to the mining tax—and can I use that phrase to comprehend both the RSPT and the MRRT just for shortness—but, if there are other officers of Revenue Group who are more immediately concerned in the topics that I want to cover, no doubt the question can be referred to them. Mr Parker, which officers of Treasury sit on the secretariat of the Policy Transition Group?

Mr Parker—There are a number of officers and if you want me to give you a complete list then I am happy to do that, but I do not have the complete list in my head.

Senator BRANDIS—That is fine. You can take that on notice. About how many?

Mr Parker—There are probably four or five, I think.

Senator BRANDIS—Are you one of them?

Mr Parker—No, I am not one of them, but I am a member of the Policy Transition Group itself—not of the secretariat.

Senator BRANDIS—Okay. The secretariat is also staffed, as we learned yesterday, from public servants from the Department of Resources, Energy and Tourism.

Mr Parker—Yes, that is right.

Senator BRANDIS—And what other departments?

Mr Parker—There are some representatives on there from the Australian Taxation Office and there are also a number of private sector people.

Senator BRANDIS—What? On the secretariat?

Mr Parker—On the secretariat, yes. It is in that sense a cooperative exercise.

Senator BRANDIS—All right. So the three elements of the Commonwealth represented on the secretariat of the Policy Transition Group are Treasury, ATO and the energy and resources department?

Mr Parker—Yes, that is right.

Senator BRANDIS—What about the members of the Policy Transition Group? You have told us that you are one. Who are the others, please?

Mr Parker—It is a group that is co-led—co-chaired, if you like. Mr Ferguson is one of the co-chairs.

Senator BRANDIS—Mr Peterson from?

Mr Parker—Ferguson—Minister Ferguson.

Senator BRANDIS—Minister Ferguson. Sorry.

Mr Parker—Don Argus, who the committee would be familiar with.

Senator BRANDIS—Yes.

Mr Parker—Chris Jordan, who has had some prior involvement in this area. He is the vice-chair of the board of tax and was also a member of the resource tax consultation panel, which was the exercise launched immediately after the announcement of the RSPT. Then there are three other members on the PTG—essentially private sector mining people with a very solid knowledge of the industry. They are Erica Smyth, Keith Spence and David Klingner.

Senator BRANDIS—Are there any other public servant members of the Policy Transition Group?

Mr Parker—No, there are not.

Senator BRANDIS—Do you not sit on this group, Dr Henry?

Dr Henry—No, I do not.

Senator BRANDIS—Okay. Mr Parker, can I put a document in front of you, please.

Senator CAMERON—Has that document been tabled?

Senator BRANDIS—Yes, it has. It was tabled yesterday. Mr Parker, while the assistant secretary is on his feet, perhaps I will show you another document as well. I will just get you to identify it, please. Only for the sake of completeness, the document that has just been handed to you is a copy, is it not, of the heads of agreement that was produced in response to a question taken on notice at the Senate Select Committee on Fuel and Energy in July?

Mr Parker—Yes, I believe that is so.

Senator BRANDIS—All right. Going back to the first document that I gave you, a document headed ‘Resource super profits tax and constitutional issues’, that is a document, is it not, that you produced in response to an FOI request on 1 October this year?

Mr Parker—Yes, it is.

Senator BRANDIS—All right. You will see that the document comprises three sections. It is a bundle of pages but the first two pages are an extract from a Treasury minute; is that right?

Mr Parker—Yes, I believe so.

Senator BRANDIS—The next five pages are an extract from legal advice, specifically paragraphs 6 through to 8, 21 through to 24, and 50 through to 72, of advice from the Australian Government Solicitor?

Mr Parker—Yes, that is correct.

Senator BRANDIS—That is attachment A. Then the balance of the document—attachment B—is a document entitled ‘How the tax would operate’.

Mr Parker—Yes, that is right.

Senator BRANDIS—And that is a Treasury document, attachment B?

Mr Parker—Yes.

Senator BRANDIS—All right. I just want to ask you a number of questions about the document itself before we get into the content of it. On what date was the Treasury advice—that is the first two pages of the document—prepared?

Mr Parker—I see. I do not have that information in my head, Senator. I do have the information in my head about the date of the AGS advice. If you like, I will take that on notice.

Senator BRANDIS—I will come to that. I just want to take you through this in a methodical way. May we take it that the reference to the RSPT means that this document was prepared before the abandonment of the RSPT or its re-announcement as the MRRT on 2 July?

Mr Parker—Yes, that would be right. The freedom of information request by the *West Australian*, specifically Shane Wright, was, through a number of stages, limited to documents which were briefings to the Treasurer in the period between the announcement of the RSPT and the announcement of the MRRT.

Senator BRANDIS—And the RSPT was announced, was it not, on 2 May?

Mr Parker—Correct.

Senator BRANDIS—So this document was prepared in either May or June of this year?

Mr Parker—That is correct.

Senator BRANDIS—All right. Can you do any better than that or are there any other officers in the room who can assist with the actual date of the minute?

Mr Parker—No.

Senator BRANDIS—All right. You will take that on notice, will you?

Mr Parker—Yes.

Senator BRANDIS—Are you able to do any better in locating the date? Was it in May or was it in June, do you know?

Mr Parker—I am not certain, Senator. I will take it on notice.

Senator BRANDIS—All right. Were you the author of that Treasury minute or was it signed off by you?

Mr Parker—I do not specifically recall, Senator.

Senator BRANDIS—Coming to attachment A—the five pages of extracts from the Australian Government Solicitor's advice—

Mr Parker—Senator, my colleague here has some further advice.

Senator BRANDIS—Mr Francis, are you able to help? That is very good, yes.

Mr Francis—I believe that the document was signed off by Andrew England.

Senator BRANDIS—By?

Mr Parker—Andrew England.

Senator BRANDIS—Andrew England.

Mr Francis—He is a chief adviser in the business tax division.

Senator BRANDIS—All right. Is he here?

Mr Francis—He is not present today.

Senator BRANDIS—All right. Just stay there, Mr Francis. You might be able to help with some of these other questions. Turning then to the extract from the AGS advice, on what date was the AGS advice received?

Mr Parker—My understanding is that it was received on 27 April.

Senator BRANDIS—20?

Mr Parker—27 April.

Senator BRANDIS—Of April. All right. Thank you. It was presumably received in response to a written request from Treasury to the AGS; is that right?

Mr Parker—Yes, that is right.

Senator BRANDIS—What was the date of that request?

Mr Parker—I understand the date of the request was 14 April.

Senator BRANDIS—14 April. All right. Can a copy of the request be tabled, please?

Mr Parker—Senator, clearly we are going to be talking eventually in this process about matters of legal privilege and so forth. So I would presume—and I do not pretend to be a lawyer, although I do have legal qualifications—that the issue of legal professional privilege may also attach to the request.

Senator BRANDIS—Privilege has been waived by you, Mr Parker, by producing the advice.

Mr Parker—Certainly privilege has been waived in respect of the material that has been put on the public record.

Senator BRANDIS—A partial disclosure of advice in this form, as a general rule, waives the privilege in the entire document and that principle would apply by extension to the request—if, indeed, it is right to say that the request is covered by the privilege at all.

Mr Parker—Senator, that may well be your view. I am not able to express a legal opinion on that matter.

CHAIR—Mr Parker, you are taking that request on notice, are you?

Mr Parker—Yes, I am taking it on notice and I am simply not conceding the point that it waives legal professional privilege.

Senator BRANDIS—I am not going to debate the legal principle with you, but you are taking the question on notice. That is fine. So you are taking on notice what? My request for the production of the instructions for the Australian Government Solicitor?

Mr Parker—Yes, that is right. I would need to consult with the Australian Government Solicitor in advising the government on that matter.

Senator BRANDIS—Mr Parker, who was the author of the instructions to the Australian Government Solicitor?

Mr Parker—I believe that it was Andrew England, but I am not certain. So again, I can take that precise question on notice.

Senator BRANDIS—All right. The advice received from the Australian Government Solicitor on 27 April in the form produced in response to the FOI request has been redacted in certain respects by the omission of a number of paragraphs. I ask for the production of the complete advice please and I assert, as I repeat my proposition to you, that perhaps inadvertently you have waived the privilege in relation to the whole of the advice by producing a substantial portion of it.

Mr Parker—As I replied to your previous question, Senator, it is not my position before the committee to concede that point. I would just note that the redaction that you see has not been prepared so far as I understand it for the purpose of responding to the FOI request. The material that you see fitted within the FOI request because it had been provided by means of advice to the Treasurer.

Senator BRANDIS—You are taking on notice, are you, Mr Parker, my requirement that Treasury produce the whole of the advice?

Mr Parker—I will take that on notice.

Senator BRANDIS—Thank you. Mr Parker, who made the decision to include and exclude from what was produced from the material? Was that your decision?

Mr Parker—Yes, it was my decision.

Senator BRANDIS—Was that decision made itself on the basis of legal advice?

Mr Parker—Yes, it was.

Senator BRANDIS—From?

Mr Parker—From the Australian Government Solicitor.

Senator BRANDIS—Was that legal advice documented?

Mr Parker—No, it was oral advice.

Senator BRANDIS—Was a minute prepared of that conversation?

Mr Parker—No, a minute has not been prepared of that conversation.

Senator BRANDIS—Is there any documentary record of that conversation?

Mr Parker—There may be a documentary record of it in the form of an email. I would have to check and in the event of you requesting that then, again, I will take it on notice.

Senator BRANDIS—I do request the production of any email of the kind that you have described.

Senator CAMERON—I remember another search for an email!

Senator BRANDIS—Mr Parker—

Senator Sherry—We will take it on notice.

Senator BRANDIS—Mr Parker, are you aware of the evidence given by Mr Wilson from the Policy Transition Group secretariat, one of the department of energy and resources' public servants, to this estimates committee yesterday afternoon concerning this advice?

Mr Parker—Yes, I am broadly aware of it. I have not had an opportunity to read the transcript of that evidence.

Senator BRANDIS—The transcript has not been prepared yet, Mr Parker, so none of us have had the opportunity to read the transcript. But can I tell you as the person who was asking the questions that Mr Wilson told the committee that the first that he knew of the existence of this legal advice was when he heard about it being published by the *West Australian* newspaper on Monday of this week, and Mr Clarke, the secretary of the department, said that so far as he was aware nobody in his department was aware of the existence of this legal advice before they read about it or heard about it being published by the *West Australian* newspaper on Monday. Mr Parker, why is it that this legal advice was not made available sooner to the department of resources and energy, given its close involvement with the RSPT and the MRRT?

Mr Parker—Let me run through the issue. As you know, there is the secretariat for the Policy Transition Group. That is the specific involvement of RET in this process. I might contextualise my comments by noting that the matter of constitutionality of the RSPT and the

subsequent MRRT is hardly a new issue. This matter has been a matter of some debate. It has been a debate in the public forum. There are all sorts of newspaper articles on it. Various comments have been made by various people which have been reported, and I can recollect discussions at this committee in previous periods where the question has been raised. So it is not a new issue, Senator. The scope of issues going to questions of constitutionality have ranged across several matters—

Senator BRANDIS—Mr Parker, I am loath to interrupt you, but I really would like a direct answer to my question.

Mr Parker—I am trying—

Senator BRANDIS—Why was the department of resources and energy not provided with a copy of this advice before they had to read about it in a public newspaper this week?

Mr Parker—I am trying to answer your question essentially by making the point that this particular element of constitutionality is one of only several. The issue of constitutionality is not new, and the fact that this particular piece of advice had not been provided to RET is hardly unusual in that context. In terms of the documents relating to the RSPT and the MRRT, obviously that would be a substantial pile of documents, many of which we have released under the FOI request. This is one of a hundred documents that were considered in that FOI request. I do not know precisely the number of those that had been previously conveyed to RET, but to pick this one out is, in that sense, to take it rather out of context.

Senator BRANDIS—I do not regard that, I have to say to you with all due respect, Mr Parker, as a responsive answer. I asked you why it had not been provided and you have not told us. Why was the advice not provided to RET?

Mr Parker—Senator, what I—

Senator BRANDIS—Did it not occur to you?

Mr Parker—Senator, as you know, there are a variety of people on the PTG secretariat who have been involved in the RSPT-MRRT thing for some time. They would have been broadly aware of it, as they have been broadly aware of a whole range of other documents which have not been provided.

Senator BRANDIS—Nobody from the department of resources and energy was aware of it until Monday. That was their evidence.

Mr Parker—And I am not disputing that statement, Senator.

Senator BRANDIS—Mr Parker, we were told by Mr Wilson, the resources and energy public servant who sits on the Policy Transition Group secretariat, that when he became aware on Monday of the existence of this legal advice he made a request of Treasury to be provided with a copy of it, and all that Treasury was prepared to do was furnish him with a copy of what had been released under the FOI request, not the entirety of the legal advice. That is right, is it not?

Mr Parker—Yes, that is partially right. We have seen reports in the *Australian* newspaper and elsewhere this morning which have quoted Mr Wilson as saying that we had refused to provide the advice. I spoke to Mr Wilson about that matter this morning and, in the absence of

a transcript, he has provided me with a more fulsome description of what he said to the committee.

Senator BRANDIS—Mr Parker, I have not put that to you. I did not say that Mr Wilson said that the advice had been refused, so please respond to my question.

Mr Parker—Fine.

Senator BRANDIS—Can you tell us, please, why it is that Treasury was only prepared to provide or make available to the department of resources and energy that part of the AGS advice which was already in the public domain as a result of the FOI request.

Mr Parker—Okay, let me go through the run of play here. The initial response to RET was effectively in the following form—that there were issues of legal professional privilege. We were not refusing to provide the advice—that is, the full advice—but we needed to talk to AGS to seek their view and advice on the issues of legal professional privilege which we have talked about several times already.

Senator BRANDIS—Mr Parker, there is an air of unreality, if I may say so with respect, about these answers. You are both working for the same government. You are involved in an interdepartmental series of arrangements through the Policy Transition Group. Why did you have a concern or a reluctance to make your partner department with whom you are working on these issues aware of legal advice going to their very constitutionality?

Mr Parker—Let me answer that in two slices, Senator. My understanding—and I would need to go back and check this formally—was that the request for the advice from the PTG secretariat went to a request for the purposes of providing that advice to the PTG. It is not simply a group within government. There are private sector people on that group, and so it is not simply a question as you have—

Senator Sherry—Chair—

Senator BRANDIS—I understand that, Mr Parker, but—

Senator Sherry—Chair, could Senator Brandis please allow the witness to complete his answer? There was not a reasonable amount of time given to what was directly relevant—directly relevant. Senator Brandis is starting to interrupt.

CHAIR—I would agree with you, Minister. It was directly relevant and I think Mr Parker said there was another half of his answer to come. So I think it would be useful to let him—

Senator BRANDIS—Madam Chair, if you will just hear me, what I was going to say to Mr Parker was to remind him that the answers given by Mr Wilson yesterday in response to my questions, verified by the secretary of his department, Mr Clarke, were directed to the provision of the advice not to the PTG but to the department of resources and energy. So that consideration as to private sector members of the PTG itself does not arise.

Senator Sherry—Chair, nevertheless, Mr Parker was directly addressing the question. Just because Senator Brandis is not happy with the question does not give him the right to interrupt with such—

Senator ABETZ—He is very happy with the question!

Senator Sherry—It does not give him the right to interrupt at such a stage.

CHAIR—I think that probably is right. Mr Parker was being relevant and was developing his answer. So, Mr Parker, would you like to continue?

Mr Parker—Yes, Senator, and I have just had the matter confirmed—that the request which was made to us for the provision of the advice was specifically in the context of a proposal to convey that advice to the PTG.

Senator BRANDIS—Go on, Mr Parker. What else were you going to say?

Mr Parker—Yes. So that does mean that issues of legal professional privilege arise. The second half of my answer is essentially as follows: I am not going to make any comment about the advice itself. It is not my position to do so.

Senator BRANDIS—Mr Parker, I have not asked you to make a comment about the advice.

Mr Parker—No, but I am giving you a reason why we need to seek the advice. This particular advice is not in respect of the MRRT proposal, which the PTG is working on.

Senator BRANDIS—Yes.

Mr Parker—That is the first point. Secondly, it is therefore advice, if you like, in abstracto, in relation to a policy proposal which is no longer government policy. Let me say three things. Firstly, it is about the RSPT, not the MRRT. Secondly, it does not talk in terms of absolutes regarding the constitutionality of something; it talks about risks. Thirdly, it proposes a way in which the government's objective of capping the royalty refund—and that is the substance of the most recent debate—could be done which on its face is not discriminatory. So the issues that are in the advice are relevant in abstracto to the work of the PTG, and no doubt they have taken notice of that. I would imagine that the PTG will itself seek legal advice—

Senator BRANDIS—I am not asking you to speculate.

Mr Parker—on this at a future point in time, and I am happy to explain to you why that would be the case.

Senator BRANDIS—I am not asking you to speculate, Mr Parker, so I will just stop you there. Mr Parker, you know that legal advice, particularly on areas of constitutional law, is seldom framed in absolute terms. If you are familiar with yesterday's evidence by your colleagues in the department of resources and energy you would know that Mr Clarke, in response to a question from me, affirmed that in relation to the rebate of royalties issue there is no material difference between the RSPT proposal and the MRRT proposal. Mr Parker, in view of what—

Mr Parker—I am not sure that is entirely true, Senator.

Senator BRANDIS—If Treasury has a different view from the department of resources and energy on this key point—there seems to be an enormous amount of confusion between agencies about the shape of this proposal, even at this late stage.

CHAIR—Mr Wilson did point out that it was not a policy area for the RET.

Senator Sherry—That is right.

CHAIR—He did point out that it was Treasury's role in the policy, so I do not want to have Mr Wilson's remarks twisted around.

Senator BRANDIS—I am merely acquainting the witness with what Mr Wilson did say. Nevertheless, I will move on.

Senator Sherry—No, I wish to respond here. Senator Brandis is not acquainting the witness with the evidence that was given yesterday. He is giving his version and, in some cases, interpretation of the evidence. The evidence that was presented yesterday will be confirmed by the transcript, which no-one has at the present time, including Senator Brandis.

Senator BRANDIS—I have a clear memory and recollection, as I would hope you do, Senator Sherry.

Senator Sherry—I do, but your recollection and emphasis is partial, and it can only be, because we do not have a transcript.

Senator BRANDIS—There was a one-word answer. I asked whether there was a material difference and the answer was no.

Senator Sherry—Senator Brandis, when we have a transcript, we can see the evidence in its entirety and in context, and you know that is the case. You are giving your potted version of the evidence yesterday and it is certainly not verbatim.

Senator BRANDIS—What part of the word 'no' do you not understand, Senator Sherry?

Senator Sherry—It is not an accurate reflection of the evidence from yesterday, as the transcript will reflect.

Senator BRANDIS—Mr Parker, you told us that the advice was received on 27 April 2010. The RSPT was announced by the then Prime Minister—the butchered Prime Minister—on 2 May 2010, five days later. At the time Mr Rudd announced the RSPT, the government was aware of this on the basis of the advice from its own legal advisers, supported it appears by advice from the Solicitor General not produced but referred to internally within this advice. Paragraph 66 at the foot of the fourth page states:

... there is a risk that a court would find that the law discriminated between States for the purposes of s 51(ii), and was therefore outside the scope of the taxation power. It follows that it would also be possible to argue that, to the extent that the law in effect permitted a mining operator to receive a more favourable tax treatment in one State over another, it constitutes a preference for s 99 purposes.

Allowing for the fact that legal advice of this character, particularly about constitutional matters, is never absolute, why did the then Prime Minister announce an important taxation policy knowing that the government's advice was that there was a risk that it was unconstitutional?

Mr Parker—I am not able to answer your question directly. You have asked me, in a sense, to speculate about the reasons—

Senator BRANDIS—Minister, do you know the answer to that question? Why did the then Prime Minister—

Mr Parker—If you would permit me to continue—

Senator CAMERON—Point of order, Chair!

Senator BRANDIS—You have just said that you do not know the answer.

Mr Parker—No, hang on—

Senator Sherry—He has not finished his answer.

Senator BRANDIS—He just said he does not know the answer.

CHAIR—Senator Cameron has a point of order.

Senator CAMERON—I have a point of order. Mr Parker is attempting to answer the questions—

Senator BRANDIS—Mr Parker just said he did not know the answer to the question. This is why I redirected it to the minister.

Senator CAMERON—This shows exactly why I was raising the point of order. Senator Brandis is somewhat agitated in terms of his questioning approach, and it does not do this committee any good and it does not do the witness any good. He should be stopped from continually interfering with the response from the witness.

CHAIR—I was distracted at the time. Minister, are you answering?

Senator Sherry—Mr Parker had not finished his answer. Mr Parker was interrupted again by Senator Brandis, who did, I accept, via interruption, attempt to pose a question to me, which I am happy to take, once Mr Parker has finished his answer.

Senator BRANDIS—We could cut to the chase here. I withdraw the question, Mr Parker, so you do not need to worry about it. Minister, let me direct the question to you. You now know that at the time Mr Rudd announced the RSPT the government had been advised by the AGS that there was a risk that it was unconstitutional. If you read those portions of the advice that have been put into the public domain by Mr Parker's decision on 1 October—and I am paraphrasing here—a fair reading of that advice is that the view of the Australian Government Solicitor was that there was a substantial risk that this proposal was unconstitutional, in particular in relation to the rebating of royalties question. Why did the then government, the then Prime Minister, announce a major taxation measure knowing that in the view of the government's own legal advisers it was probably unlawful?

Senator Sherry—We had a discussion about this yesterday at the resources committee hearing and obviously again some further discussion this afternoon. I do not have anything further to add about the development and finalisation of government policy. That was a matter for the Prime Minister and the Treasurer and other ministers of the day, and I was not involved. I cannot assist you directly. What I can do is take your question on notice and respond appropriately on behalf of the government.

Senator BRANDIS—Thank you, Senator Sherry. Mr Parker, I now want to go to the issue of the heads of agreement, a copy of which I placed before you earlier. The heads of agreement were announced by the Prime Minister at her press conference on 2 July 2010. It is apparent from what she said on that occasion that they were signed the previous evening, 1 July 2010. Let me just read to you what the Prime Minister on that occasion said about the heads of agreement. She stated:

Last night we sat down to settle the final agreement, and I can now announce we've reached agreement on the basic structure of minerals taxation for the future.

She went on to say a few minutes later:

I'm delighted that last night we were able to sign a heads of agreement with some of our major mining companies.

Then she went on to foreshadow the establishment of the Policy Transition Group. The document you have before you is the heads of agreement. I want to take you to that term of the heads of agreement which deals with the rebating of state royalties issue which you will see at about eight-tenths of the way down the document. It states:

All state and territory royalties will be creditable against the resources tax liability but not transferable or refundable.

Do you see that?

Mr Parker—I do.

Senator BRANDIS—As was confirmed yesterday by a Mr Clarke on behalf of the department of resources and energy, at a function in Brisbane last Friday the Minister for Resources and Energy said:

The government's position on this issue is clear—royalty rates that applied or changes to royalty rates that were scheduled to apply in the future, as at 2 May 2010, will be credited. Any increases outside these parameters will be a matter between miners and state and territory governments.

Minister, you observed, in your words, that there appeared to be an inconsistency. Mr Clarke, the secretary of the department of resources and energy, simply agreed there was an inconsistency between those two positions. What do you understand the position to be, Mr Parker? The position as articulated by the minister as at Friday or the position as documented in the heads of agreement signed on 1 July?

Mr Parker—Senator, there is clearly a dispute as to the meaning of that part of the heads of agreement. The Prime Minister made a statement in response to a question in the House yesterday.

Senator BRANDIS—Yes. I will come to that.

Mr Parker—I cannot really add to that.

Senator BRANDIS—What do you mean you cannot add to it? The only dispute is that the government is walking away from the heads of agreement. The heads of agreement do not limit the right to a rebate of royalties. The minister's statement last Friday and the Prime Minister's statement in the House of Representatives yesterday afternoon do. Where is the dispute?

CHAIR—Senator Brandis, I think you are asking Mr Parker for an opinion.

Senator BRANDIS—It is Mr Parker who said there is a dispute and I am asking him how he would characterise a dispute.

CHAIR—You are asking Mr Parker for an opinion on the legality and nature of the dispute.

Senator BRANDIS—No, I am not.

CHAIR—I do not think he is required to answer that question.

Senator BRANDIS—Mr Parker, let me make it perfectly clear to you. I am not asking you for your opinion about the law and none of my questions have sought that of you. You said, ‘Clearly there is a dispute.’ I have pointed out to you that there is a plain inconsistency between what Mr Ferguson said last Friday and what the Prime Minister said yesterday afternoon on the one hand and the words of the terms of the heads of agreement, which I have taken you to. What is the dispute, Mr Parker?

Mr Parker—The dispute is the position of the two parties.

Senator BRANDIS—The two parties being?

Mr Parker—The two parties being some of the mining sector and the government on the other hand.

Senator BRANDIS—Mr Parker, where in the heads of agreement is there a limitation in time on the right of affected mining companies to claim the rebate in respect of movements in state or territory royalties?

Mr Parker—Senator, this is a document which is 1½ pages long, which lays out the broad outlines of a new proposed tax. When the PTG came to write up its initial consultation paper, which was released on 1 October—if my memory serves me correctly—the length of that document, which went into all of not just subsidiary issues but issues of interpretation of this document, I think it came to how many pages? About 130. So one could say that the heads of agreement is, to use a musical analogy, a rather staccato document.

Senator BRANDIS—Would you pass the document, please, to the minister. You are familiar with this document, Senator Sherry, of course?

Senator Sherry—No, I am not.

Senator BRANDIS—Just familiarise yourself with it. But I can take you to—

Senator Sherry—It is only 1½ pages, I know, but I would probably need a couple of minutes to read through it.

Senator BRANDIS—We will pause while you do.

Senator Sherry—Thank you.

Senator BRANDIS—But just to help you, Senator Sherry—

Senator Sherry—Sorry, I do not know how you can help me read. I know you are capable of many things, Senator. You challenged me to read it and I am going to take a minute or two to read it.

Senator BRANDIS—You do that, Senator Sherry. But just to help you focus your attention, the only part of the document that I am going to be asking you about is the sentence towards the foot of the first page beginning with the words, ‘All state and territory royalties’. So by all means read the whole document, but I do not think you will find anything in the rest of it that bears on this issue.

Senator Sherry—Thank you for your help. You have asked me to read the document, which I will. It is 1½ pages long and I will get to the last couple of lines in about a minute, I think, Senator.

Senator BRANDIS—We will wait. I am very happy to wait.

Senator Sherry—Yes, Senator Brandis?

Senator BRANDIS—Senator Sherry, my question is this and it is to you: is it the position of the government that this document, the heads of agreement, creates rights and obligations?

Senator Sherry—As I indicated to you yesterday—and I do not have anything further to add to the broad comment, and these are not the precise words I used yesterday—we have a heads of agreement document. We have a speech by the minister, Mr Ferguson, in which he has made the entirely reasonable point that the government is not going to cover future state royalty increases other than those already scheduled. He has made that entirely reasonable point. Secondly, the point I made yesterday and I make again today is we have a Policy Transition Group. The third point I made and I acknowledged yesterday was that, yes, there is a difference of view, and that again has been acknowledged here today. The Prime Minister indeed has acknowledged there is a difference of view and it is the Policy Transition Group that is the appropriate forum to resolve the details of the difference of view. Beyond that I have nothing further to add and I am very confident that the Policy Transition Group is the appropriate place to deal with this.

Senator BRANDIS—Senator Sherry, is it the position of the Australian government that this document creates legal rights and obligations?

Senator Sherry—Senator, I do not have anything further to add. As I have indicated, the Policy Transition Group will deal with the issues of detail of implementation of the announcement made by the Prime Minister and the mining companies as detailed.

Senator BRANDIS—Senator Sherry, are you prepared to tell this committee on behalf of the government, whose representative you are here, that it is the view of the government that this document creates legal rights and obligations?

Senator Sherry—This would be the third occasion that I have responded.

Senator BRANDIS—I am giving you every opportunity because this is a very important matter.

Senator CAMERON—*Rumpole of the Bailey!*

Senator Sherry—I think you are overstating my importance in the scheme of things, but I am the representative minister for my colleague in the Senate. The Policy Transition Group will deal with these matters, and this is the third occasion on which I have said that today. I think I did say it twice yesterday—having acknowledged there is a difference on this issue—and the PTG will deal with the matter.

Senator BRANDIS—Senator Sherry, I do not think anyone can say I have not given you an opportunity to accept on behalf of the government that it considers that the document creates rights and obligations. Your failure to do so or your demurral from doing so speaks for

itself. Senator Sherry, this is a document that the Prime Minister on 2 July described as ‘the final agreement’.

Senator Sherry—I would make the very obvious point: it was very clearly understood that there would be a policy transition group, and this is the fourth occasion I have said that. You can embellish, assert, argue, put forward a polemic—which you are doing. As I have said, the Policy Transition Group will deal with the ongoing detail issues that flow as a consequence of the heads of agreement. Beyond that, I cannot add anything further.

Senator BRANDIS—Senator Sherry, do you accept that the three mining companies that signed this heads of agreement—BHP Billiton, Rio Tinto and Xstrata—signed that agreement with the expectation that the other party to the agreement—that is, the Australian government—would be bound by its terms?

Senator Sherry—Senator, this would be the fourth time I have answered essentially the same question, and I have to say repetition—

Senator BRANDIS—In a sense, Senator Sherry, you are answering my question without actually saying the government does not accept it is bound by its own agreement.

Senator Sherry—Chair, yet again Senator Brandis is interrupting before I have a chance to respond to his question. As I pointed out—

Senator BUSHBY—You have just told us that you have done the same thing for the fourth time.

Senator Sherry—Can I continue? Were you asking a question as well?

Senator BUSHBY—Are you going to tell us something new this time?

CHAIR—Senator Sherry, please continue.

Senator Sherry—Thank you. As I have said, this is the fourth occasion on which you have re-posed the same question, embellished with argument, polemic et cetera. So, having answered it three times today and at least on one occasion yesterday, I do not have anything to add beyond what I believe will be the very effective work of the Policy Transition Group.

Senator BRANDIS—Senator Sherry, it is not hard. In the view of the Australian government, is this an agreement or isn’t it?

Senator Sherry—Senator, for the fifth time, albeit you were a touch shorter on this occasion, the Policy Transition Group will deal with any issues of difference on the particular matter we have been discussing. That is for the fifth time.

Senator BRANDIS—Senator Sherry, do you accept or do you not accept the Prime Minister’s characterisation of this document as a final agreement?

Senator Sherry—Senator, for the sixth time, as I have indicated, the Policy Transition Group will be the appropriate place—

Senator ABETZ—This is getting silly. It is not assisting.

Senator Sherry—It is getting silly, Senator Abetz. You are totally accurate, albeit by interjection. It is getting very silly—

Senator ABETZ—No, your answers are.

Senator Sherry—when a senator—in this case, Senator Brandis—poses the question for the sixth time. As informative and useful as I have been to the committee, when we get to the seventh time I think I will have to take it on notice because I have made the government's position abundantly clear.

Senator BRANDIS—I think you have made the government's position abundantly clear. Senator Sherry, do you think it is acceptable that citizens, including corporate citizens, contracting with the Australian government cannot take it for granted that the government will honour its commitments?

Senator Sherry—What I do think, for the seventh time—again, the core of the question for the seventh time is asked; I think we are just starting to reach the stage of what would be called tedious repetition under the standing orders—is that I am very confident that we have a mechanism in place, in this case the Policy Transition Group, that can determine and establish matters of detail and any differences.

Senator BRANDIS—Senator Sherry, on seven occasions now you have declined to affirm that the government considers itself bound by the terms of what the Prime Minister described as a final agreement. You realise that, don't you? By your silence, by your demurral from answering the question, you in fact are answering no.

Senator Sherry—Firstly, I have not been silent. I have answered your question, albeit you vary the delivery of essentially the same bore—if I can use that reference—seven times, and now for the eighth time. We have a Policy Transition Group which will consult and deal with issues of detail, implementation and any differences that occur. I cannot add anything beyond that. As helpful as I have been, I just cannot add anything beyond that, having answered the question now seven times.

CHAIR—While Senator Brandis confers, I will ask you a question. In this heads of agreement, the design of the minerals resource rent tax is set out. The final paragraph underneath that says:

A mutually acceptable Committee comprising credible, respected leaders will oversee the development of more detailed technical design to ensure the agreed design principles become effective legislation.

I just say this because it seems to reinforce your point that the actual implementation is with that committee and that the government has agreed as part of this final binding agreement that the finer details will be worked out in consultation with that industry and government committee.

Senator Sherry—Thank you, Chair. All I can indicate is that, in that last paragraph, you referred to an implementation committee, and we have this Policy Transition Group which is responsible for dealing with issues. It is referenced in the document that Senator Brandis has kindly given me a copy of. I cannot add anything beyond the fact of my confidence. We have a Policy Transition Group that will deal with these issues of detail.

Senator BRANDIS—Senator Sherry, having heard you seven times decline to tell us that the government considers itself bound to honour its own agreements, no company in Australia would ever feel confident in contracting with your government again.

Senator Sherry—Senator, I do not accept your characterisation, interpretation or assertions polemic. I just do not accept it. I have fully answered—and this will be the eighth occasion today—

Senator BRANDIS—No, you do not need to, Senator Sherry.

Senator Sherry—I have fully answered and explained today—

Senator BRANDIS—You have answered my question. You have explained it loud and clear.

Senator Sherry—in excruciating detail to your excruciatingly repetitive questions the importance of the Policy Transition Group in finalising the details.

Senator BRANDIS—Where is the integrity, Senator Sherry, in a government that refuses to honour its own agreements with some of the biggest companies and largest employers in the nation?

Senator Sherry—Chair, I think that is a debating point; it is not a question. That is the first point I would make.

CHAIR—Indeed.

Senator Sherry—Secondly, I believe we have covered and canvassed the issue.

Senator BRANDIS—Madam Chair, Senator Abetz is going to take over these questions.

CHAIR—It is very nearly time for the afternoon tea-break. The committee will resume after the break at 4.15.

Senator Sherry—Chair, you are aware that I will not be here at 4.15 and that Senator Wong, the Minister for Finance and Deregulation, will be here.

CHAIR—Yes, there will be a change of minister after the break.

Proceedings suspended from 3.59 pm to 4.15 pm

CHAIR—The committee will continue with the Treasury Revenue Group and the Australian Taxation Office. The committee has agreed to continue this group until 5.45 pm and, therefore, Treasury Macroeconomic Group will be from 5.45 pm to 7 pm. I welcome Senator Wong to the table. I invite questioning from Senator Abetz.

Senator ABETZ—Thank you, Chair. Has the government agreed to release the minerals price and volume assumptions on which its MRRT revenue forecasts are based?

Mr Parker—Senator, no, it has not released the assumptions.

Senator ABETZ—Right. Why not?

Mr Parker—No, it has not released the assumptions regarding prices, volumes, the market value of the starting base, expected investment in the sector. All of those numbers were provided to the Commonwealth on a commercial-in-confidence basis by the group of companies which were involved in the final heads of agreement arrangement. I am happy to tell you the story around that if you wish. There are two elements to the commercial-in-confidence matter.

Those issues are very sensitive to the companies involved. I am sure I do not need to rehearse before this committee the importance of the protection of commercial-in-confidence information. We have asked the companies if they would object to us providing that information. That question was put to them in the context of the freedom of information requests which have been talked about, and the companies objected to the release of that information. So on that basis those assumptions have not been released.

I might add contextually that this issue has come up in discussions at the Policy Transition Group. In order to fill in the details of the tax, that group is consulting with companies. The group has asked the companies—not just the three companies related with the heads of agreement but more broadly—to provide to the Policy Transition Group information relating to the activities, prices and so forth of the companies. The Policy Transition Group has put out a model for companies to use to input the data to send back to the Policy Transition Group. The reason that that has been done is that, the more information we have, the better we can design the relevant detail. It has been a matter which companies have been particularly wont to emphasise that the information is commercial-in-confidence. They have sought assurances to that effect and they have been given.

Senator ABETZ—Mr Parker, thank you for that. Minister, I draw your attention to procedural order 9 of continuing effect, which requires that the Senate or a Senate committee shall not entertain any claim to withhold information from the Senate or a committee on the grounds that it is commercial-in-confidence unless the claim is made by a minister and is accompanied by a statement setting out the basis for the claim. Clearly you do not have a statement with you, but if you could take that on notice—

Senator Wong—I will take that on notice.

Senator ABETZ—and get back to the committee, with respect, as a matter of urgency in relation to the statement in relation to the commercial-in-confidence claim.

Senator Wong—I suspect, Senator, the statement that I would provide on behalf of the Treasurer would bear some similarity to the reasons which have just been outlined, but if you feel a need for me to take it on notice and get someone to write it down and provide it, I will do so.

Senator ABETZ—Well, it is not me. In fact, Mr Parker could not make that claim before the committee under the Senate's procedural orders of continuing effect. Is it correct that the MRRT framework was developed by the government in cooperation with the three major companies—Rio Tinto, BHP and Xstrata? Are we agreed on that?

Mr Parker—Yes.

Senator ABETZ—Were the companies' price and volume assumptions discussed at these meetings?

Mr Parker—Well, there was a series of meetings leading up to the final agreement.

Senator ABETZ—All right, at any of these meetings.

Mr Parker—I was not personally involved in the meetings which were undertaken around the modelling of the tax and the specific provision of the material that you have referred to, so

it is not personally in my knowledge, Senator, but I would be astonished if it were not because they were meetings about those issues.

Senator ABETZ—Is there somebody in the room who can confirm that to us, Mr Parker? It looks as though there might be.

Mr Brown—There were consultations held with the companies, and the companies provided information to the Treasury.

Senator ABETZ—Right, but were these assumptions discussed at the meetings where the three company representatives were present along with government?

Mr Brown—Quite a range of issues were discussed with companies around the modelling of tax, including assumptions.

Senator ABETZ—Right. The issues were companies' price and volume assumptions.

Mr Brown—The company price and volume assumptions were probably not discussed at the meetings. They were provided to us by the companies subsequent to them.

Senator ABETZ—So they were not discussed among the competing companies? Is that what you are telling us?

Mr Brown—No, they were not discussed between the competing companies. The data requirements were discussed and then provided to the Treasury.

Senator ABETZ—So the data was submitted individually to Treasury?

Mr Brown—The data came to us directly from individual companies.

Senator ABETZ—Right. And did the government then aggregate those figures and average them?

Mr Brown—We took account of the data that had been provided to us to develop a model of the sector.

Senator ABETZ—And was that shared with the companies at the meetings—aggregated data to which you have just referred?

Mr Brown—No.

Senator ABETZ—Right. So Treasury assumptions and aggregated data from the companies—

Mr Brown—The data itself is sensitive to each company that was involved. So to provide back what we had done with it would have been a breach of confidence.

Senator ABETZ—But was it in any way aggregated and then presented in an aggregated form to the meetings?

Mr Brown—No. We did not present back the aggregated data. They provided data to us.

Senator ABETZ—So they just provided information to Treasury and you never provided feedback to the meetings of any of that data that you were provided?

Mr Brown—We were not asked for it.

Senator ABETZ—You were not asked for it?

Mr Brown—And there was—

Senator ABETZ—But did you provide it? No.

Mr Brown—No.

Senator Wong—We have answered that question, Senator.

Senator ABETZ—No, it is different between whether you were asked and whether you gratuitously provided it.

Senator Wong—No, he has answered it previously, Senator—about three or four questions ago.

Senator ABETZ—So we are just closing off all the steps here. So you are saying neither occurred?

Mr Brown—Correct.

Senator ABETZ—All right. Thank you. A key executive of one of the companies has said publicly that the government expects higher revenues from the MRRT than the companies expect to pay because you can only assume the government is using different assumptions to the companies. Is that agreed?

Senator Wong—I am sorry?

Senator ABETZ—Is that agreed?

Senator Wong—Is what agreed, Senator—that someone said that?

Senator ABETZ—No, that the government is using different assumptions to the companies. You are in receipt of the companies' assumptions in relation to price, in relation to volume et cetera. Something else has come out of Treasury and somebody is saying from one of these companies that, clearly, there are different assumptions. So can I ask, without giving us the specifics, whether that which Treasury provided to the companies at these meetings varied considerably or in any way from that which the companies had provided to you?

Senator Wong—Senator, I do not understand 'that which Treasury provided' at the meetings. Are you referring to the data that was not provided, about which you have had a previous extensive round of questions?

Senator ABETZ—Well—

Senator Wong—What is the thing against which you are measuring the difference?

Senator ABETZ—Did Treasury provide any of their assumptions to the meetings? Surely they must have. Otherwise there would not have been anything to sign off on, Minister, with respect. Let us go through it step by step. Did Treasury provide any assumptions as to price and volume to the meetings or any of the meetings from Treasury's own independent assessments?

Mr Brown—At the start of the process, yes, we did.

Senator ABETZ—Right. And throughout the process did that change—those assumptions?

Mr Brown—The assumptions that we put into the revised modelling took account of the information provided to us by the companies.

Senator ABETZ—And that revised modelling: was that shared with the companies?

Mr Brown—Not in detail. An aggregate outcome in terms of the final result was shared, but not the details of the actual assumptions that went into that because that was an issue of sensitivity with the companies.

Senator ABETZ—I thought I had previously asked about aggregated figures so—

Mr Brown—I was interpreting that as being aggregated price and volume data.

Senator ABETZ—It would surely be inclusive of price and volume data that aggregated figures in those two areas would have been supplied as well?

Mr Brown—The information I am talking about in terms of aggregated results refers to the bottom line outcomes.

Senator ABETZ—Right. Was that all that was shared or were aggregated figures shared in relation to price and volume also?

Senator Wong—You have asked that question quite a number of times, Senator.

Mr Brown—Not in terms of price and volume.

Senator ABETZ—Not at all?

Mr Brown—Once we actually revised those assumptions it would be apparent to one player or the other what the other player's information is. So, no, that was not shared back.

Senator ABETZ—So you provided your Treasury assumptions at the first meeting, then the companies provided their information; is that correct?

Mr Brown—Correct.

Senator ABETZ—Then at the end of it you provided some aggregated assumptions?

Mr Brown—Not assumptions.

Senator ABETZ—Aggregated what?

Mr Brown—Results.

Senator ABETZ—What you anticipated the outcomes would be which are—

Mr Brown—The nature of a forecast is an anticipated outcome.

Senator ABETZ—Exactly, which is, in layman's terms, an assumption. Let us not quibble about the words. I think we know what we mean here. That comment by one of these companies that the government is using different assumptions to the companies; are you able to confirm that for us?

Mr Brown—I do not know what assumptions the companies are using or what company you are talking about.

Senator ABETZ—Were you provided with the companies' assumptions in relation to price and volume and other matters?

Mr Brown—We were provided with information by the companies on price and volume.

Senator ABETZ—And they are now saying that that which came out of the process is different to their own? Are you agreed that that is what has been said by at least one of the companies?

Senator Wong—I am not sure it is really fair to ask an official whether he can agree that an assertion was made in the public arena. It either was or it was not. That is a matter of fact.

Senator ABETZ—And I am asking whether he is aware of it. If he is not aware of it then clearly he cannot answer any more questions. If he is aware of it then I can ask him whether or not he agrees with that statement.

Mr Brown—I am not aware of what specific company you are talking about.

Senator ABETZ—We do not need to know about a specific company. The question is: are you aware that such a statement has been put in the public domain?

Mr Brown—I have heard statements in the public domain from a range of areas but I am not in a position to confirm or otherwise the veracity of those.

Senator ABETZ—You are aware of the general statement that one of the companies is of the view that the government is using different assumptions to that which the companies had been using?

Mr Brown—I would have to say I am not aware of that. I do not know what the specific case you are referring to is.

Senator ABETZ—We do not need to know the specific case. Either you are aware or you are not aware of one of these three companies making a public statement as to the assumptions as I have put it to you. You either know that or you do not. You need not look across the table because your knowledge is in your head.

Mr Brown—I would have to say in that case I do not.

Senator ABETZ—In that case you do not know about it. You are telling us that you are not aware that one of the companies has publicly said that the government expects higher revenues from the MRRT than the companies expect to pay because he can only assume the government is using different assumptions to the companies? You are not aware of such a statement being made and put into the public domain?

Mr Brown—I do not have immediate knowledge of that that I can give.

Senator Wong—My understanding of Mr Brown's earlier evidence is that he has a general knowledge of a range of public statements being made. I understand his evidence is that he does not have a specific recollection of that statement, nor by whom it was made. You are welcome to rely on that statement for whatever reason, but I do not think it is reasonable for Mr Brown to be asked to comment on the veracity of it. It is not his statement.

Senator ABETZ—I did not ask about the veracity of it.

Senator Wong—You asked him to comment on whether the statement was correct.

Senator ABETZ—No. First of all, I asked whether or not he was aware if such a statement had been put into the public domain by one of the three companies. That is the first question.

Senator Wong—He has answered that question. I do not want to rephrase it but I understood it to be that, whilst he has a general recollection of various statements being made, he cannot specifically recall the detail of that statement nor whom it was made by.

Senator ABETZ—If that is your evidence, so be it, but for somebody who is intimately involved with this not to be aware that one of the three had made such a statement publicly, in the public domain, surprises me. We cannot take it any further. If you are not aware of such a statement being made, so be it.

Senator Wong—The KPI for Treasury officials is not them reading the *Australian*.

Senator ABETZ—But having been so intimately involved in this, I do find it surprising that you are not aware of this public reaction by one of the companies.

Senator Wong—Senator, there is a lot written and a lot said about this issue. I think it is a little unreasonable to expect officials to recall every single public statement in the media on a particular issue.

Senator ABETZ—Once again, this is hyperbole at its worst. I am asking about specifically one of the three companies that you must have been dealing with on a fairly regular basis at meetings, getting information from them to develop this. For one of them to come out publicly and say, 'These guys are operating on different assumptions to us,' I would have thought you might have taken note of that and been aware of it, but if your evidence is that you do not, so be it. I must say I find that hard to believe.

Senator Wong—When you have finished the lecture, Senator, do you have a question?

Senator ABETZ—I am giving the witness the opportunity to reconsider his answer.

CHAIR—Senator Abetz, I think we have been over and over this question, and there are a number of your colleagues and a number on this side who have further questions to ask.

Senator ABETZ—Yes, I know that, but I do not know why the witness needs to consult as to what he knows in his personal knowledge. He either does or he does not.

CHAIR—I am happy to spend the remainder of the time on this, Senator Abetz. Perhaps he is consulting because it is his view and the view of many others that he has answered this question many times and he is looking to find a way to get through to you.

Senator ABETZ—Oh, really. Mr Brown, can you tell us? Has your memory been refreshed?

Mr Brown—All I can really say is that the modelling we did and the estimates we produced were consistent with the information that was provided to us by the companies in the meetings we had with them.

Senator ABETZ—If that is the case, I would have thought such a statement being put into the public domain—that your assumptions were out of whack with theirs—would have hit you by surprise as a result and you would have been aware of that. But you are telling us you are not aware of it. Is that right?

Mr Brown—I am saying I am not specifically aware of the case you are talking about.

Senator ABETZ—How many such statements are you aware of that were put into the public domain? I am putting it to you there was only the one by one of the companies. So you are aware of general comments to this effect, but you cannot remember which specific one. I am suggesting there might have only been one.

Senator CAMERON—Point of order, Chair.

CHAIR—Senator Cameron.

Senator CAMERON—This is repetitious. The witness has answered. The witness has indicated clearly what his position is and Senator Abetz now seems to be determined to try and extract a different answer when the witness has clearly outlined his position. I think it is getting down to nearly bullying the witness.

Senator ABETZ—Oh!

CHAIR—I did indicate earlier, Senator Abetz, that we had spent quite a long time on this question and there are other senators at this table with questions to ask.

Senator ABETZ—I know, and these are very serious matters. This is where I am trying to get some specificity from the witness. I understand he has a general understanding that such a statement may have been made. Is that correct?

Mr Brown—I have a general recollection of statements that have been made in the media by people in the industry that they believe that the revenue estimates will be different or the revenue will be different from what we estimated.

Senator ABETZ—Right. What about one of the three companies which you have been dealing with? Do you have a recollection of such a statement being made out of all of those statements that you are aware of?

CHAIR—Senator Abetz.

Senator Wong—This is the same question.

Senator ABETZ—The answer is either yes or no. He is or he is not aware.

CHAIR—Senator, we have been through this again and again. I am starting to take Senator Cameron's point that this is repetitious in the extreme. Mr Brown has given answers to these questions and I repeat that there are other senators here who have questions to ask and I will go to them shortly.

Senator ABETZ—Fine. Can I ask yet again, Mr Brown, are you aware specifically of one of the three companies making the type of statement that I have previously described?

Mr Brown—Not specifically, Senator.

Senator Wong—He has answered that now, Senator. Can we move on from this question?

Senator ABETZ—Have you finished, Minister?

Senator Wong—Yes, I have.

Senator ABETZ—Good.

Senator Wong—Have you?

Senator ABETZ—No, I have not.

Senator Wong—Because I just think that it is completely unfair to simply repeat the same question over and over again to an official. You may not like the answer.

CHAIR—Senator Abetz has indicated that he is moving on to other questions. So could you please continue, Senator.

Senator PRATT—We have all got things that we can move on to.

CHAIR—We have just over an hour left. If you could continue.

Senator ABETZ—Without the interruptions we would be moving on very well, Chair.

Senator CAMERON—That beggars belief.

Senator ABETZ—What input to the discussions with the resource companies did the government's experts in this field, that is officers from the Department of Resources, Energy and Tourism, have?

Mr Parker—We can take that question on notice, if you like, Senator. A number of the early meetings, working on the modelling and price numbers, took place in the Department of Resources, Energy and Tourism.

Senator ABETZ—Sorry, can you speak up, please.

Mr Parker—Yes. I am saying that a number of the very early meetings in the process of reaching this agreed modelling approach took place in RET but, as I said, I do not know—

Senator ABETZ—Was Mr Brown at the meetings? Who was at the meetings?

Mr Brown—Senator, I was at some of those meetings and RET officers were present.

Senator ABETZ—Excellent. Can you go into all the meetings you were present at? If not, take it on notice.

Mr Brown—I would take that on notice.

Senator ABETZ—Yes. If you could then also tell us what the level of representation was by that department.

Senator Wong—Senator, it might be better for these to be put on notice for that department. You are asking Treasury to give you advice, to respond to questions about the attendance of meetings of a department, which, as I recall, appeared earlier today. Or was it yesterday.

Senator ABETZ—Who ran the meetings? Who provided the secretarial assistance for these meetings? Who kept the minutes of these meetings? Treasury? What is the difficulty?

Mr Brown—Senator, as Mr Parker pointed out, the early meetings were actually held in RET offices and they provided facilities for the meetings.

Senator ABETZ—They provided the facilities. I asked about the secretarial services, as in who organised the meeting, who invited people to the meeting, who took the minutes of the meeting. Was it Treasury or DRET?

CHAIR—Perhaps you would like to take that one on notice.

Senator ABETZ—I must say this is unbelievable. Surely somebody at the table must know who was in charge of secretarial services.

CHAIR—Senator Abetz, the question has been taken on notice and will be answered in due course.

Senator Wong—Perhaps you could be clear what you mean by ‘secretarial services’, Senator.

Senator ABETZ—Organising the meeting, taking the minutes, inviting people to the meeting—who was responsible for that? DRET or Treasury?

Senator Wong—We will take that on notice.

Senator ABETZ—Oh, please! With all these officials in the room, not a single person knows who. Mr Brown, how did you get to the meetings? Who invited you and told you about the meeting? Was it from within Treasury or was it from DRET? This is not difficult, surely.

Mr Brown—The invitation I received came from within Treasury.

Senator ABETZ—From within Treasury?

Mr Brown—But I was also having that relayed to me, so I cannot—

Senator ABETZ—From whom in Treasury did you receive the invitation to go?

Senator PRATT—These are not the kinds of details officials he should be expected to remember.

Senator ABETZ—What? Do you know, Mr Brown?

Mr Brown—I would have to consult my diary and get that information.

Senator ABETZ—What—your diary?

Mr Brown—That would be something I would need to take on notice.

Senator ABETZ—You really do not know what department or—

Senator Wong—He is entitled to take the question on notice, Senator.

Senator ABETZ—section or officer you received the invitation from?

Senator Wong—He is entitled to take the question on notice, Senator.

CHAIR—Senator Abetz—

Senator Wong—He is an official. He is entitled to take the question on notice.

CHAIR—Senator Abetz, the witness has said to you in a very straightforward way that he does not remember. Can we now move on to the next question?

Senator ABETZ—No.

CHAIR—Perhaps—

Senator ABETZ—Chair, he said he would have to take it on notice. I am now asking—

CHAIR—It might be helpful if you would explain why you need this kind of detail. It might help if you went to the point.

Senator ABETZ—No. Chair, with great respect, in the Senate it has never been the role of the President or the Chair of Committees to require a senator to explain why they are asking a question.

CHAIR—I am just trying to be helpful, Senator Abetz.

Senator ABETZ—I accept Mr Brown—

CHAIR—We are all getting frustrated.

Senator ABETZ—That is your problem. I accept that Mr Brown has taken the question on notice. What I am asking is: why are you taking it on notice? Is it because you genuinely cannot recall where the invitation came from?

Senator Wong—He does not have to give you a reason as to why he is taking it on notice. He is an official. He is entitled to take it on notice.

Senator ABETZ—But I am entitled to ask it—

Senator Wong—Yes, and I as the minister at the table am saying he is not required to give you that answer. Officials are entitled to take the questions on notice.

Senator ABETZ—Yes, I accept that, and I am entitled to ask why the official needs to take it on notice.

Senator Wong—He said he would have to consult his diary. He has answered that already, even though he is not required to. So he has taken the question on notice. Move on to the next question, Senator.

Senator ABETZ—I am asking if it is simply because he cannot remember from where the invitation came.

Senator Wong—Senator, he has taken the question on notice.

Senator ABETZ—We know that and I am now asking if he has taken it on notice because he cannot remember.

Senator Wong—He is not actually required to give you an answer as to why he is taking something on notice.

Senator ABETZ—Yes, he is.

Senator Wong—If he wants to do that—

Senator ABETZ—But he can take that question on notice as well. Technically he is entitled to take on notice whether or not he cannot remember, but I am not sure that taking it on notice will assist his memory banks, so I am sure he can tell us today—

Senator Wong—There is no need to behave like that, Senator. These people are—

Mr Brown—Senator, there were a number of meetings that were organised. I do not recall precisely who organised them. I would have to take it on notice. I would not like to mislead the Senate.

Senator ABETZ—All right. On what basis does Treasury have confidence in the forecast levels of revenue in the budget as a result of the introduction of the MRRT?

Mr Parker—That is a very open question, is it not? Mr Brown has provided you with a range of information on that. If I take the essence of Mr Brown's responses and draw out the particular points which go to it, there was a range of quite particular, detailed and sensitive information provided by the companies to us. We have taken those numbers and put them into

models which are carefully constructed, the construction of which, as I understand it from what Mr Brown has said, the companies were involved in in reaching an understanding about how the modelling was done. We have used assumptions consistent with the information provided by the companies. Then I might note that there are a range of other numbers which have been put out in the public arena and everyone is entitled of course to—

Senator ABETZ—I am also asking about your confidence in your forecasts.

Mr Parker—Yes, I am coming to the point. People will get different numbers by using different assumptions through exchange rates, prices and so forth. The Treasury estimates, which have been published, are not at the top of the range of estimates which are in the public arena. Access Economics, for example, has recently published in its publication *Budget Monitor* estimates for this, and they are above those provided in the Treasury numbers.

The final point to flag out of Colin's response is that we provided the aggregate outcomes to the companies. The companies did not demur from those numbers. Indeed, the companies did their own numbers and they have provided some of that information to us and the numbers are not inconsistent.

Senator ABETZ—I understand all that, Mr Parker. That is why if one of the companies did go out publicly, disputing that very point I would have thought, with great respect, Mr Brown might have been able to recall the fact for the very reasons you have just explained. But we have moved on from that.

Mr Parker—It is not our role to police what companies say in public.

Senator ABETZ—I am not asking you to police it at all, Mr Parker, with respect. It seems that there is a capacity to deliberately ignore the one comment made by one of the companies that seems to be contrary to that which you have just told us.

Mr Parker—I am not sure that is the only comment that has been made. I think Colin has mentioned that there were a range of company comments.

Senator ABETZ—By the three companies. Sure, there has been a huge amount of speculation and commentary. I limited my questions to the three companies. I think we know that.

Mr Parker—I cannot present you with an audit of everything that any of the three companies has said publicly since that point. I do not know. I am not in a position to agree—

Senator ABETZ—Have I asked you to provide us with an audit of all the comments they have made?

Mr Parker—No.

Senator ABETZ—No, I have not.

Mr Parker—The question that you put was based on a statement that there had been only one, and I am simply not in a position to confirm or concede that.

Senator ABETZ—But given all your evidence about the information being shared, that the companies did not demur from that which you had said and provided to them as Treasury assumptions, I would have thought a public statement by one of the companies asserting the exact opposite just may have caught your attention. Clearly, the evidence is that it did not, and

I have to accept that. I do also say that I find that surprising. I have four more questions. Is the MRRT, as currently proposed by the government, at risk of being deemed constitutionally invalid, Minister?

Mr Parker—The minister has referred the question to me. We have been around this matter earlier in these estimates hearings. Senator Brandis took us to the advice which has been released under FOI. Can I take you to page 7 of that advice, specifically paragraphs 68 and 69, which point to a method by which the particular issue of capping could be legislated. No doubt that is not the final word on the matter. As I have mentioned in an earlier answer, the issue of constitutionality of this has been a matter of debate. It has ranged across various issues or heads of constitutional power. So is it at risk of being found unconstitutional? Well, I suppose there is a reasonable chance that the matter will be tested in court.

Senator ABETZ—I will move on. Has the MRRT been changed in a way which makes the advice that we have just been referring to irrelevant?

Mr Parker—Well, we have already talked about that. This advice was set against a proposal—at that stage the RSPT, which is no longer government policy. The issue of whether the MRRT, when it is legislated, is constitutionally invalid will have to be tested on the face of the legislation, Senator.

Senator ABETZ—Yes, but I am wondering whether any parameters have changed from the RSPT to the MRRT which might therefore make that advice not as relevant.

Senator Wong—Senator, I think that is asking the officer to give you, I suppose, a legal opinion about that. I was working in my office and I heard the unmistakable voice of Senator Brandis for some time on this issue, and I think it has been traversed. I think the position of the government is very clearly that we will implement the MRRT to the letter of the Constitution. There is an extensive consultation process underway, and I am not sure we can take it much further than what has already been traversed before the committee.

Senator ABETZ—I understand all that, Minister, but it stands to reason that if you have a proposal then you get legal advice concerning it. You then are able, having been armed with that legal advice, to recalibrate or whatever the proposal to deal with some problems that the legal advice may have thrown up. That is all I am asking. Is that or is that not the case? Have we recalibrated from the RSPT to the MRRT to try to take account of that legal advice?

Mr Parker—We are in a process now of working into the detail of the MRRT, and when we have detail no doubt we will seek advice from AGS as to a range of matters including constitutionality and we will, in formulating that detail, take into account the advice we have previously had. That is a standard course of business.

Senator ABETZ—All right. But at this stage nothing has been changed in the process?

Mr Parker—There is a whole range of changes between the RSPT and the MRRT, Senator.

Senator ABETZ—Of course, Mr Parker, but in relation to the legality of it.

Senator Wong—This is where we have a non sequitur, isn't it? You ask a question about aspects of advice which is in the public arena. You then ask the witness to tell you whether or

not he thinks any changes which have been made or may or may not be contemplated would have different legal effect and then you assert something else. Now, the official—

Senator ABETZ—Read the *Hansard* and you will see that is not a correct version of what I have just put to the witness.

Senator Wong—I think Mr Parker has outlined the process, as have I. It is unsurprising that the government would ensure that it got advice in relation to this issue. Some of that is in the public arena. There is also a process of consultation through the mechanisms that have been traversed through this committee. Obviously it is the government's intention to implement the MRRT in accordance with the letter of the Constitution.

Senator ABETZ—Has any other advice been received on this matter?

Senator Wong—On which matter?

Senator ABETZ—Constitutional legal advice.

Mr Parker—Yes, Senator, there has.

Senator ABETZ—Postdated to that advice that we have been discussing?

Mr Parker—I would have to take on notice the precise dates of advice that we have received, Senator.

Senator ABETZ—But surely, given the controversy about the particular legal advice that we have just been discussing, it would be within your knowledge whether there is advice that has been received subsequent to that.

Senator Wong—Senator, I am going to intervene here. You are doing precisely the same thing in relation to Mr Parker that you did in relation to Mr Brown, which is where an answer is given you then call into question the answer by making a range of assertions—

Senator ABETZ—Do you know what? That is what cross-examination is all about.

Senator Wong—If I can finish: a range of assertions about why the answer—

Senator ABETZ—Otherwise the witness would simply deny that he did it and then you would not be allowed to ask any other questions.

Senator Wong—These people are not on trial.

Senator ABETZ—It really is a nonsense, Minister.

Senator Wong—No. These people are not on trial. The answer has been given. You are now suggesting again that somehow the answer is wrong.

Senator ABETZ—No. I am probing the answer to see whether further information can be gleaned.

Senator Wong—Probing? It is an interesting verb in this context. I am not sure that is what I would call it.

Senator ABETZ—Mr Parker has indicated to us that other legal advice has been received, other than that which Senator Brandis has been discussing. I am wondering whether some of that other legal advice was obtained subsequent to that which Senator Brandis was discussing with Mr Parker.

Mr Parker—Okay. Now that you have clarified the question, yes, I believe so.

Senator ABETZ—Thank you. Re-read the *Hansard*, Mr Parker, and we might need to discuss that next time as to whether the question had to be clarified, but thank you for that.

Mr Parker—I am sorry if I misheard you, Senator.

Senator ABETZ—How many pieces of legal advice have been received since the one that Senator Brandis and you discussed in relation to the constitutionality question?

Mr Parker—I would have to take that on notice.

Senator ABETZ—If you could, and if you could also take on notice whether that advice might be released and the dates of each.

Mr Parker—I will take that on notice.

Senator ABETZ—With respect, I think you will be able to provide us the dates of the advice, even if you do not actually provide us with the detail of the advice.

Mr Parker—Yes, that is my understanding.

Senator ABETZ—Thank you.

CHAIR—Thank you, Senator Abetz. I would like to go back to the paragraph of that advice that I think Mr Parker mentioned—that is, paragraph 68. It states, ‘It would be possible to revise the proposal to avoid the risk that the law could be held to be invalid on section 51(ii) or section 99 grounds. Specifically, as noted above, we do not consider that there would be a risk that the law would be invalid if it did not include a cap on the refund credit which discriminated between the states.’

It goes on in paragraph 69 to give an example. I think attempts have been made to say that this advice points out the risk of unconstitutionality, but those people have been at pains to avoid that part that indicates that there might be ways around it. The Department of Resources, Energy and Tourism said yesterday that it is not unusual in a major piece of legislation or in other pieces of legislation to have many pieces of legal advice in the process of drawing up that bill. Would you agree with that, Mr Parker?

Mr Parker—Yes, I think that is right.

CHAIR—In terms of the finality of the second part of the document which we have seen today, which is the minerals resource rent tax heads of agreement, that agreement talks about the design of the minerals resource rent tax rather than the detail of the minerals resource rent tax. That would seem to me to indicate that it is not something particularly set in concrete. As I mentioned earlier to the previous minister, it talks about an implementation committee which is charged with ‘the development of more detailed technical design to ensure the agreed design principles become effective legislation’. To me, in talking about design principles, that indicates that there was an overall agreement of the general way that the parties wanted to go, rather than a concrete understanding of how it would work. Would you agree with that?

Mr Parker—I understand that is the position of the government.

CHAIR—I just wanted to clarify that because it is very easy to talk about things as if they are fixed and ignore other parts of documents. Senator Cameron, do you want to ask your question?

Senator CAMERON—Dr Henry, I am not sure whether you or one of your officers can advise me as to why countries overseas have introduced a resource rent tax and what the benefits of a resource rent tax are for Australia.

Senator ABETZ—Is it Doug or ‘Dorothy’?

Senator CAMERON—We’ve got to get it back to some sense after what you’ve been going on with!

CHAIR—Can I have some order please.

Senator ABETZ—I am being very unruly—you are quite right, Chair.

Dr Henry—Senator, I can refer you to the treatment of these issues in the Australia’s Future Tax System Review—quite an extensive treatment of these issues which puts the case for countries extracting fair value for the benefit of their taxpayers from the exploitation of non-renewable natural resources. It is a matter of some considerable interest globally. There are a number of countries—it is not a large number—for whom the extraction of natural resources represents a substantial proportion of economic activity, particularly of exports, and in that small number of countries there is considerable interest in the issue of whether the citizens of the country are receiving full value for the exploitation of those natural resources.

Senator CAMERON—Thank you. Can I now come to Mr D’Ascenzo. I have some questions in relation to sham contracting I am not sure you can help me with. Are you aware of a report that three children in South Australia were put on a contract under what is described as an Odco type system and that the Fair Work Ombudsman is taking legal action in relation to these contracts that children are being put on in South Australia?

Mr D’Ascenzo—I am not aware of that specific case. I do not know whether my colleague Mr Quigley might be.

Mr Quigley—I also am not aware of that particular case, Senator.

Senator CAMERON—Is that a case that would draw the attention of the tax office in relation to children being put in a situation where tax is avoided and illegal actions may be entered into?

Mr Quigley—We do find in our inquiries that what you refer to as sham contracting arrangements often involve people who are less able to represent themselves. So we find often that it is young people or people from non-English-speaking backgrounds who are put in situations where employers are insisting on particular arrangements.

Senator CAMERON—Are you aware of this Odco system that is being peddled around various industries?

Mr Quigley—Sorry, what was that particular term?

Senator CAMERON—The Odco system.

Mr Quigley—No, Senator, I am not.

Senator CAMERON—I am quite surprised, because both the Australian Building and Construction Commission and the Fair Work Ombudsman have expressed concern about this system, which is being used to in some areas avoid tax and in some areas ensure workers do not have access to their legitimate entitlements. And you are not aware of this?

Mr Quigley—I am not aware of that particular terminology, Senator. It may be that some of my officers are actually looking at those types of arrangements. And, given that those other organisations are, I would suspect that we would be looking at something. But I am not aware of that particular—

Senator CAMERON—Could you take it on notice so you can advise me in relation to whether the Taxation Office is aware of these issues and is doing anything about it?

Mr Quigley—Sorry, could I clarify: we certainly are aware of those types of issues. What I am not familiar with is that particular term. But I certainly will take that on notice.

Senator CAMERON—What are you doing about the issues, then, as distinct from the term?

Mr Quigley—Senator, there are a number of approaches we take in this particular area. The strategies go from communication strategies followed all the way through to full-blown audits. So there is a range of activities. For instance, for the four years up to 13 October we completed over 4,000 field audits in this particular area. Sorry, that was up to 30 June. From 1 July to 13 October we have completed about 1,200 field audits.

Senator CAMERON—And what is the result of those audits?

Mr Quigley—The 1,200 odd—it was over 1,200—that have been completed, they raised an average revenue of just over \$24,000 per case and nearly a third of the revenue that was raised was relating to superannuation guarantee.

Senator CAMERON—How many audits did you undertake?

Mr Quigley—The exact number is 1,263 and, as I say, the average revenue per case was \$24,237.

Senator CAMERON—What is the percentage of those audits where you had to take remedial action in terms of the taxpayer?

Mr Quigley—I have not got figures to say how many of those 1,263. There were particular adjustments that were made. I have only the average figure that I have provided to you.

Senator CAMERON—Would you not think that that would give you some idea, given that you have done these spot audits, as to what the proliferation of this problem is in the industry?

Mr Quigley—Certainly. I am sure we have that figure, but I do not have it. I will take it on notice.

Senator CAMERON—Can you take it on notice and provide me with that figure?

Mr D'Ascenzo—Can I just add that they are not actually spot audits. We actually do a prioritisation and risk assessment. So they are actually targeted audits and you would expect

that there would be a high rate of conversion of those in terms of people not doing the right thing.

Senator CAMERON—Are you doing this across all industries?

Mr D'Ascenzo—We are highlighting some specific industries that are more high risk than others, such as the building and construction industry.

Senator CAMERON—Can you provide a list of those industries?

Mr D'Ascenzo—Yes, we can.

Senator CAMERON—Can you take that on notice. Are you aware that the ABC Commissioner, Leigh Johns, is reported in the press this morning arising from Senate estimates yesterday saying that he is looking to develop an all-of-government action plan to eliminate sham contracting in the construction industry. He went on to say that the ABCC intends to host a government and industry roundtable in eliminating sham contracting in the building and construction industry. Would the Taxation Office take part in this all-of-government action plan? Can you provide some leadership in this all-of-government action plan?

Mr D'Ascenzo—I think the answer would be yes to the extent to which we have identified the fact that there is a level of noncompliance at two levels. One is employers not complying with their pay-as-you-go requirements or superannuation guarantee charge. There is also a level of noncompliance by some of the contractors who do not return income. We have recently been given further funds by government in the last budget. I think we have added 66 more resources into that area of scrutiny. We still think that it is a risk area and we would be more than happy to work on a whole-of-government front.

Senator CAMERON—Have you ever considered taking some leadership in an all-of-government approach in this issue that has been around for many years?

Mr D'Ascenzo—I think we are very active in that field—more active than probably anybody else in any other agency.

Senator CAMERON—That is not what I asked you—your activity, because there are other agencies that are now caught up in this. It seems to be so prevalent that the ABCC and the workplace Ombudsman have now said that this is a serious issue for both those organisations. I am just wondering why the tax office never thought to do what Commissioner Johns is now proposing and that is to have an all-of-government approach on this.

Mr D'Ascenzo—I think that we have been in consultation with respective governments about what can be done in this area.

Senator CAMERON—So you would participate in any roundtable that is designed to deal with sham contracting?

Mr D'Ascenzo—Again, what this means is that you really have a very resource intensive exercise of following through individual employers and employees. As I said, it is very resource intensive. So you either have to put more resources into doing that or you have to look at systemic solutions.

Senator CAMERON—That is not what I asked you. I asked if you are prepared to take part in the roundtable.

Mr D'Ascenzo—The answer is yes.

Mr Quigley—Senator, could I just add that we are also working with state and territory revenue authorities in this regard as well.

Senator CAMERON—Do you have any idea how much revenue is lost through sham contracting?

Mr D'Ascenzo—When people talk about sham contracting, it is sometimes arrangements which are legal but which force onto the employee certain legal requirements that make them contractors under common law. Sometimes they work through companies that take them out of this dichotomy of employee or employer. So it is not that easy to work out which part of that industry practice—

Senator CAMERON—So is it a legislative impediment? Have you actually been able to ensure that people pay the proper tax?

Mr D'Ascenzo—I think it is a question of having to have a look at the individual arrangements of a range of employers and a range of employees to see whether or not they meet the legal requirements.

Senator CAMERON—But that is not what I asked you. I asked you if you see any legislative impediment to being able to deal effectively with ensuring that people are properly classified and pay their proper tax.

Mr D'Ascenzo—I think the answer I gave you is quite relevant, because it is a question of finding the arrangement and then examining it in terms of whether it meets the common or legislative processes. That is a very resource intensive exercise.

Senator CAMERON—I do not intend doing a Senator Brandis or a Senator Abetz on you. I ask if you could take that on notice and see whether you consider there is any further information you can advise me of in relation to this question. It is an important question for me and I will be pursuing it further. I still am not sure. You cannot tell me what the cost to the economy is of tax evasion through sham contracting?

Mr D'Ascenzo—No, not to that degree of specificity.

Senator CAMERON—What could you do to provide me with some advice on the amount of tax evasion there is through sham contracting? Is there something you could provide to advise the Senate of those issues?

Mr D'Ascenzo—We have highlighted it as a risk in terms of our compliance policies. So we think it is a risk. We agree with you in that regard. The government has given it some more resources in the last budget, but the way you currently address issues is very resource intensive.

Senator CAMERON—Are you aware that in the UK there have been estimates of tax revenue lost in relation to sham contracting?

Mr D'Ascenzo—I am not aware of those figures. Perhaps Mr Quigley might be.

Mr Quigley—I am not specifically aware of the figures that might be reported in the United Kingdom, but the United Kingdom, Canada and the United States, for instance, do have income-reporting and withholding arrangements that we do not have in Australia. So they would be better placed to be able to come up with those sorts of figures.

Senator CAMERON—So do you think we should be better placed to allow you to ensure that everyone pays their fair share of tax?

Mr Quigley—Senator, that is not for me. That is up to the government.

Senator CAMERON—Could you provide me advice in relation to the legislative process in the countries that you have indicated that provide the taxation offices in those areas with a better approach on dealing with sham contracting?

Mr Quigley—I did not say they had a better approach. I said because they have got reporting and withholding arrangements—and they may or may not be better approaches—

Mr D'Ascenzo—We can provide the information about what we know is happening in other countries.

Senator CAMERON—Yes. I should not have said 'a better approach', but you did indicate that there was more information. I would have thought that was a better approach. Thanks, Mr D'Ascenzo. You will provide the information on how this issue is handled in other overseas administrations?

Mr D'Ascenzo—We will do what we can in that regard.

Senator CAMERON—Thanks very much.

Senator BOSWELL—Dr Henry, your second five-year term as secretary ends next April. Are you going to go around again?

Dr Henry—That is an issue for me and the Prime Minister, Senator.

Senator BOSWELL—What is the process of having your term accepted again? Is there a process that goes on?

Dr Henry—There is, and that process involves, at a bureaucratic level, the Secretary to the Department of the Prime Minister and Cabinet and the head of the Australian Public Service Commission.

Senator BOSWELL—In the Red Book you said:

We will need to discuss further with you the implications of the parliamentary reforms and the operation around minority government.

What has Treasury got to do with a minority government? How can it be of any consequence or interest to Treasury whether there is a minority or majority government?

Senator Wong—If we are going to have a range of questions on the Red Book—the book which is the incoming government brief—then the approach I ask to be adopted in relation to the finance questions is that you refer officials to where you are quoting from. I do not think that is unreasonable, so they know what part of the document you are referring to and are able to respond.

Senator BOSWELL—I am actually quoting from a column by Mr McCrann. No doubt he had a copy of the Red Book.

Senator Wong—The Red Book that was released is on the website.

Senator BOSWELL—Dr Henry has never been stuck for a word in his life. In fact he has been very forthcoming in his views. I am sure he will not mind answering this question. He will know what I am referring to and the place in the Red Book.

Senator Wong—Could you read just the quote again, Senator? You do not have a copy of the IGB here?

Senator BOSWELL—I do not have a copy of the book here. What it says is:

We will need to discuss further with you the implications of the parliamentary reforms and the operation around minority government.

Senator Wong—I have found—and I am happy for Dr Henry to add to my answer—where that is. It is on page 1. The sentence goes on to read: ‘including establishing of the PBO, the Parliamentary Budget Office, and facilitating the Greens’ and Independents’ access to Treasury and finance analyses and costings et cetera as well as the commitments in relation to the proposed tax summit’. That is a very reasonable proposition. You may recall that after the election and post the negotiations with various parties and individuals in the House of Representatives a range of commitments were made by the then government in caretaker mode which have to be subsequently implemented. Some of those commitments are referenced in that sentence. They include the Parliamentary Budget Office and also the Independents’ access to Treasury and finance officials for costings advice or costings information. The details of those arrangements were released publicly by the Prime Minister.

Senator BOSWELL—Thank you for that.

Senator Wong—Dr Henry may wish to add to that.

Senator BOSWELL—I am sure Dr Henry is capable of answering the question without your assistance.

Senator Wong—I am just wanting to be helpful, Senator.

Senator BOSWELL—Thank you. Maybe I could try my arm again. Warwick McKibbin has declared Treasury ‘an arm of political policy’ and responsible for a panic package in the context of the GFC. Do you believe Treasury is an arm of political policy? Do you believe that the government’s response was panicked?

Dr Henry—No, I think both those suggestions are completely absurd, frankly. I really doubt that Professor McKibbin made those comments. Perhaps you can take me to a source document.

Senator BOSWELL—I will refer you to the quote, but I have not got it with me at the moment. I am going back a bit, but you were quoted in the *Australian Financial Review* during the 2007 election as saying: ‘a greater than usual risk of the development of policy proposals that are, frankly, bad’. That is your quote at the end of the quote. Did you say that? Is that an accurate reflection of what was said?

Senator Wong—Sorry, Senator, are you asking Dr Henry to confirm a quote that you say related to the 2007 election campaign?

Senator BOSWELL—Yes, that is what I am asking. It was made in the *Financial Review*. No doubt Dr Henry would remember it if he said it. If he did not say it, I will accept that he did not say it.

Senator Wong—I am not sure. Do you remember everything you said in 2007, Senator?

Senator BOSWELL—No, but I would remember that if I said it. Did you say that, Dr Henry?

Dr Henry—I think that what you are referring to are some comments that were contained in an all-staff address early in 2007, although my memory is not perfect on these matters. That particular all-staff address was reported in a series of articles in the *Australian Financial Review*, I think, fairly early in 2007. Without a copy of the address in front of me, I would not want to confirm or deny any particular quoted references.

Senator BOSWELL—You have also been quoted a couple of times as saying, ‘The sooner an emissions trading scheme can be implemented the better; too much time has already been wasted.’ I accept that they are your views and you have every right to be entitled to them, but should you be making those decisions on behalf of a government in your position as head of Treasury? It is my understanding that the head of Treasury is there to implement government policy, not to make government policy. Would you agree with that? Government policy is made by the Treasurer, the ministers and the government, not by the head of Treasury.

Dr Henry—Well, that is certainly correct. Ultimately, as you know it is parliament that decides what gets legislated—in fact the Governor-General—but it is the responsibility of all public servants, at least in policy agencies, to provide policy advice to government.

Senator BOSWELL—Accepted, but do you have to do that publicly?

Dr Henry—Perhaps you would refer me to particular comments that I may have made publicly on these matters. I am afraid that the way in which you put the question to me does not provide sufficient detail for me to be able to recall whether the comments you are attributing to me are comments that I have made in public.

Senator BOSWELL—Do you deny having made those comments?

Senator Wong—Well, Senator, no. Dr Henry has just asked you to refer him to where you assert he made those statements. I do not think you can—

Senator BOSWELL—I am only taking them out of a public document.

Senator Wong—That is fine, but it is not fair to officers to—

Senator BOSWELL—I am asking if Dr Henry denies making that comment.

Senator Wong—He has just given evidence that he has asked you to refer him to where the statements were made so he can answer you. That is not unreasonable.

Senator BOSWELL—I think the gist of my argument that is coming through is that Dr Henry is a senior public servant, and the government obviously thinks he does a good job or it would not be renewing his contract next month or whenever it comes up.

Senator Wong—Dr Henry served your government, too.

Senator BOSWELL—I did not say he did not. What I am saying, Dr Henry, is that there is a perception out there that you are leading the government in its policy rather than enacting the policy. I do not want to say any more than that. It is quite well recognised in the press and everywhere else.

Senator CAMERON—I raise a point of order, Madam Chair. Is a question ever going to emanate on this issue?

CHAIR—I think Senator Boswell is perhaps getting to a question.

Senator CAMERON—Is he?

Senator BOSWELL—No, I have asked the questions.

Senator Wong—I just want to respond to Senator Boswell on one issue. Senator Boswell, I think—and this serves to demonstrate why it would have been fairer to Dr Henry for you to have outlined from where you were quoting—you were quoting from page 11 of the IGB, which is the incoming government brief. That is a brief to the incoming government. A brief would also have been prepared, obviously, for your party and provided to you should you have formed government. This advice, which includes the reference to an emissions trading scheme to which you referred, is obviously advice that Treasury provided the government as part of its incoming government brief. It is not a public assertion or a campaign on an issue; it is advice to government, as is entirely appropriate and consistent with the policy that the Labor Party took to the election.

Senator BOSWELL—Thank you. I am sure Dr Henry would appreciate your support.

Dr Henry—I certainly do.

Senator Wong—I think it is more being helpful to you, Senator Boswell, so you understand the nature of the advice provided.

Senator PRATT—Helpful to add as a clarification.

CHAIR—I must say it is very difficult when senators impute motives to people.

Senator XENOPHON—I have some questions for Mr D'Ascenzo in relation to the change program. When we last met in estimates there was a problem with the change program—the BAS being switched over to the change program. Can you tell me whether that has happened and, if not, whether it is likely to happen and what issues there are in respect of that?

Mr D'Ascenzo—The BAS was originally in the 2004 contract. Over time the requirements to the BAS have changed, which would mean that we would need to enter into new contracts to pick up any changes to the BAS from the date of the original contract. Over time, including propositions raised in the AFTS review, there was consideration as to whether or not an integrated system for BAS would be sensible. So we have since arranged for BAS not to be part of the change program contract underway.

Senator XENOPHON—When was that decision made?

Mr D'Ascenzo—That was done in the wrap-up of the change program. Mr Butler can give you greater detail.

Mr Butler—The change program contract came to conclusion on 30 June this year. The negotiations with Accenture continued over a number of months before and after 30 June. I would need to check the exact dates that we finalised the negotiations.

Senator XENOPHON—If you could take that on notice. As I understand it, there are fewer complaints in relation to issues with delays. Would it be fair to say that some of the problems have been ironed out in relation to the change program?

Mr D'Ascenzo—I think what happened was that people did not appreciate that the changeover to the new system was going to mean that the old system had to be offline for six weeks. Then we did have the two weeks of issues on top, and I think that was what caused a lot of angst in the marketplace. We have now been busily trying to catch up in terms of the amount of returns that have been issued. We are not having any significant problems and, in fact, Mr Butler can give you some details of what—

Senator XENOPHON—Just before Mr Butler does that, it might be useful to establish—and you may want to take this on notice—that I take it you have had to take on extra staff with respect to catching up with respect to the change program. If you could confirm that—the number of staff and the number of hours that have been put into this? Again, on notice would be fine.

Mr D'Ascenzo—I am not sure—we will provide that on notice, but I just want to put the context to you, if I can. Every tax time we put on new staff. We have a range of casual and ongoing staff that we put on because tax time is our busiest time of the year. So it is hard to differentiate what is there because of normal tax time duties or what is there to catch up.

Senator XENOPHON—But in terms of seasonal variations, for tax season you could establish how many staff you had in the previous couple of years?

Mr D'Ascenzo—Yes, we can do that. We can give you the comparisons over time.

Senator XENOPHON—That would be useful. And also whether it was anticipated that the new system would lessen the need to have that many staff—whether that was something that was anticipated in the initial contracts and the scoping for the change program.

Mr D'Ascenzo—We will provide whatever information we can in that regard.

Mr Butler—If I can just give you the context around that, in this tax time we have certainly overengineered. I think I mentioned last time we were here that we were planning to do that, and we have done that. We brought on some additional staff, or brought forward in some sense the spending we would do this year. We are in a position now that we have—since late July the system has performed extremely well, we believe, and we have met or come very close to meeting our service standard during August and September and it looks reasonably good for October as well.

Senator XENOPHON—When do you expect to reach those service standards, given that you are in a catch-up phase now?

Mr Butler—The catch-up phase that Mr D'Ascenzo referred to was really early in this calendar year, when we had the system switched off for six weeks. You will recall that last time we were here I answered questions from you about where we were up to with processing those returns. By the end of June this year we actually had fewer unprocessed returns on hand than at the end of June the two previous years. So we had caught up by then. We then moved into tax time. During July we had a range of different things happen. We did not meet our service standards then—and I can explain those if you wish. But during August and September we have done very well.

Senator XENOPHON—Is it the case that in July, when the 2009-10 returns were lodged, there was a problem associated with the matching data between the agencies? Is that the case? Mr D'Ascenzo is nodding, so—

Mr D'Ascenzo—We had to tie in the requirements of CSA and Centrelink, and their processing did add time to our processing.

Senator XENOPHON—And that has been sorted now in terms of the matching?

Mr Butler—For example, for Centrelink clients we send 50,000 to 100,000 transactions per day to and from Centrelink. So as you build these quite significant new systems and get them working together, there will be some things that need to be clarified and fixed. Even last weekend, for example, we put some fixes in the system for some particular Child Support Agency issues. We were processing things manually and the new system fix removed the need to do them manually.

Senator XENOPHON—And finally on this—hopefully at the next estimates I will have even fewer questions to ask you about the change program—has it met the benchmark or expectations in terms of the contract that was entered into with Accenture back in 2004? Is there a way of robustly and transparently measuring that, given that so much taxpayers' money was spent?

Mr Butler—We have undertaken a benefit realisation work. We have had an independent person do that—Richard Tait, who is the principal of Aquitaine Consulting. He has undertaken benchmark work which shows that the costs incurred by the ATO in the whole of the change program will be returned in the way of benefits over a four-year period.

Senator XENOPHON—Is that a public document?

Mr Butler—It will be. We do plan to put it on our website, so we can certainly arrange for you to have a copy when that is there.

Senator XENOPHON—That would be terrific, thank you.

Mr Butler—It does show a good return, we believe.

Senator BUSHBY—In the incoming government brief, known as the Red Book, Treasury stated, 'The superannuation system is increasingly leaking revenue, with—'

Senator Wong—Senator, through the chair, if we are going to have a range of questions on the IGB I would really think it is fair to the witnesses for you to refer to where in the brief you are referring. Okay?

Senator BUSHBY—Well, I do not have the reference.

Senator Wong—If there are a range of questions—we were taken in detail through the finance brief, and I made the same request. I do not think it is fair—

Senator BUSHBY—On what basis?

Senator Wong—Because I do not think it is—

Senator BUSHBY—I am sorry, but if you are going to refuse to accept a question—

Senator Wong—I am not refusing to accept it. I am asking you, before you—

Senator BUSHBY—I do not think this is a particularly—

Senator Wong—I had not finished, Senator.

Senator BUSHBY—Well finish, then.

Senator Wong—Thank you. I am saying: if there is going to be a range of questions in relation to the incoming government brief, I think it is fair to officials, to enable them to answer properly, for you to be able to refer them to where you are quoting from. We had an example of it with Senator Boswell, where once we found where he was quoting from it was quite easy to answer the question. This is a public document.

Senator BUSHBY—This is not a range of questions. It is one question. I quote one aspect of it. I think it is a fairly obvious area. Officials will have no particular problems in actually identifying what I am referring to. If there is an issue, please feel free to raise it. In the Red Book, Treasury stated, ‘The superannuation system is increasingly leaking revenue, with self-managed super funds now the tax minimisation vehicle of choice.’ That has been a widely quoted quote and I apologise for not having the reference. What particular aspects of noncompliance cause the Treasury to hold such a view?

Mr Willcock—If I could just provide the context or the background to that statement from the Red Book briefing that you quoted. It has become apparent I think to Treasury that there is a shortfall in the revenue that is flowing from superannuation funds in comparison to revenue forecasts, so we have been doing some work—indeed, we are continuing to do some work—to understand what is going on and to understand what is behind that variance. A number of factors seem relevant to us. One is the impact of the global financial crisis. That will clearly have an effect on the investment returns of superannuation funds and hence on the tax that superannuation funds have been paying. Other things that have happened recently that can affect these sorts of outcomes and could be anticipated to have an effect on the revenue that flows from superannuation funds include the changed taxation arrangements for superannuation that were put in place as part of the Better Super reforms in 2007—

Senator BUSHBY—In that respect, are you saying that the changes themselves—the actual impact of the provisions in those changes—are causing this? Or is there a further effect maybe caused by people looking at the changes that are occurring and wondering and worrying about what other changes might occur and therefore looking at other assets as alternative choices to invest?

Mr Willcock—I think it is probably most simply expressed as we think this is a factor and there are a number of factors operating here, and we are trying to, if you like, understand what

the complexity of the picture might be and what different factors might be brought to bear. Then understanding what the relevant weight of each factor might be is quite complex.

Senator BUSHBY—That latter reason I suggested—the sovereign risk argument, so to speak—is potentially a factor and you will be looking at that to see if that had any impact.

Mr Willcock—We are certainly doing as much work as we can to understand—

Senator BUSHBY—Okay, I am sorry I interrupted you. I thought you might have had other reasons.

Mr Willcock—Certainly, the tax settings applied to superannuation were the subject of change through the Better Super reforms in 2007. There has also been, if you like, in terms of just the composition of the superannuation fund industry, a lot of growth in the SMSF sector such as to make that sector now the largest part of the superannuation fund industry, with approximately 430,000 SMSFs.

What I suppose I am referring to is the fact that there have been very significant changes to the investment environment in which superannuation funds are operating—that is, the GFC—there have been some big changes to the composition of the industry and there have also been some significant changes to the nature of the taxation arrangements that the industry is operating under.

I would also note there are large things happening. It is a relatively short time span when we are thinking about the Better Super changes and the impact of the GFC, so there has not been a lot of time, if you like, to get a time series to work out what may or may not be happening. All of those changes paint a fairly complex picture for the industry that we are looking at to try to work out what might be the most appropriate, if any, policy options for government in considering that.

Senator BUSHBY—Absolutely. So in that context, why have you focused on tying self-managed super funds to the statement that the superannuation industry is increasingly leaking revenue?

Mr Willcock—I suppose just to think of those three factors that I have mentioned, and I would not like to imply that they are the only factors, what I think Treasury was trying to do through that Red Book briefing—and it is just one or two sentences—is essentially three things.

We wanted to alert the government to the fact that we do have some concerns about the revenue receipts from superannuation. That is a factual thing in that we are seeing a divergence between the receipts that are coming in versus our estimates. We also wanted to indicate to the government the scope for the SMSF sector to be a factor there because of its large growth and the way that it is now such a significant part of the overall industry composition. We also wanted to highlight that there is a sentence following the one that you read out to do with the Cooper recommendations—that is, note improved standards for the professional advisers to the sector, such as those that are recommended in the Cooper report, in terms of the scope for those to help address that problem.

CHAIR—Senator Bushby, I am sorry but I cut Senator Xenophon off early. He just has one more question.

Senator XENOPHON—It is out of left field but it is perhaps to the minister and to Mr D'Ascenzo. I have been contacted by retailers who have complained to me about the issue of online sales in that if you purchase goods and books overseas you do not pay GST on that. I know that online sales are about \$30 billion a year, I think, of a \$300 billion a year retailing sector, and not all of them would be overseas. Has any consideration been given or any analysis done as to what potential revenue leakage there is with respect to, say, the GST on those overseas online purchases? I am happy for that to be taken on notice, but it is an issue that has been raised with me by small retailers.

Senator Wong—From my perspective I would take that on notice. I do not know about Mr D'Ascenzo.

Mr D'Ascenzo—We know the issue and that is the way that the law operates. There is not any inappropriate leakage through those processes other than what the law allows.

CHAIR—And the minister will provide further information on notice?

Senator Wong—Yes.

Senator BUSHBY—I will ask a question in the last 30 seconds, if I may, given that the tax commissioner is here—I have lots of questions to put on notice, which I will. I have asked questions about this change before, but I am interested to know how many individuals have had their superannuation balances paid to the commissioner under the Superannuation (Departing Australia Superannuation Payments Tax) Act 2007. Also, how many additional individuals have had superannuation balances paid to the commissioner under amendments made in 2009 to the Superannuation (Unclaimed Money and Lost Members) Act? If you could advise what the value of each of those amounts to.

Mr Olesen—I can give you some aggregate figures quickly around the value of unclaimed moneys that we hold. As at 30 June 2010 we hold around \$390 million in unclaimed moneys. About \$323 million of that relates to temporary residents from the first three rounds of collections we have done. I think the amendments you were referring to are in relation to small accounts.

Senator BUSHBY—Yes, I think so.

Mr Olesen—The reporting on that is not due until the end of October, so we do not have any of that information at the moment.

Senator BUSHBY—Good. Can you take on notice for me a break-up of the temporary residents for each of those three rounds?

Mr Olesen—Absolutely, yes. We have got that information.

Senator BUSHBY—Thank you.

CHAIR—That ends the Treasury revenue group and the Australian Taxation Office. Thank you for your patience in coping with the organisation and rearrangements. We will see you next time. I will ask the Macroeconomic Group to come to the table.

[5.47 pm]

CHAIR—Thank you to the Macroeconomic Group for coming along. We have a shortened session for you tonight. Unless there are any opening statements or remarks to make we will get straight into it. I call Senator Pratt.

Senator PRATT—There has been public debate today about the possibility of regulating interest rates, largely brought forth by the statements of the shadow Treasurer, Joe Hockey. It does seem like a radical departure from their previous approach, but I am not going to ask you a political question. I just want to ask what the consequences would be for the broader economy of the government re-regulating interest rates.

Dr Henry—I must start with two propositions which might be helpful to the committee. Firstly, the government used to regulate interest rates. On my recollection the regulation of the mortgage interest rate ceiling, which I believe at the time was 13½ per cent, was removed in May 1986—I stand to be corrected. Since that time mortgage interest rates have not been regulated. That is the first point I would make.

The second point—and again it is by way of background—is that since that time the Reserve Bank has operated monetary policy with respect to interest rates. It would be rather difficult to have a central bank independently operating monetary policy through interest rates and at the same time another body—that is, the government—regulating those interest rates. That does not sit too well together.

I certainly remember the pre May 1986 period because I was affected by it along with a lot of other Australians. I was simply unable to obtain a mortgage from a bank and obtained a mortgage from a financial institution outside the regulated sector. This is why Australia had building societies. So the effect of regulated interest rates in that period—that is, prior to May 1986—was that people who had sufficient wealth to be able to get to the front of the queue were able to get low interest mortgages and those, particularly young people, who did not have sufficient accumulated wealth had to go elsewhere. Obviously they paid much higher interest rates on their mortgages. These are some relevant considerations. I remember those factors in particular were highly relevant to the government that decided to abolish the mortgage interest rate ceiling back in 1986.

Senator PRATT—So in a nutshell the largest problem is access to flow in credit and indeed also a lack of clarity? You are putting government in conflict with the RBA?

Dr Henry—Those I think are two essential issues. As to the first, of course you can in principle regulate the price at which something can be transacted, but you cannot force somebody to sell something at that price. You can in principle, of course, stop a bank from levying an interest rate higher than some ceiling, but you cannot force the bank to lend the money to anybody.

Senator PRATT—We have had a pretty massive credit crunch recently as a result of the global financial crisis and there were pretty significant consequences from that. I would imagine that small business, for example, could be affected in the same way.

Dr Henry—Without going into specific cases, I just make the general point that when prices are regulated at a level below the market clearing level there must be quantitative

rationing. That is pretty obvious. A queue will form and the seller—in this case a bank—will choose among the people on the demand side—that is, the purchasers—on some basis other than a price basis. In the case of mortgages, as I said earlier, back in that pre May 1996 period the decision as to who was at the front of the queue and who was at the back of the queue was made largely on the basis of accumulated wealth. So it had a pronounced distributional consequence. If interest rates were to be re-regulated today, just how that rationing would be effected is something we could only speculate on.

Senator PRATT—But there is a possibility of the rationing of credit, in a sense.

Dr Henry—Well, there would be rationing of credit. It is not a possibility; that is pretty definite. That could be guaranteed. But as to how the credit is rationed, that is something that I should not venture an opinion on.

Senator PRATT—Well, we had some examples, I suppose, of the banks to some extent rationing credit quite recently with small businesses as a result of the global financial crisis. Homeowners were actually, relatively speaking, much more protected. But really what you are saying is that this raises the possibility of different sectors of the economy and consumers—whether they are homeowners or small business—potentially being impacted by another credit squeeze.

Dr Henry—Well, yes, I suppose so.

Senator BUSHBY—I have just a couple of follow-up questions to those questions that were asked by Senator Pratt. Firstly, in the Red Book Treasury claims that the financial services market is oligopolistic. Does that raise the possibility that interest rates are higher than they would be in a more competitive market?

Dr Henry—Yes, it does, Senator.

Senator BUSHBY—Secondly, you sort of indicated to us how, when you were younger, in past decades there were more challenges in accessing finance because of the reasons you outlined. Is it the case that the only reason there were more challenges at that time for accessing loans was the interest rate controls, or did other factors, like the statutory reserve deposit and liquidity requirements and other aspects that contributed to inflexibility in the financial services market, also contribute to that?

Dr Henry—Certainly there would have been other regulatory features of the regulated sector that would have played a role.

Senator BUSHBY—A lot of things have changed since that time in terms of prudential regulation.

Dr Henry—It is true that a lot of things have changed since that time, but I did not have any trouble securing a mortgage in the unregulated sector—that is, in the sector that did not have a mortgage interest rate cap applying to it. I just had to pay a higher rate of interest—a considerably higher rate of interest, as I recall.

Senator BUSHBY—In asking that question, I am not actually suggesting that I am advocating interest rate controls, as the media seems to have suggested. But I am curious as to that.

Senator Wong—I think your shadow Treasurer suggested that, Senator—not the media. If it is your policy, I am interested—

Senator BUSHBY—It is not for me to answer questions here today, but I think we are advocating taking a harder line with the banks rather than necessarily any measure in particular.

Senator Wong—And I think you would have some credibility on that issue if you would indicate what that harder line is, Senator. It is all very easy to come up with a slogan, but what is the policy mechanism? You do not have an answer.

Senator BUSHBY—Minister, today you are sitting on that side of the table. I am sitting at this side of the table.

Senator Wong—Yes.

Senator BUSHBY—I will ask you the questions.

Senator Wong—And I am very happy for that to be the case, but can I say to you that in the court of public opinion there may come a time where people will see the repetition of slogans as opposed to the proposition of policy being the hallmark of your party.

Senator BUSHBY—I suspect that is what actually happened in this year's election and why you went from a position of record popularity to a point where you almost lost the election.

Senator Wong—Your party lost.

Senator BUSHBY—Anyway, we will move on.

Senator BOSWELL—Moving forward.

Senator BUSHBY—Yes, moving forward, so to speak. Dr Henry, I am interested in your tax review's recommendations for superannuation. I have read your and your colleagues' analysis and your tax proposals seem to be a more efficient, more effective and fairer way of increasing Australia's retirement savings. Can you indulge the committee a little and put in plain English why you thought that your tax recommendations were more fit for the purpose than an increase in the superannuation guarantee to 12 per cent, which you actually specifically note in your report is now government policy?

Dr Henry—Actually, Senator, I think the report speaks for itself.

Senator BUSHBY—It does and it is clear, but could you indulge the committee and just in simple terms give an explanation of why that is the case?

Senator Wong—I assume you are not asking Dr Henry for his opinion, Senator.

Senator BUSHBY—I am asking him to summarise a report that he was the head of, which has been released publicly.

Senator Wong—It has been released publicly and you want him to summarise the entire report?

Senator BUSHBY—I want a short summary of the reasons that Dr Henry admitted were outlined in that report—why he came to the conclusion in that report, why that report came to the conclusion that it did.

Dr Henry—In respect of the superannuation issues, the report considered whether there was a restructuring of the tax concessions relating principally to superannuation contributions that might achieve a more uniform distribution of the tax concessions by level of income and which might be done in a way that increased superannuation assets under management in the superannuation industry in total. We asked that question. We came up with a proposal that we considered—and I am talking on behalf of the review panel now—would have achieved those two objectives.

Senator BUSHBY—That is the end of that?

Dr Henry—Yes.

Senator BUSHBY—Thank you. Did you get the opportunity to put that case to the government before they announced their superannuation guarantee increase policy?

Dr Henry—Certainly, yes, Senator.

Senator BUSHBY—Okay. And they were not receptive?

Dr Henry—Well—

Senator BUSHBY—Clearly not, because they did not accept the argument.

Dr Henry—The government had the entirety of the tax review to consider before it made its announcement on 2 May and it had had it for a few months.

Senator BUSHBY—Has your department done any analysis of the budgetary cost of implementing recommendations 18 through to 20 in the Henry review?

Dr Henry—I would have to take that on notice, I am sorry.

Senator BUSHBY—You are not sure whether they have done any modelling?

Dr Henry—I am not, no. I would have to take that on notice.

Senator BUSHBY—And there is nobody else in the room who is aware?

Senator Wong—Senator, he has taken it on notice.

Dr Henry—I do not think so. This is, after all, the macro group and we have just dealt with the Revenue Group.

Senator BUSHBY—Okay. Can you tell me whether the net outcome of those three recommendations is positive or negative for the Commonwealth budget?

Senator Wong—Senator, you are asking Dr Henry to tell you what the revenue impact of policy changes which are not government policy—what it would be; is that right?

Senator BUSHBY—Three of the recommendations are contained in his report.

Senator Wong—In his report. They are not government policy. You are asking him to cost his report.

Senator BUSHBY—In the development of his report I am quite sure they did some modelling and an assessment of what impact it would have. I am asking him whether he is aware of whether it would have a net positive or negative impact on the Commonwealth budget.

Dr Henry—I am sorry, Senator, I will need to take it on notice.

Senator BUSHBY—That is fine. On page 11 of one of the other publications of the Henry committee called *Australia's future tax system*, its retirement income system, states:

An increase in the superannuation guarantee would also have a net cost to government revenue even over the long term (that is, the loss of income tax revenue would not be replaced fully by an increase in superannuation tax collections or a reduction in Age Pension costs).

Am I right to infer from this statement that an increase in the superannuation guarantee is a net cost to budget?

Dr Henry—Yes, I think that is a reasonable interpretation.

Senator BUSHBY—In the red book, Treasury states—and, once again, I apologise, Minister, I do not have a reference:

If the budget is to guard against the risk of a faster than anticipated fall in the terms of trade and make room to deliver on further reform, then it will be necessary to take further steps to strengthen the structural position of the budget.

What steps can the government take to strengthen the structural position of the budget?

Dr Henry—That is very much a policy question.

Senator Wong—Senator, it is—

Senator BUSHBY—Well, what options are available to government?

Senator Wong—Well, Senator—

Senator BUSHBY—I do not think it is a policy question.

Senator Wong—Of course it is a policy question. There are a whole range of things that could occur.

Senator BUSHBY—Yes, and we have the officers from Treasury in front of us—

Senator Wong—They are not here to give you policy advice, Senator.

Senator BUSHBY—who have knowledge and expertise in the tools that are available to government in order to deliver particular outcomes.

Senator Wong—They do but—

Senator BUSHBY—And I am asking what tools are available to government in order to strengthen the structural position of the budget.

Senator Wong—Senator, it is the case that they have the expertise, but you are asking them to give you policy advice. That is not the purpose of estimates committees. If you want to develop policy as an opposition, you will have to utilise other sources.

Senator BUSHBY—Okay, I will move on. I draw your attention to an article in the *Australian Financial Review* this week by Stephen Anthony, a former Treasury and Finance official whom you may know and now a director at Macroeconomics, an economics consultancy. He makes a number of critical observations about the state of the Commonwealth budget. He contends that the budget this year is in a massive structural deficit of four per cent of GDP or \$58 billion. Moreover, he thinks the structural deficit will remain

at about three per cent of GDP for the rest of the forward estimates and the rest of the decade. What is your estimate of Australia's structural budget deficit this year?

Dr Gruen—Senator, as you may be aware, we published in the latest version of the *Economic Roundup* an article on estimates of the structural budget balance of the Australian government. As you are probably well aware, the estimates of the structural budget position depend on a range of assumptions, the most critical of which at the moment is the assumption you make about the structural level of the terms of trade.

As you would be aware, since about 2003-04 the terms of trade have risen by about 80 per cent compared to their pre boom levels, and most people would accept that some proportion of that is structural as in it is likely that over an extended period the terms of trade are likely to be higher than they were before the boom. Most people would also agree that it is not all structural; in other words, the current high levels of the terms of trade will not be sustained forever. The reason most people think that is that there has been a big increase in demand from the growth in China and India, and there is going to be a supply response which will almost certainly bring down prices. We have assumed that in our budget, figuring that the prices will come down from their current high levels and we in fact assume a long-term trend decline.

The reason I am saying all this is that, in order to make structural budget estimates, we, Mr Anthony or the OECD, have to come to a view about what level is appropriate for the structural level of the terms of trade. As we demonstrate in this article, the answer to your question, which is what is the structural level of the budget at the moment, depends critically on what assumption you choose for the structural level of the terms of trade. In the 2009-10 budget we provided an estimate of the structural budget position through time. In this article we have provided updated estimates based on that same structural level of the terms of trade. With the benefit of a bit more history you may well argue that the structural level of the terms of trade is higher than we thought it was in May 2009. We provide a range of estimates up and down 20 per cent, and up 40 per cent, compared to the estimates that were provided in the May 2009 budget. We provide a range of estimates of the structural budget balance. They do show that the budget is currently in structural deficit by several per cent of GDP. But it is hard to be more precise than that, simply because you have to make a call on what you want the structural terms of trade to be.

Senator BUSHBY—What is the range?

Dr Gruen—For 2010-11, which is the year we are currently in, the range would be between about three and five per cent of GDP as the structural budget deficit based on these assumptions.

Senator BUSHBY—Using the same assumption for terms of trade that we used a year ago—

Dr Gruen—If we use the same assumption that we used in the 2009-10 budget, the answer would be a number of the order of four per cent of GDP or a bit above.

Senator BUSHBY—So that is pretty consistent with Mr Anthony's assessment?

Dr Gruen—Our estimates show a significant improvement in the structural budget balance over time on all of these measures.

Senator BUSHBY—On all assessments?

Dr Gruen—Yes. What was the number you quoted?

Senator BUSHBY—Four per cent for this year and three per cent for the rest of the forward estimates.

Dr Gruen—It improves fairly quickly over the forward estimates on each of these projected assumptions and improves further out into the medium term.

Senator BUSHBY—You have answered this in part. Mr Anthony actually stated in that article that he believes the government is basing its forecasts on the maintenance of a 50-year commodity price peak and that without the 50-year record terms of trade there will be no return to surplus in a decade.

Dr Gruen—That statement is not true. He does make that claim, but he is or should be aware of the fact that the budget numbers are predicated, as I said earlier in my previous answer, on a significant decline in the terms of trade from here. So the projected path—

Senator BUSHBY—With an improvement in the structural terms of trade?

Dr Gruen—Wait a second. The budget numbers are predicated not on the terms of trade remaining at their 50-year high but on the terms of trade declining over time.

Senator Wong—In other words, they are not predicated over the longer term on the high terms of trade we see now. My recollection is there is a graph in PEFO that indicates that. I could be wrong. I am speaking off the top of my head. Box 1 in PEFO talks about the fall in the terms of trade that is forecast in 2011-12 of 4½ per cent.

Senator BUSHBY—Is that the structural terms of trade or the overall?

Dr Gruen—This is the actual terms of trade.

Senator Wong—If the argument is that the budget figures are predicated on unrealistic assumptions about the terms of trade, what I understand Dr Gruen to be saying is that there is a decline projected in the government's budget assumptions. Are these assumptions or parameters?

Dr Gruen—Probably both. All of the above.

Senator BUSHBY—The ABS category No. 5204.0 and the Treasury graph chart 6, 'Australia terms of trade', indicates it is continuing to increase until about 2011-12 and then will drop off slightly. I am looking at chart 6, 'Australia's terms of trade'.

Dr Gruen—What is that from?

Senator BUSHBY—It is an ABS chart.

Dr Gruen—It is from the round-up article.

Senator BUSHBY—It hits a peak but then flattens off or starts decreasing far more slowly than it has actually increased.

Dr Gruen—So the peak is in the current financial year.

Senator BUSHBY—On those estimates.

Dr Gruen—Yes. Obviously, the history is ABS numbers but the forecast and projections are ours.

Senator BUSHBY—It is still, up until 2019-20, significantly higher than it has been prior to 2003-04.

Dr Gruen—Indeed, that is certainly true. There are structural reasons why the terms of trade are higher now, not just commodity prices but also the import of computer equipment. That tends to improve the terms of trade over time because we import a range of products whose prices are falling.

Senator BUSHBY—What is the structural deficit predicted by the end of the forward estimates, or the range of structural deficits?

Dr Gruen—On these estimates, the range based on these alternative assumptions—did you say the end of the forward estimates?

Senator BUSHBY—The end of the forward estimates.

Dr Gruen—Which is 2013-14? Have I got that right?

Senator BUSHBY—Yes.

Dr Gruen—The range is between a deficit of about 3½ per cent of GDP and balance on the structural.

Senator BUSHBY—When does the structural balance get back into surplus? You have balance there in one of those. Is that the first time it potentially, depending on the range, reaches that?

Dr Gruen—Yes.

Senator BUSHBY—So none of the earlier years has it reaching a balance or better?

Dr Gruen—That is correct.

Senator BUSHBY—That graph I just referred to shows one range of terms of trade. Those structural deficits are based on a range of assumptions. Where does that graph fall into that range?

Dr Gruen—The structural budget balance estimates are based on a constant terms of trade through time at different levels, at least in the most recent past. There is a subtlety earlier on, but let us not get into that. There is a range here which is four different alternative assumptions for the level of the terms of trade. The highest assumed level of the terms of trade is about 10 per cent below the expected peak, and the others are about 20 per cent below the peak, two-thirds of the peak and a little over half of the peak. So those are the four alternative assumptions.

Senator BUSHBY—Have you done any modelling as to where you expect it to be within that range? Is there a more likely scenario?

Dr Gruen—We have made an assumption in the forward estimates. The more detailed modelling that we have done was in the context of global modelling of the impact of the CPRS on the Australian economy. That modelling, which is an attempt to look at the global

supply balance for products that are relevant for Australia's terms of trade, is suited to longer run statements about the supply-demand balance, but it does not cope well with a situation where there has been a very big run-up in demand and supply has not had a chance to catch up. That is the situation we find ourselves in at the moment, so it does not really help us to answer the question you have asked.

Senator BUSHBY—That is fine. What are the major factors that are causing our actual budgetary position to be better than the structural position? Are commodity prices the most important factor? If not, what is?

Dr Gruen—Certainly, if with a structural calculation you are assuming the terms of trade are well below their current actual level, I think the statement you have made is correct—that is the main effect. There are some other effects but that one is the main one: the fact that the terms of trade are actually significantly higher than the assumption you are making for the structural level.

Mr McDonald—I think the answer to that question is as Dr Gruen said, but I will add this just to assist. Chart 12 of the paper on page 67 provides the composition of the cyclical components of the budget. If you combine that with what is on page 64 at chart 9 relating to the composition of the cyclical component of tax, you see there that the terms of trade is the major positive factor. It is not the only factor but it is the major positive one, and that is particularly true as you go over to the medium and longer term.

Senator BUSHBY—That probably flows well into my next question, which is more general. Can you tell me how sensitive the budget is to changes in Australia's terms of trade? Is there a rule of thumb of some sort that you use?

Dr Gruen—There has been some sensitivity analysis published in the budget of precisely that question, so we can refer you to it.

Senator BUSHBY—Thank you.

Mr McDonald—That is true, and within the paper itself there are methodologies of the paper. Of course, in an aggregate model like this you are not going to have the same level of sophistication as you will in the sensitivity analyses that Dr Gruen is referring to within the budget. The essential calculation is to compare a notional nominal structural level of GDP to the actual level of GDP. So you do not actually look at the terms of trade separately, but it is one of the things that is feeding into the calculation of the structural nominal level of GDP. We then compare the difference between those two—the actual and the structural level of GDP—with an average elasticity, which I think is set out in the paper, and that then translates to, if you like, a cyclical component which is subtracted—or added, as the case may be—from the actual level of the budget balance to give you the structural level.

Senator BUSHBY—I do not pretend to fully ingest all of that in one bite, but a lot of it sounds very familiar from my days when I did my economics degree. I will probably think about that one a little more, but Dr Gruen may be able to assist a little more.

Dr Gruen—In the 2010-11 budget on page 324 is an appendix which discusses the sensitivity of the budget estimates to economic developments and looks in particular at a decline in commodity prices which would be consistent with a one per cent fall in nominal

GDP. So that is about a five per cent decline in the terms of trade, because exports are about 20 per cent of GDP. So a five per cent decline in the terms of trade, according to this appendix, delivers a deterioration in the underlying cash balance of the order of \$5 billion within a year.

Senator BUSHBY—That gives a much easier way of understanding the sensitivity.

Dr Gruen—So one per cent would give you about \$1 billion. A one per cent change in the terms of trade would give you about \$1 billion. Again, these things are tricky because it is a question of what you hold constant and just how much you allow this to flow through the economy.

Senator BUSHBY—Yes, I understand that.

Mr McDonald—At the top of page 70 as well we talk about the aggregate effect of the difference within the different assumptions in chart 15. We say that the alternative assumptions—that is, 20 per cent higher or lower than the baseline—translate to a one per cent of GDP improvement or deterioration in the structural budget balance.

Senator BUSHBY—Thank you for that. The Treasury red book noted—and, Minister, you would be pleased to note that I can actually tell you which page—at page 1 that continued delivery of your deficit exit strategy will be a key but very difficult priority. What are the particular difficulties which Treasury foresees and what is the best way to deal with these?

Dr Henry—I can answer the question in general terms. The fiscal consolidation strategy is quite demanding. It involves a reduction in the budget deficit by about 4½ percentage points of gross domestic product over three years. That is quite demanding when revenue is not growing as strongly as revenue was growing through the period from 2003-04 through to 2007-08 and also when one factors in that there are always spending programs before government on which it is very difficult not to make some upward adjustment for a variety of reasons. Some spending commitments are simply unavoidable. We were simply, in this brief, making the point that achieving the announced degree of fiscal consolidation is going to require considerable effort and a lot of discipline.

Senator BUSHBY—Thank you. The budget papers do not show the interest rate used to forecast the interest cost of Australia's debt—not that I could find, anyway. Is that correct, firstly? And then why is that, if that is correct?

Dr Henry—Well, that question really should be asked when the Fiscal Group people are here. We have answered this question in estimates on a lot of occasions in the past, and people from Fiscal Group would be able to help you again with the answer to that question. But basically the summary answer to the question is that we use a weighted average cost of debt in calculating the PDI impact of pluses and minuses in the budget balance. There is not one single interest rate that is used.

Senator BUSHBY—I find it curious, because you can effectively back out the interest rate from the debt and the interest payments data which is published. You can get a rough—

Senator Wong—Senator, can we cover this when Fiscal Group is here? We are quite happy to respond.

Senator BUSHBY—I am happy to go into it with Fiscal Group, but I thought I would ask while we had the secretary. You are not going to be here for Fiscal, are you, Dr Henry? Or are you?

Dr Henry—I have a choice?

Senator Wong—I do not think he does. I think he is going to be here for Fiscal Group.

Dr Henry—I had intended being here.

Senator BUSHBY—Okay. Thank you. In relation to the Charter of Budget Honesty, the Treasury red book noted at page 3 that ‘certain provisions have not stood the test of time, in particular those governing the process for costing of election commitments’. Could you elaborate on this comment? What are some possible solutions?

Senator Wong—You could actually put your policies in, Senator.

Senator BUSHBY—I beg your pardon?

Senator Wong—You could put your policies in for costing. That would be a solution.

Senator BUSHBY—I am interested in hearing Treasury’s perspective on the reasons they put that line in the red book.

Senator Wong—I am sure you do not want to talk about that. It is quite an extraordinary series of excuses by Mr Robb, and now Mr Hockey tells us that he did not even know about the costings anyway. Anyway, Dr Henry, I am sure, can respond.

Senator BUSHBY—I think I know.

Dr Henry—Well, I do not have a lot to add to what has already been said. My understanding is that at the time—and I was around at the time—there was an expectation that governments and oppositions would both use the provisions of the Charter of Budget Honesty Act to have their election policies costed during the election campaign period, and that has not always happened. Whatever the reasons for that, it has not always happened and we were simply making the point here that it might be timely to have a review of the charter to consider why it has not always happened and to see in what ways the Charter of Budget Honesty Act could be enhanced in order to improve the operation of those provisions.

Senator BUSHBY—And maybe improve the confidence of political parties in the process.

Dr Henry—Sure. If a review such as we were suggesting here were to reveal that that was a significant issue, then of course.

Senator BUSHBY—I mean, the minister raised issues regarding the most recent election, but there were issues regarding the 2007 election with respect to opposition costings as well which I imagine hold true for this comment just as much as the 2010 election.

Dr Henry—We were not referring—

Senator BUSHBY—No, you are saying—

Dr Henry—You specifically mentioned 2007.

Senator BUSHBY—that there had been problems, but it is not just confined to one election.

Dr Henry—We were not suggesting that it was.

Senator BUSHBY—Yes, exactly. Would you describe Australia's fiscal policy settings as tight? It is a term used commonly in terms of fiscal and monetary settings. Are they tight at the moment?

Senator CAMERON—Aren't we described as that from time to time?

Senator FAULKNER—Is a one-word answer—yes or no—adequate?

Dr Henry—The stance of fiscal policy at the moment is, I think it is fair to say, accommodative but tightening.

Senator BUSHBY—Accommodative but tightening. Thank you.

Senator FAULKNER—That will have people diving for their dictionaries.

Senator BUSHBY—I had not noticed your arrival, Senator Faulkner, but I am enjoying having you here. The Treasury red book notes on page 4, in referring to the interaction between monetary policy and fiscal policy, that tighter fiscal policy and measures to boost labour force participation and productivity could play a useful role in complementing monetary policy, reducing the size of the required increases in interest rates and the exchange rate. Could you confirm that there is a trade-off between fiscal policy and monetary policy?

Dr Henry—It depends on the state of the economy. We have discussed this on numerous occasions in the past, I am sure you will recall, Senator. In an economy which is at some distance from full capacity, there is probably not a great deal of trade-off. That is to say, fiscal policy probably does not crowd out a lot of private sector activity and we were in that position not too long ago. But if an economy is close to full capacity then it is more likely that an expansionary fiscal policy—and, of course, that is not what is being envisaged by anybody—would to some extent crowd out some level of private sector activity because it would mean, other things equal, that interest rates would have to be higher. It would mean that the nominal exchange rate would be higher than it otherwise would be—indeed, the real exchange rate would be higher—and through those channels in particular there would be some crowding out of private sector activity.

We were also making the point that if an economy which is close to full capacity is experiencing a terms of trade shock then there is some trade-off between monetary and fiscal policy as well. An economy that is close to full capacity that experiences a positive terms of trade shock will have to have, some way or another, an increase in the real exchange rate. Fiscal policy will have an impact on the required size of the increase in the real exchange rate and monetary policy will determine how much of that then comes through the nominal exchange rate and how much comes through domestic cost or domestic price level. So that, in a nutshell, is the sort of trade-off between fiscal and monetary policy that we were referring to.

Senator BUSHBY—So when you say—to paraphrase the quote—that tighter fiscal policy could play a useful role in complementing monetary policy, reducing the size of required increases in interest rates—

Dr Henry—Sure. In an economy close to full capacity, where interest rates are being tightened through the operation of monetary policy, it is generally the case that a fiscal tightening could, at least to some extent, substitute for a monetary tightening.

Senator BUSHBY—Right, and the reverse. You say here that tighter fiscal policy—

Dr Henry—Yes.

Senator BUSHBY—could reduce the size of required interest.

Dr Henry—Yes. That is what I am saying. If there were to be a tighter stance on fiscal policy than what we are already seeing in the forward estimates, which is already a quite aggressive amount of fiscal tightening—as I said, 4½ percentage points over three years—an even tighter stance on fiscal policy or an even more rapid reduction in the size of the budget deficit would, other things being equal, mean that less of a role would need to be played by monetary policy in achieving the Reserve Bank’s inflation target.

Senator BUSHBY—Meaning there would be less pressure for interest rate rises?

Dr Henry—Yes, that is generally the case. If an economy is close to full capacity a tightening of fiscal policy would mean that there is less work left to be done by monetary policy. That would mean, other things equal, that interest rates would be somewhat lower.

Senator BUSHBY—Is there any—

CHAIR—Senator Bushby, I have questions from Senator Pratt in a second.

Senator BUSHBY—I will finish the questions on this particular area, then. I think I have asked this question before in previous estimates. Is there any rule of thumb by which you could assess or otherwise calculate the relationship between actual interest rate rises and the degree to which fiscal policy could actually impact on it?

Dr Henry—Those rules of thumb exist, but they are heavily dependent upon the state of the cycle. They are heavily dependent on how far from full capacity the question is judged to be.

Senator BUSHBY—Presumably Treasury can judge that?

Dr Henry—That is what we do when we try to estimate the NAIRU, the non-accelerating inflation rate of unemployment. You probably recall—and I think we have had this discussion in the past—that we tend to chase the NAIRU down. That is to say the NAIRU always ends up being lower than we seem to think it is. Those sorts of calculations and the application of rules of thumb are a little risky. If we were absolutely certain about that question of how close to full capacity we were there would not be so much risk involved.

Senator BUSHBY—But there is risk in all your monitoring, and we have had that discussion before too.

Dr Henry—Sure there is. I am just suggesting that one needs to exercise caution about the use of simplistic rules of thumb on this trade-off between fiscal and monetary.

Senator BUSHBY—Given your assessment of where the economy is currently and using the most commonly accepted rule of thumb, what—

Senator Wong—He has just declined to—

Senator BUSHBY—He has indicated that you have to take it very carefully. You have to take the results of those rules of thumb very carefully.

Senator Wong—I thought that Dr Henry had declined to indicate to you what the—

Senator BUSHBY—I asked him whether there were rules of thumb. I did not ask what they were.

Senator Wong—You cannot do that. You cannot say, ‘I know you can’t tell me what X is, but now please do a calculation or make an assertion based on X.’

Senator BUSHBY—I did not say ‘I know you can’t tell me’. I asked him were there rules of thumb. Dr Henry gave me a very considered reply to that.

Senator Wong—Yes, he did.

Senator BUSHBY—I will ask the question slightly differently. Have Treasury applied any of those rules of thumb or any of those methods of calculation of looking at the interplay between monetary and fiscal policy in a way that would indicate, say, how much you would need to tighten fiscal policy to offset the need for a rise in interest rates of 0.25 per cent?

Dr Henry—Not to my knowledge. I will take that on notice, if you do not mind—but not to my knowledge. I would be a little loath myself to endorse any particular rule of thumb for the reason that I have mentioned.

Senator BUSHBY—I understand why you do not want to endorse them. I am interested in hearing whether Treasury has actually used them.

Dr Henry—Sure.

Senator BUSHBY—I have one final question in this area. Treasury’s assessment of the macroeconomy includes the comment:

... there are upside risks that will require coherence and consistency between the stance of monetary and fiscal policies ...

In Treasury’s view, are fiscal and monetary policies coherent and consistent at the moment?

Dr Henry—That is very much asking for a policy opinion. I am happy to answer it if the committee considers it is appropriate for me to do so, but normally we would not answer a question like that.

Senator Wong—Can I respond, because it puts officials in a difficult position if they are asked to give you policy opinions. I think the government is both highly conscious of and extremely focused on many of the issues that you have traversed and that are laid out in the RGB. For that reason, as Dr Henry has referenced, we are engaging in what he described as quite an aggressive fiscal tightening—over three years, a tightening in the fiscal stance of 4.4 per cent, I think, of GDP. My recollection of my briefing is that that is the fastest fiscal consolidation since the 1960s. I recall being told that in fact I do not think we kept the same types of data prior to that.

I do not want this part of the discussion to go by without understanding the context of the government’s commitments. The two per cent cap on real growth in expenditure that Dr Henry also referenced is quite substantially lower than was achieved in the last five Costello

budgets. I am not making a political point; I am making a point about the stringency of the commitments the government is going to adhere to.

Senator BUSHBY—The debt situation was very different under those years. The great irony is that that is all conducted in a time when a large proportion of the stimulus package is yet to be rolled out.

CHAIR—I will come back to you, Senator Bushby, if you want to go into that area.

Senator PRATT—I want to pick up on the comments of the minister and Senator Bushby about the consolidation issue. Minister, you were saying that historically this consolidation compares very favourably. It is a rather rapid consolidation in comparison to past consolidations.

Senator Wong—I was referencing the briefing I had, which talked about this being the largest fiscal consolidation since the 1960s. I try to say it publicly as the largest fastest return to—

Senator BUSHBY—It is very easy to implement the fastest fiscal consolidation when you have just conducted the fastest fiscal expansion.

Senator Wong—This is coming from a senator who represents a party whose election policies would have implemented a deterioration of the budget bottom line and had a \$10.6 billion black hole.

Senator BUSHBY—Focus on the issues, Minister.

Senator Wong—You want me to focus on the issues. You want to talk about economic and fiscal responsibility, but you did not get your policies costed; and, when you did, they actually made the budget bottom line worse and you had a \$10.6 billion black hole. For you to come in here and lecture us—seriously! I have lost my train of thought but I think I was simply saying that I try to describe the fastest fiscal consolidation as the largest fastest return to surplus because I hope that is a little more comprehensible to those of us who are not accountants or economists.

Senator PRATT—So a significant amount of that consolidation is happening in the current financial year; is that correct?

Dr Gruen—Yes, that is correct.

Senator PRATT—I want to go back to Senator Bushby's discussions about terms of trade and use that as an opportunity to ask about the international environment that is affecting our terms of trade. What kinds of analyses and forecasting have been done in relation to China and Japan that have underpinned the forecasting about our terms of trade?

Dr Gruen—In putting our forecasts together, we obviously look at evidence about the behaviour of the world economy. Just briefly, as a characterisation, the advanced world continues to be in a reasonably fragile recovery from the deepest recession since the Second World War. That applies obviously to North America, Europe, the UK and Japan. Japan, despite not having the financial problems of the North Atlantic, suffered a very bad recession—a remarkably deep recession, in fact—and is yet to recover the level of GDP that it enjoyed at the beginning of 2008.

But by contrast, as you would be aware, China in particular on the back of a very big, quick and early fiscal and monetary stimulus accelerated its growth rapidly in 2009 and into 2010 and now they are in the position of, and have been for a while, trying to moderate the strength of their economy to some extent. I think data came out today confirming that through the year China continues to have a growth rate of above nine per cent. So they are still growing extremely rapidly by any standards we would be used to, and the same is true of India. Although it does not grow quite as fast as China, it has been growing extremely fast. So in putting our forecasts together obviously we look at developments in the major economies which are of relevance to us. Our assessment would be that it is continuing to be the case that China and India are growing rapidly but that the recovery in the advanced economies is much more tentative and will probably be more drawn out.

Senator PRATT—Thank you.

Senator CAMERON—I am not sure who wants to take this—Dr Gruen or Dr Henry—but Timothy Geithner made a speech that was reported in the *New York Times* on 6 October where he indicated that there was a real problem with economies when doing the necessary rebalancing and the rebalancing was being undermined by countries trying to prevent their currencies from rising in value. I have missed some of this session, so if you have answered this I am happy to go back to *Hansard* and look at it. Mr Geithner says that focusing on strengthening growth rather than risking a premature shift of restraint was the way forward. He spoke about the problem of the 1930s, which was competitive devaluation, but we are now focusing on competitive nonappreciation. What are the implications of this for our economy?

Dr Henry—You do ask the big questions, Senator. That is a massive question. How much time do we have, Chair? That is a serious question.

CHAIR—Fifteen minutes.

Dr Henry—I will just outline some of the issues. Obviously his comments were, at least in part, directed to China—that is obvious—and in particular are directed to Chinese exchange rate management. Of course there has been from time to time some frustration expressed by quite a number of countries actually, although I guess particularly the United States, about the pace at which the renminbi is appreciating against the US dollar. Mr Geithner, as I understood his comments, was saying that one cannot characterise what China is doing in exchange rate management as a competitive devaluation since it is true that the renminbi is appreciating but gradually against the US dollar, but that in a free foreign exchange market, a market absent of any central bank intervention, the renminbi would be appreciating at a faster rate. So he chose to use the language of competitive nonappreciation.

There is quite a lot of focus on exchange rates at the moment. This is not unusual in a period of global weakness, and I can certainly recall several instances over the past 30 years in which at times of global weakness there has been a lot of interest in bilateral exchange rates and a lot of finger-pointing. At some points in the past agreements have been brokered amongst major countries concerning exchange rates. At times like this there is a risk of bad decisions being taken.

There is a risk of economies being regulated—re-regulated—through the imposition of various controls, whether they be controls that affect the capital account, or the balance of

payments capital controls, or whether they be controls that are designed to have an impact on the current account or the balance of payments. Obviously I am referring there to things like tariffs and quantitative controls.

There is a risk at times like this of economies becoming more protectionist in one or more senses. It is in nobody's interests, including Australia's, that major economies take those sorts of decisions. By and large we have, in this economy at least, benefited from openness with respect to both the capital account and also the current account and we have—perhaps more importantly here—benefited from other countries' liberalisation efforts as well. So there are some risks for the global economy and some risks for the Australian economy of inappropriate policy responses in respect of exchange rates at this time of a pretty general amount of global weakness.

I would make the observation that right now just about every country in the world, with the possible exception of Australia, seems to be focused on achieving growth through growth in exports. This is a rather difficult thing for everybody to achieve and the fact that so much focus is on export-led growth by so many countries at the same time gives one a sense of the seriousness of the issue and of the risk of inappropriate and harmful decisions being taken.

CHAIR—Has anyone any further questions?

Senator BUSHBY—I do. At the last estimates I asked about chart A on page 2-23 of Budget Paper No. 1 and you indicated that an error was made and pointed the committee to a new analysis of 26 OECD countries in which there was a statistically significant relationship between those countries applying more stimulus outperforming against forecasts relative to those that did not. Will you continue to provide the analysis for each of these countries showing relative performance against predictions as the stimulus payments wind down and the consequences of bringing forward spending and higher borrowings become evident?

Dr Gruen—Senator, I think we had a discussion about how important I thought these results were and I think at the time I made the point that I thought it was a piece of evidence but it was not conclusive either way.

Senator BUSHBY—Yes, that is right.

Dr Gruen—So I had not been planning on doing so. I think the other problem is that the way this analysis was done was to compare outcomes with forecasts and I think the crucial period of time was 2009, if my memory serves, because that was the period of the significant budget interventions. To the extent that the analysis is trying to ask the question, 'Did countries that used more fiscal stimulus outperform what the IMF expected they would do?' and to the extent that that question is of any interest, it is of interest at the time when these fiscal stimuluses were being implemented. I guess one could redo it for 2010.

Senator BUSHBY—No, I acknowledge that the further you get away, the less relevance it has. But clearly, you have to have a look at the impact of that stimulus while it is rolling out in order to get any value.

Dr Gruen—Yes.

Senator Wong—What are you seeking, Senator?

Senator BUSHBY—I was just wondering whether they are were going to continue that for any further than what has been done.

Senator Wong—I think Dr Gruen said that he was not intending to. If you are asking him to—

Senator BUSHBY—I would be interested to see it for at least another year.

Senator Wong—I would think the question will be taken on notice and the government will consider it.

Senator BUSHBY—I am happy with that. I also asked, in the context of that discussion that we had, whether you performed a similar analysis of commodity-producing nations and you stated no. Have you since?

Dr Gruen—No, I have not done any further work on this.

Senator BUSHBY—Fine. The Reserve Bank and others have expressed concerns over capacity constraints in the economy and the potential for this to lead to inflationary and other pressures. Do you consider the constraints on capacity, skilled labour in particular, present any threat of impacting on the Australian economy in the next two years?

Dr Gruen—I think we made comments that were along those lines in the red book.

Senator Wong—The government is very conscious of that. I would make the point—and you do not have to answer this as you pointed out to me—that a number of the programs you cut in your election castings included a range of investment in skills programs that the government has committed to.

Senator BUSHBY—As you rightly point out, I am not answering the questions, you are.

Senator Wong—Yes, you do not have to answer that.

Senator BUSHBY—And you can make gratuitous comments that you claim are probably irrelevant, but I will leave it up to others to decide whether they are.

Senator Wong—I am not sure it is gratuitous to point out that there is some irony and inconsistency in you putting questions about skills shortages when you advocated removal of a range of programs investing in skills formation and acquisition.

Senator BUSHBY—I also believe we had a range of programs to replace them, but that is another matter.

Dr Gruen—In the PEFO we did make a comment that is not exactly the one that you refer to.

Senator BUSHBY—Mine was not a quote; I was just asking it as a general question.

Dr Gruen—We make the point that inflationary risks are on the upside with the labour market reaching full capacity over the next year and the strong incomes boost from the terms of trade expected to see demand increasingly stretch the economy's supply capacity.

Senator BUSHBY—If that continues, what impact will that have on the Australian economy? How will that manifest?

Dr Gruen—It manifests in inflationary pressure. Obviously the government and the Reserve Bank have a commitment to the inflation target. Obviously the Reserve Bank aims to achieve inflation of between two and three per cent over the medium term and, to the extent that that was put at risk, the Reserve Bank would respond.

Senator BUSHBY—Does Australia currently have surplus underutilised employment? Essentially, how close are we to the notion of full employment?

Dr Gruen—I think this goes back to an answer that Dr Henry gave. We have for an extended period used five per cent as an assumption for the NAIRU. We have done this all the way back to the 2002-03 *Intergenerational Report*. But as I said at the last Senate estimates, I think, that estimate has a considerable margin of error, and neither we nor anyone else is in a position to make definitive statements about the level of the NAIRU. Obviously, if the NAIRU was five per cent then we are pretty close to it. It is certainly possible, as Dr Henry mentioned, that the NAIRU could be somewhat below that, though I think we are clearly closer to capacity than we were six months ago. The unemployment rate has been coming down. Our view is that we are not at capacity but we are close.

Senator BUSHBY—But we are getting close to it?

Dr Gruen—Yes.

Senator BUSHBY—I will quote from the red book again. In the red book, Treasury states: Tighter fiscal policy and measures to boost labour force participation and productivity could play a useful role in complementing monetary policy in reducing the size of the required increases in interest rates and the exchange rate.

Over what time period should these policies operate? Is it sensible for essentially microeconomic policy, such as labour force participation and productivity, to target macroeconomic variables such as interest rates and the exchange rate?

Dr Gruen—If you think that we are in the midst of a long-lived mining boom, and there are certainly lots of signs that that might be true, then to the extent that you can improve the supply side of the economy, that will help the economy to adjust to that shock. In particular on participation, to the extent that you can raise the participation rate of the workforce, that provides one safety valve for dealing with the extra demands for labour that are being imposed on the economy by the mining boom.

Senator BUSHBY—You also commented in the red book at page 4 that we have not managed previous commodity booms well. What you have just outlined there is an example of how we could manage it better?

Dr Gruen—That comment goes back to several of the previous mining booms. Certainly the one that sticks in my mind where the Australian economy suffered very badly in the aftermath was the huge rise in the terms of trade in 1974, where in 1971 there was a widespread suggestion that the Australian dollar should be appreciated and it was depreciated, and then, in the world before floating exchange rates, the government in 1973 chose 27 December to appreciate the currency because they were trying to keep it out of the papers. So we now have an institutional structure that copes rather better with terms of trade shocks than the one we had in those days.

Senator BUSHBY—But, despite that, you warn that we have not managed them well. Are there things we should proactively do, looking forward, to manage them better? What are your views in terms of the things that need to be done to ensure that future Treasury officials do not say that we did not manage this one well?

Senator Wong—I think, Senator, you are seeking a policy advice answer again from Dr Gruen.

Senator BUSHBY—I will leave it at that.

CHAIR—I think we might leave it there for the dinner break. Thank you very much to the Macroeconomic Group, and we will see Dr Henry and the Fiscal Group after dinner.

Proceedings suspended from 7.00 pm to 8.01 pm

CHAIR—We will begin this session with the Fiscal Group of Treasury.

Senator CAMERON—I would like to take this opportunity to table a document. It is a Macquarie Research Economics report. My questions are on this document. Dr Henry, I intend asking you some questions on this.

Dr Henry—You will find Mr Ray quite expert in these matters.

Senator CAMERON—The Macquarie Research Economics report is a report on fiscal consolidation within Australia. Under the heading ‘Impact’ on the third last line, it says, ‘A closer inspection of the budget projections suggests that a sharp reduction in public spending complemented by an increase in revenues is already on the cards.’ Is that an accurate statement?

Mr Ray—Yes, that is an accurate statement. If you were to look in the budget papers, there was some analysis of the pace of fiscal consolidation included in budget statement No. 3. Also, if you look at the historical tables in budget statement No. 10, you will see that payments as a proportion of GDP across the forward estimates are declining from 25.1 per cent of GDP in the current financial year to 23.6 per cent by the end of the forward estimates. Last year, 2009-10, revenue was at a low, at around 20 per cent of GDP. We are forecasting about 21 per cent of GDP in the current year, rising to 22.8 per cent by the end of the forward estimates.

Senator CAMERON—The second paragraph of the Macquarie Research Economics analysis says, ‘A closer look at Treasury’s projections makes it harder to argue that the rate of fiscal consolidation is too slow. Indeed, if Treasury forecasts are achieved and the budget is returned to surplus by 2012-13 then this would be the most aggressive period of fiscal consolidation since records began in 1970.’ Is that an accurate statement?

Mr Ray—I will take the last part of the question first. Records began in 1970 I think as to the consistent cash series. We do not have underlying cash balance data to precede that. In terms of fiscal consolidations, if you look at box 1 in statement No. 3, which is at page 3-10, there is a chart in there which looks at fiscal consolidations after the early-nineties, after the early-eighties recession and then after the fiscal stimulus in 2009-10. That shows that it is the fastest fiscal consolidation on record. The first part of your question is a judgment question, which I would rather not go to.

Senator CAMERON—I will take you to page 2 of *The Economic Spotlight*. There is a figure 1 and a figure 2. There is commentary referring to figure 2 which says, ‘The rise in receipts is being complimented by a relatively steep decline in government expenditures.’ Is that, to your knowledge, accurate in terms of the steep decline in government expenditures?

Mr Ray—Certainly, in terms of the forecast and projections that were in the budget, that is accurate. That goes to the numbers I quoted earlier, which are from the historical tables.

Senator CAMERON—On page 3, the final commentary from Macquarie Research says, ‘That by any measure this is an aggressive consolidation. Just as the stimulus was aggressive so too is its removal. It is the change in stimulus that matters for growth—that is, the contribution of government reflects not only that it will subtract two per cent from GDP but in addition that it won’t be adding two per cent of GDP. That might not be as aggressive as some people would like but it is more aggressive than at any time previously.’ Is that an accurate comment as well?

Mr Ray—It is certainly more aggressive than at least the 1960s. We do not have the data to go back before that to know. On that ground it is a fair comment to say it is quite an aggressive consolidation, and it is certainly the case that it is the change in stimulus that matters. We have discussed in this committee in the past that as the government withdraws its stimulus it is making a negative contribution to growth.

Senator CAMERON—In terms of the reduction in stimulus, and that stimulus being replaced by increasing private sector activity, is that how Treasury tried to balance dealing with the Global Financial Crisis along with the government?

Mr Ray—It is a matter for the government to choose. It is certainly the case that the withdrawal of the stimulus is aggressive. As the economy gets closer to full capacity, it is undoubtedly the case that there is more likelihood that government activity could crowd out private activity than what we were looking at in, say, the 2009-10 budget. The balance is hard to say. The better thing to say is that it is an aggressive consolidation and that the government’s contribution to growth is negative.

Senator BUSHBY—I have just had a very quick look through the interesting document that Senator Cameron has provided. A number of documents examining this particular issue have been put out by all sorts of commentators, many of whom would be just as eminent as Macquarie Research Economics. They have not all drawn the same conclusions but they have all looked at the same statistics. Given that it is the day after World Statistics Day, I am tempted to use the old line ‘lies, damned lies and statistics’.

After a quick analysis of this I have drawn some conclusions. You would not disagree that the statistics they are using, particularly those in figure 3 on page 3, indicate that the largest part of the heavy lifting, in terms of leading to what they call the ‘trough in budget deficit’, is the largest in this particular case because of the revenue implications. I concede that it shows that expenses also contribute, but the largest part of that 4.2 per cent comes from revenue implications.

Mr Ray—The fall in receipts as a result of the global financial crisis flowing through to the real economy was substantial. Receipts are recovering back to their level before that shock to the economy.

Senator BUSHBY—When we spoke to representatives from Macroeconomic Group and the minister mentioned that it was the fastest period of fiscal consolidation recorded, I made the comment, ‘Yes, but it came on the back of one of the fastest periods of fiscal deterioration that we had seen for a long time.’ Is it normally the case that, following a period of significant fiscal deterioration, receipts tend to come back more quickly? I think we have had evidence on this before in the context of some of your projections at earlier estimates hearings that they do tend to come back more quickly once you have come out of a period of problems.

Mr Ray—Yes. I am trying to do a calculation in my head, which is never wise. If you look at it in terms of proportions of GDP, the contributions of spending restraint and the return of tax receipts are about the same.

Senator BUSHBY—So, essentially, I could look at those two columns and claim that revenues is doing the heavier lifting out of it but you can look at it as a percentage of GDP and draw different conclusions. You could probably look at it from another direction and draw a different conclusion again.

Mr Ray—I don’t know about that. We would look at it as a proportion of GDP.

Senator BUSHBY—Okay, you would look at it from that perspective, but that is not what the focus of this paper has been.

Mr Ray—As I was explaining to Senator Cameron, we have done this sort of analysis about the pace of fiscal consolidation, and that was published in the budget. With no disrespect to Macquarie, we look at what we have done.

Senator BUSHBY—That is fine. In Treasury’s view, what is the most accurate and credible assumption to use when calculating either interest earnings or savings associated with government investments or borrowings? For example, would it not be reasonable to apply the average of the 10-year government bond rate over the preceding 10 years?

Mr Ray—Senator, we have discussed many times how we calculate public debt interest. I will re-cover all of that. For debt that has already been issued we know what the cost of that debt is and so we obviously use the actuals. For debt that is projected to be issued in the forward estimates we use a technical assumption—we take that assumption off the yield curve at the time that we strike the estimates. That basically gives us a weighted average cost of funds. That is the way that we do it. That is the way that we have done it for many years. I do not quite know what your question is but, if it is whether it would be reasonable to do it another way, choosing a particular bond rate does not seem that sensible to me. Given that the average duration of our stock is around the five-year mark, it does not seem that sensible to just use a rate of interest that is at the longer end.

Senator BUSHBY—Certainly commentators such as UBS market strategist Matthew Johnson and Citigroup investment manager Paul Brennan have publicly stated that they consider that the bond rate is in fact a reasonable assumption in forecasting the cost of future government finance. Obviously those commentators do not have access to the figures and the internal modelling capacity that Treasury does. For those who do not have access to that, is that a reasonable approach?

Mr Ray—I would not have thought so. They have exactly the same access to exactly the same data on the yield curve that we do—it is published on the Reserve Bank website every day. So I do not accept they do not have access to that sort of data.

Senator BUSHBY—That was my assertion, not theirs.

Mr Ray—That is the first point. Also, it depends on what the purpose of the calculation is. If you are asking me a generic question: ‘Are there alternative ways of calculating various elements of the budget?’ I would answer: there could be, but it depends on what the purpose is. If the purpose is to calculate the cost of a policy against the forward estimates then it does not make any sense to use a different methodology than is in the forward estimates.

Senator BUSHBY—The reason I am asking—and you have mentioned you are not sure—in relation to not proceeding with the NBN, the coalition based its interest rate savings on unnecessary borrowings on the average of the 10-year bond rate, which was 5.5 per cent, and Treasury and Finance applied an interest rate of just 4.9 per cent. So, in explaining why you did that, is it because you used the method of calculation of an appropriate interest rate that you have just described?

Mr Ray—I will go back a step. We costed the coalition’s policy with our colleagues in the department of finance. The first element of that was to work out—and our Finance colleagues did this—how you would unwind the NBN Co. and what that would mean for, if you like, the return of capital to the budget. That is a loose way of putting it—I know that. And therefore the PDI were worked out from that. That is exactly what we did. Our conversations with the opposition were confidential, so I am at a slight disadvantage in talking about how the opposition might have calculated it. But, in the documents that we did not publish but have been published, the difference in the interest rate used is only one of the reasons for the difference in the costing.

Senator BUSHBY—I understand you used a rate of 4.9 per cent, and all I am asking is: what was the basis of the calculation of that 4.8 per cent.

Mr Ray—That was because that was the weighted average cost of funds that was underlying PEFO.

Senator BUSHBY—And, just for the record, is that the same method of calculation used to look at the interest earnings or savings associated with government investments and borrowings that you outlined earlier?

Mr Ray—Yes.

Senator BUSHBY—Are you aware of any instances where Finance or Treasury have used the 10-year bond rate to calculate costs or savings within government?

Mr Ray—We used the 10-year bond rate to market the superannuation liability. I have just used that as an actual at FBO. We use a different interest rate at budget and at MYEFO, where we use the long-term cost rate that is developed by the Australian Government Actuary.

Senator BUSHBY—Any other examples that you can think of?

Mr Ray—Not off the top of my head. I am happy to take it on notice to see if there are any. But on PDI calculations, the methodology that we use is the same methodology that you and I have discussed, and that I have discussed with Senator Joyce on many occasions.

Senator BUSHBY—I now have some questions on rule-of-thumb approaches to the interplay between monetary and fiscal policy. I apologise to Dr Henry in particular and the minister for going over some similar ground again.

Mr Ray—That is okay. Dr Henry can probably answer them.

Senator BUSHBY—I refer to comments made recently by the director of Access Economics, Chris Richardson, about the impact of government spending cuts on both interest rates and exchange rates. He said:

The rough rule of thumb in economic models is that you have to cut by about \$13 billion a year to achieve maybe a 1 per cent reduction in interest rates, which might, in turn, make maybe a cent or two difference to the level of the Australian dollar.

That is from the *Sydney Morning Herald* on 12 October this year. In the context of the Australian economy, is there a tangible way of measuring what impact a reduction in expenditure would have on interest rates and exchange rates, as per Mr Richardson's comments?

Dr Henry—Mr Ray, was right, I am happy to answer it—and I think I did answer it before the break, or at least I answered it as well as I can answer it.

Senator BUSHBY—I apologise for going over the same ground again.

Dr Henry—That is all right. The point I made on that occasion is that it is possible to construct rules of thumb. Their usefulness and their reliability depend upon the state of the cycle, in particular how close the economy is to full capacity, and particularly because of that there is a lot of uncertainty attaching to those estimates. Most of those sorts of estimates—the rules of thumb—come out of simulations conducted in macro models and different macro models produce different answers. For those two reasons—the second one I did not mention before the break—I would be reluctant to endorse any particular rule of thumb.

Senator BUSHBY—The fact that it is labelled a rule of thumb indicates it is not an accurate assessment. Is the rule of thumb along those lines something that is commonly used by economists in this context?

Dr Henry—I do not know that it is commonly used. It is not. This sort of discussion of the trade-off between fiscal policy and monetary policy, particularly in a period of fiscal consolidation and a period in which monetary policy is also tightening, is not a very common discussion, frankly. I cannot recall this being a significant issue. Back before the global financial crisis, for example, I guess there was some discussion about it, but it does not resonate strongly with me.

Senator BUSHBY—There was certainly some discussion at that time about the need for the government to maintain a significant surplus in order to remove pressures on interest rates. I have a quote from you at an estimates in 2008 where you made comments along that line.

Dr Henry—I do not remember that. You asked me whether it is common for economists to talk about these sorts of trade-offs. It is common for economists to talk about the trade-offs in qualitative terms, but putting numbers on it is something else. Yes, we could have an informal discussion and in that informal we could use rules of thumb in order to make a point. But it is one thing to have an informal discussion about these things, particularly in private; it is quite another thing for me in a public forum to be endorsing a particular rule of thumb.

Senator BUSHBY—That question was not asking you to endorse the rule of thumb; it was asking whether it was something that is used, at least for indicative purposes, by economists in a general sense.

Dr Henry—Probably not one number, one rule of thumb—in fact, certainly not.

Senator BUSHBY—Just for the record, the quote I was referring to was from the June 2008 estimates. In the context of the 2008-09 budget, you stated:

... the budget is estimated to have a mildly or moderately contractionary effect on the economy through the increase in the size of the budget surplus, and through that higher budget surplus or moderately contractionary effect on the economy that comes with that higher budget surplus there would be downward pressure exerted on inflation.

Dr Henry—Right.

Senator BUSHBY—In September last year Treasury advised the Senate inquiry into the economic stimulus package that, over the course of 2010-11 and 2011-12, \$31 billion in stimulus money was still to be spent. In light of further delays in spending stimulus, such as in the case of Victoria where just 40 per cent of its \$2.5 billion school stimulus package has been spent, can you please now outline how much of the stimulus package is yet to be spent in 2010-11, 2011-12 and 2012-13?

Senator Wong—Did you say \$31 billion?

Senator BUSHBY—Yes, \$31 billion was the figure we pulled out.

Senator Wong—You pulled out?

Senator BUSHBY—I did not pull it out personally.

Senator Wong—I do not think that is the figure that the government has advised in other estimates hearings.

Mr Ray—If we are talking about the payments that are made through the states—

Senator BUSHBY—I was talking about the total stimulus money.

Mr Ray—I do not have that with me. I have only got what has been paid through the states, which is 78 per cent of it. I am happy to take it on notice.

Senator BUSHBY—In doing so could you also provide a breakdown of the composition of such spending, transfers, investments, COAG reforms et cetera?

Mr Ray—When you say ‘transfers’ you do not mean transfer payments in the normal sense; you mean transfers to the states?

Senator BUSHBY—Yes, transfers to the states. Basically, I would like as much detail as you can provide as to how it will be spent.

Senator Wong—The figure to the states is the \$23 billion that Mr Ray outlined. So when you say ‘transfer payments’—

Senator BUSHBY—I did not say ‘transfer payments’; Mr Ray clarified that for me. Have you managed to clarify whether the \$31 billion figure I mentioned was correct?

Senator Wong—No.

Senator BUSHBY—I will proceed on the basis that—

Senator Wong—I have a recollection—and I do not have the details in front of me—of the government indicating \$23 billion. There was an additional amount over and above that which related, from memory, to COAG reform packages and the pension increase, but I do not recall the figure being \$31 billion.

Senator BUSHBY—As I said, I did not pull that out myself. I have had staff assist me with that.

Mr Ray—Why don’t we take on notice that we will check what it was 12 months ago and what it is today?

Senator BUSHBY—I will use the \$31 billion for the purposes of these questions, but if that is incorrect we will get—

Senator Wong—Why don’t we use the \$23 billion?

Senator BUSHBY—I have done the calculations on \$31 billion.

Senator Wong—The Treasury advice about at least a substantial proportion is \$23 billion. You can tell me where you did your calculation and we will check that too.

Senator BUSHBY—Using Mr Richardson’s rule of thumb, theoretically that would mean if the government were not to proceed with the remainder of its planned stimulus spending over the course of 12 months that this fiscal readjustment could in fact reduce interest rates in the order of some per cent. Is that an outcome that economists may well look at, using that rule of thumb in this context?

Senator Wong—Can I just be really clear here. The assertion that you are positing is that the government stop, for example, payments in Victoria—which you reference—for construction which may or may not have already commenced in schools and the like?

Senator BUSHBY—I am looking at the potential impact of—

Senator Wong—Of stopping construction half way through.

Senator BUSHBY—a decision to proceed towards further fiscal consolidation. Applying that rule of thumb, could a decision not to proceed with the planned stimulus spending result in a reduction in interest rates in the order of some per cent?

Senator Wong—‘Some’ per cent?

Senator BUSHBY—Depending on the accuracy of your rule of thumb and which rule of thumb you apply. But in the order of a per cent or two.

Senator Wong—Is that a question to me?

Senator BUSHBY—I would probably be very interested in the Treasury officials' perspective on that.

Dr Henry—Further to my earlier answer, I would not want to endorse any particular number, obviously. I think it is important to understand that this is not a simple trade-off between fiscal policy and monetary policy. The reason a more rapid fiscal consolidation—a more aggressive consolidation—would to some extent result in lower interest rates is because the economy would be weaker. Growth would be slower, the unemployment rate would be higher and the fact, therefore, that the economy would be further from its full capacity position would call for a more accommodative stance of monetary policy. It is not a simple choice between a particular size budget deficit and a level of the cash interest rate or mortgage interest rates.

Senator BUSHBY—Which is why it is a rule of thumb.

Dr Henry—Yes, but then there are other rules of thumb. Suppose there was that degree of fiscal consolidation, by how many percentage points would the unemployment rate go up? By how many percentage points would GDP growth be lower? We could talk about a lot of rules of thumb. The summary indicator that you are referring to of a link between the size of the budget deficit and the level of cash interest rates abstracts from and, in fact, is a consequence of, everything else that would be happening to the real economy—the unemployment rate, the level of GDP growth and so on.

Senator BUSHBY—But it is a matter of striking the appropriate balance. We are into macro again now. We heard evidence earlier that we are nearing full employment. We are not at it yet, but we are nearing full employment. As you get closer to that and you experience the constraints that that imposes on an economy, loosening those constraints may well enable you to stay at or around full employment rather than increasing it to a point where it is significantly above that. It is a matter of balance.

Dr Henry—A looser fiscal policy relaxes the constraint by taking you further away from full employment—

Senator BUSHBY—It does, but if you are up against the wall with full employment you may actually be relieving some pressure that is imposing significant pressures on inflation.

Dr Henry—That is true. You are quite right; it is a policy choice. If the view is that the unemployment rate is too low then one could have a more aggressive fiscal consolidation in order to increase the unemployment rate, or one could increase—

Senator BUSHBY—Which would be consistent with your quote from June 2008.

Senator Wong—What was the quote?

Senator BUSHBY—I read it earlier:

... the budget is estimated to have a mildly or moderately contractionary effect on the economy ...

Quite intentionally, the budget was intended to have a contractionary effect on the economy because it was intended to address certain perceived problems within the economy that a contractionary effect would fix.

Dr Henry—Yes. Inflation, in particular.

Senator BUSHBY—Yes, exactly.

Dr Henry—And at the time, I think, the unemployment rate was in the low fours.

Senator BUSHBY—Which was below what Treasury considered to be full employment. Is that correct?

Dr Henry—It certainly was a very low level of unemployment and there were questions about the sustainability of that low rate. In particular, was that level of unemployment below the NAIRU, as we discussed earlier—in other words, could that level of unemployment be maintained without the rate of inflation increasing? As you know, at that time monetary policy had been tightened, at least in the early part of 2008 and, from recollection, the budget that was presented in early 2008 also had a modest amount of fiscal tightening.

Senator BUSHBY—Okay, I will move on from there. Recently, the RBS's Kieran Davies suggested that, for every \$10 billion increase in real public debt, long-term government bond rates rise about 0.07 percentage points. To put that in context, it implies that if government debt were to increase by about \$50 billion, interest rates would rise by 0.35 percentage points.

Senator Wong—Sorry, who is this?

Senator BUSHBY—Kieran Davies, from the RBS.

Senator Wong—Are we going to have these officials being asked to comment on the views put by every commentator in recent weeks?

Senator BUSHBY—There are quite a lot of commentators.

Senator Wong—Yes, there are.

Senator BUSHBY—We would be here a long time if I did that. I have no intention of doing that.

Senator Wong—I have not intervened much, Senator, but you are essentially asking officials the same questions by simply putting someone else's opinion to them over and over again.

Senator BUSHBY—I think this one is slightly different. It is related, but it is different.

Senator Wong—What is the question?

Senator BUSHBY—The question is: is this a factual assessment of the correlation between public debt and interest rates? If not, can you please outline the effect that a \$10 billion increase in public debt has on the long-term government rate?

Senator Wong—It is the same subject matter.

Senator BUSHBY—I am talking about the long-term government rate—

Senator Wong—The long-term government rate.

Senator BUSHBY—What impact does increasing government debt have on long-term government bond rates?

Senator Wong—Oh, bond rates.

Mr Ray—I will start. We have not got the benefit of seeing how those calculations have been made, so I do not want to talk—

Senator BUSHBY—Are you aware of those?

Mr Ray—No, I am not. The long-term government bond rate is principally the result of two elements: one is inflation expectations and the second is an assessment of relative risk, which is typically looked at vis-a-vis, say, the US Treasury market. I think that we would treat with a degree of suspicion simple calculations which say that if you increase government debt by a certain amount that then affects the long-term bond rate. We operate in a global capital market.

Senator BUSHBY—It was reported by the *Australian*—I know it is the government's favourite newspaper—that the Rudd government:

... booked a \$4.6bn fiscal improvement in the 2009-10 budget as a result of its own decision to reduce the CBA—

the conservative bias allowance—

over the following three years.

Is this an accurate characterisation? Can you confirm the government took a policy decision to adjust the allowance and can you confirm that this was a \$4.6 billion reduction to the underlying cash balance over the relevant years?

Senator Wong—I do not think you were in the Finance estimates. Your colleague Senator Cormann traversed the conservative bias allowance in some detail, as did Senator Faulkner. So the opposition does have quite a detailed amount of questioning and answers on this issue from Finance. If you wish to traverse it again, I will take advice from Dr Henry about that, but I did want to alert you to the fact that these answers have been—

Senator BUSHBY—I was not participating in that.

Senator Wong—I appreciate that.

Senator BUSHBY—I am interested, and I am also interested that there was the quote referred to Treasury and Finance officials in the report, I believe. It was also reported in advice to the Independents. It was subsequently released publicly. It said:

The officials—

That is, of Treasury and Finance—

conceded ... that it was an option for government to prepare their budget papers on the basis of a lower percentage allowance.

The secretaries accepted that an incoming government might wish to do so as a policy measure.

Dr Henry—Senator, I think that Mr Ray made this clear earlier. I am not comfortable discussing that document to which you refer since I believe I have given the Leader of the Opposition a guarantee of confidentiality with respect to the contents of that document.

Senator BUSHBY—Okay—and advice to the Independents that was released publicly?

Dr Henry—Yes. In that undertaking to the Leader of the Opposition it was understood that the document had been provided for the Independents, and in discussing the document with the Independents we were able to tell the Independents that it was their document. But it was

not our document and we were not at liberty to deal with the document freely, and certainly not at liberty to discuss it other than with the Independents.

Senator BUSHBY—I will ask a general question then. Based on what has been publicly reported, is it accurate to say that while the departments may not necessarily agree with a government decision to adjust the CBA, they accept that it is within a government's right to do so?

Mr Ray—The conservative bias allowance is primarily the responsibility of the Department of Finance so, as the minister said, it was more appropriate for you to be having a long conversation with that department than with us.

Senator BUSHBY—I am not intending to have a long conversation on this.

Mr Ray—Secondly, I can confirm that there was a process involving advice to government ahead of the 2009-10 budget, as a result of which the government took a decision to adjust the conservative bias allowance. I am happy to take on notice what the implications of that were, but I do not have the 2009-10 budget papers with me. That was all disclosed in that document.

Thirdly, I should say that governments in the past have taken decisions to adjust the conservative bias allowance both up and down. Fourthly, since you referred to the document which is public, on the conservative bias allowance and the advice that was provided to the Independents, it points out that the charter of budget honesty requires the department secretaries to certify that the estimates of the fiscal outlook—the pre-election economic and fiscal outlook, that is—reflect professional judgment of the departments. This includes all parameter variations including the conservative bias allowance, and that the department's best estimate of a prudent conservative bias allowance remains that published in the 2010 PEFO. It then goes on to say that since budget documents are published by the authority of the government of the day it would be open for an incoming government to decide to adjust the conservative bias allowance.

Senator BUSHBY—Okay, I think that answers what I was going to ask next.

Senator Wong—Senator, before you do, my adviser has just alerted me to an answer I gave in response to stimulus questions. I think I referenced the 2009-10 figures, I am not sure. We could not recall whether you were seeking 2010-11 figures. I just wanted to clarify that.

Senator BUSHBY—The only specific change to the CBA that I was referring to was the one that was referred to in the *Australian*.

Senator Wong—Sorry, I thought you had finished that part of the question. I was referring to the stimulus discussion we had earlier.

Senator BUSHBY—Sorry, the stimulus discussion—

Senator Wong—I gave an answer where I was actually referencing the 2009-10 spend, and I cannot recall whether you were asking about 2009-10 or 2010-11.

Senator BUSHBY—I was asking for all future spends for the next three years.

Senator Wong—I just wanted to clarify that. When I responded it was in the context of the 2009-10 spend—

Senator BUSHBY—That clarifies the issue. What I am interested in is that Treasury concedes that it is within the authority of a government to decide to make adjustments to the CBA.

Mr Ray—Yes, the budget estimates as opposed to the PEFO estimates. They are two different things. Budget estimates are the government's estimates. The PEFO is the secretary's estimates.

Senator Wong—There was a reasonably detailed discussion of the review process that Treasury and finance engage in in the context of any decision of a government to alter the conservative bias allowance and that was gone through in some detail in finance estimates.

Senator BUSHBY—I will move on from there then. I think Mr Ray largely answered what I was going to ask next. We have touched on this as well, but forecasts of commodity prices are an important input into the forecast of government revenue. What is your current view for price movements of Australia's key export commodities of iron ore and coal? How certain are these forecasts?

Dr Henry—Our most recent forecasts were contained in the Pre-election Economic and Fiscal Outlook to which Mr Ray referred earlier. We are in the process of finalising forecasts for the purposes of the Mid-Year Economic and Fiscal Outlook, which is normally or nearly always published some time between now and the end of January.

Senator BUSHBY—Do you have an anticipated date for that?

Dr Henry—No. Our forecasts will be published at that time, but we do not normally reveal—in fact, I do not think we ever reveal—forecasts of these things outside of regular budget and Mid-Year Economic and Fiscal outlooks except in an election campaign.

Senator BUSHBY—Okay. I will not ask you to do anything other than that, but how certain would you say the most recent publicly available forecasts and those forecasts in general are? Would you place a degree of confidence around those?

Dr Henry—I would not want to put a number on it. I would not want to put a confidence level around it. You are familiar, I think, with our forecasting track record on commodity prices, if I can call it that, where we have been continually surprised on the upside—that is, commodity prices have been considerably stronger than we have been forecasting since 2003-04 with the exception of one year. That year, of course, coincided with the global financial crisis. We are now forecasting, as we have forecast in every year, that commodity prices have peaked. I guess the higher these things go the more probable that is, but there is a risk that commodity prices could go higher. My own view is that the risks are weighted more to the downside, but I have had that view before and been proved wrong.

Senator BUSHBY—Essentially it is pretty hard to forecast accurately. You make informed decisions based on the best information available to you and you make the best decision you can make given that, but they are not things that you can accurately identify.

Dr Henry—Yes, that is correct. As we have discussed on numerous occasions in this committee in years gone by, starting with the 2005-06 budget, in our projections we took out some insurance by, in our projections, having the prices for iron ore and coal fall somewhat over the projections period. We have broadly maintained that methodology ever since. We

have extended the methodology out to cover a longer run of years because these days we occasionally look at longer periods of time for projections purposes, but broadly that same conservative approach to the budget forecasts that we introduced in the 2005-06 budget has been maintained.

Senator BUSHBY—You mentioned that you will have new forecasts that will be apparent in the May PEFO when it is published and presumably there were forecasts that you did for the budget earlier this year.

Dr Henry—Correct.

Senator BUSHBY—Do you just revise those figures twice a year?

Dr Henry—I said normally.

Senator BUSHBY—For internal purposes, do you do so more often?

Dr Henry—For internal purposes we have another forecasting round, but we normally only publish twice a year.

Senator BUSHBY—You publish twice a year but internally you do it more often than that?

Dr Henry—We do to inform our own thinking, largely.

Senator BUSHBY—Given the potential impact it could have on government revenue, it makes a lot of sense. Is that a formal thing you do internally or is it more ad hoc as movements suggest that you need to do it?

Dr Henry—On one occasion it is formal. I think we have three formal reviews annually, maybe four in an election year.

Senator BUSHBY—What is the role of the contingency reserve in the budget?

Mr Ray—If you look at pages 6-54 and 6-55 of the 2010-11 Budget Paper No. 1, you will see a long explanation of the contingency reserve.

Senator BUSHBY—I will not hold things up by having a good read of that now—

Mr Ray—I could describe it, but it is all here.

Senator BUSHBY—How is the required size of the reserve estimated? What process do you go through?

Mr Ray—There are a number of different things included in the contingency reserve. The first is what we were discussing before, the so-called conservative bias allowance. That is calculated as a percentage of total general government expenditure excluding the GST payments to the states. There is a provision for underspends in the current financial year, which is the opposite of the conservative bias allowance. As decisions on, for example, some commercial-in-confidence matters or in particular national security matters are taken they would be included in the contingency reserve. Decisions occasionally get taken quite late in the budget process. After access to the rather complicated system that we have to put the budget together has been restricted to Finance and ourselves we would include those decisions in the contingency reserve because individual agencies cannot get them into their estimates in time. One of the last things we get is the consumer price index release I think late

in April. We do not go through a whole parameter revision back through every single estimate in the budget, but we include any resulting parameter changes in an allowance in the contingency reserve. There may be some other things we would include. An obvious example is an allowance for future overseas development assistance.

Senator BUSHBY—I acknowledge the commercial-in-confidence one in particular would not fit what I am about to say, but most of those could be loosely categorised as uncertainties about specific revenue and expenditure items. You quite clearly have the ability to make an assessment as to what some of those uncertainties might be in advance. In the interests of transparency why couldn't they be included in actual forecasts and noted as uncertainties in those forecasts?

Mr Ray—I would not say that they are about uncertainties. They are actually about anticipated events that—

Senator BUSHBY—If they are anticipated, similarly, couldn't you include them for transparency purposes?

Mr Ray—I was going to say they are anticipated events that cannot be assigned to individual programs.

Senator BUSHBY—Would it be better to break up the contingency reserve and call it something that actually highlights that and sets them out?

Mr Ray—That is a question which goes to how the government's accounts are presented. It is a matter of judgment whether or not the detail that is included in the appendix B to statement 6 is sufficient for this purpose, but there is quite a bit of detail included in that appendix every year about what is in the contingency reserve.

Senator BUSHBY—Okay. When you are preparing the budget and you are looking at what might fall into the contingency reserve—and I note the things you pointed out—is there any consultation between you and the government as to what might be in there or the size of what might be in there?

Senator Wong—It is part of the budget decisions, Senator.

Senator BUSHBY—Yes. From the way you have explained what form the contingency reserve takes, it sounds to me like it is a pretty pure analysis that would be conducted by Treasury, and you would give them advice saying, 'This is what we need to put in there.'

Mr Ray—Yes.

Senator BUSHBY—Is there a two-way dialogue, in terms of what might be in there, coming back to you?

Mr Ray—There is almost continual dialogue between the Treasury, the department of finance and our two ministers over the budget estimates, as we put the budget together.

Senator BUSHBY—Yes. Obviously, that is over vast areas of the budget, but I am particularly interested in the contingency reserve and whether you are left alone to identify things that you think should be in the contingency reserve or there is a degree of decision making by the government as to what might go in there and the size of it.

Mr Ray—These things are largely obvious, really.

Senator BUSHBY—I beg your pardon?

Mr Ray—These things are—

Senator BUSHBY—Subject to direction by the government?

Mr Ray—No, no.

Senator Wong—You may not have heard what Mr Ray said, Senator. He said ‘these things are largely obvious’.

Mr Ray—I said I think it is largely obvious whether something is national security or commercial-in-confidence. It is not really a contentious issue, I would not think. If a decision is taken at a late stage and therefore it is too late to put it through individual agency estimates, it would be unusual for the government not to take our advice on that, because that is—

Senator BUSHBY—We have already discussed the conservative bias allowance—

Mr Ray—Yes.

Senator BUSHBY—which forms part of that, and you have indicated that that could be subject to government direction as to size.

Senator Wong—Not direction, a decision.

Senator BUSHBY—Decision. Okay.

Senator Wong—I again reiterate that there is a review process, which occurred, from memory—

Mr Ray—In the 2009-10 budget, there was a review process that officials went through on which they provided advice to the government, looking at the historical pattern of demand driven programs. The conservative bias allowance is about demand driven programs, and there was a review process, advice was given to the government and the government took a decision.

Senator BUSHBY—Okay.

Mr Ray—But the government took a decision on the ratio. We in the department of finance did the calculation.

Senator BUSHBY—So there are decisions that the government can make on certain aspects, which can influence what goes into the contingency reserve and the size of it?

Mr Ray—Sure.

Senator BUSHBY—Okay.

Senator Wong—But the parameters of that, Senator, are set out in the budget papers.

Senator BUSHBY—Yes, and are those parameters affected by decisions of the government?

Senator Wong—The parameters are in the budget papers.

Senator BUSHBY—Yes, but can those parameters be varied by decisions of the government?

Senator Wong—If you go to page 6-54 under statement 6, there are a list of anticipated events which Mr Ray very helpfully has read out to you. It is good way to spend an estimates evening! I assume that, if the government chose to expand the types of anticipated events, the budget papers might well include an additional dot point—for example, in that range of dot points under anticipated events on that page.

Senator BUSHBY—So, to an extent that the government chooses, it may vary the parameters of what might constitute the size, the ratios and the way you might calculate elements in the contingency reserve?

Mr Ray—Were a government to decide to put everything in a contingency reserve—

Senator BUSHBY—No, I am not suggesting everything, but the actual composition of what you might include is subject to decisions about parameters by the government of the day, on the basis of advice from Treasury and all the other factors you would expect, but ultimately it is the decision of government?

Senator Wong—The way in which I understand it to be applied—and Mr Ray might want to correct me—is to reflect anticipated events that cannot be assigned to individual programs. So you could not suddenly define something that did not fit within that kind of broad remit to be something that should be in the contingency reserve.

Senator BUSHBY—I can see why you would come out with that answer from what I was asking. Within reason, and provided Treasury were accepting of the advice, or based on Treasury advice or if options were presented by—

Senator Wong—You are asking a range of hypotheticals. My Ray has given evidence about what sorts of—

Senator BUSHBY—What I am interested in is what sort of process—

Senator Wong—What sorts of allowances are in the contingency reserve—the budget papers are transparent about that. I am not sure we can take it much further. Essentially what you are putting to us is if, if and if, then couldn't something be, and I am just not sure if that is—

Senator BUSHBY—Ultimately what is in there is subject to decisions on the parameters and the appropriate ratios and all those sorts of things, in accordance with decisions made by the government of the day.

Senator Wong—Is that a question?

Senator BUSHBY—That is a question, yes.

Senator Wong—The parameters of the contingency reserve are set out in the budget papers, and we do not have anything to add to that.

Senator BUSHBY—If a government of the day—

Senator Wong—We are not doing this anymore. We are not doing 'what if'. I have been extremely patient over quite a long period of questioning. You have a political proposition you wish to make about the contingency reserve; you can make it. I do not think that is going to remedy the problems with your costings. You can relitigate that for hours if you wish. But we

have gone through in detail the sorts of things in the contingency reserve and why they are in there.

Senator BUSHBY—We have gone over the sorts of things—

Senator Wong—As I said, I think I have been most patient, but all you are doing again is putting hypotheticals to these officials.

Senator BUSHBY—I am asking—

Senator Wong—You are putting hypotheticals: ‘what if’—that is by definition a hypothetical.

Senator ABETZ—The budget and the budget strategy and outlook is the government’s document. Is that correct?

Mr Ray—Correct.

Senator ABETZ—So ultimately that which is contained in this document is the decision and owned by the government?

Senator Wong—This is the government’s budget, yes. Hold the presses!

Mr Ray—Subject to, under the Charter of Budget Honesty Act, a requirement that it be put together consistent with external accounting standards and things like that. And also in the Charter of Budget Honesty Act, from my recollection, is a list of things that are required to be in the budget.

Senator BUSHBY—Given that you have clarified that it has to be prepared in accordance with appropriate accounting standards, would those accounting standards limit the matters that are in the contingency reserve to those that are currently listed on page 6-54?

Senator Wong—We would probably have to take that on notice. I do not know if Mr Ray has got that off the top of his head or whether that might even be something Finance—

Mr Ray—I do not have the GFS manual with me, so I am happy to take it on notice.

Senator BUSHBY—Okay.

Mr Ray—Sorry—by definition, yes, those accounting standards will limit what is in the contingency reserve.

Senator BUSHBY—They will limit it just to those matters that are currently incorporated within the contingency reserve for the purposes of this year’s budget. Could a government be pinged for—

Mr Ray—I expect the answer to that is no, but I will take it on notice rather than—

Senator Wong—Let me just be clear about the question. You are asking—

Mr Ray—The question is: could something else be in the contingency reserve other than what was in the contingency reserve under these categories in the 2010-11 budget? That is what you are asking?

Senator BUSHBY—Yes.

Mr Ray—We will take that on notice.

Senator Wong—What would the GFS contemplate, if anything, over and above those categories? Is that a reasonable—

Senator BUSHBY—That is reasonable, yes.

Senator ABETZ—Could you draw our attention to the GFS statement, or whatever the relevant page is?

Senator Wong—I do not have those accounting standards here.

Senator ABETZ—No—on notice. Sorry, I presumed it would be on notice.

Senator BUSHBY—We will move on from there and make the minister happy by not asking any more questions about contingency reserves.

Senator Wong—We can read out the whole of the budget papers if you like!

Senator BUSHBY—Can you confirm as to whether the spending associated with the National Broadband Network totalling \$18.3 billion over the forward estimates is included in the government's commitment to have real spending growth capped at two per cent until the surplus has reached one per cent of GDP?

Mr Ray—No, because that is an equity injection.

Senator BUSHBY—Thank you. What other forms of government spending are not included in the government's real spending growth cap?

Mr Ray—The real spending—

Senator Wong—Is exactly that.

Mr Ray—Is exactly that. It is all on payments. The government has not accepted any payment—

Senator BUSHBY—What other outlays or government spending are there? You mentioned investment spending as an example with NBN Co.

Mr Ray—It is not a payment, it is a financing transaction.

Senator BUSHBY—Okay, what other transactions—

Mr Ray—Sorry, Ms Harris reminded me that there may be some elements of NBN Co. that are small. I think they are to do with Tasmania; they are payments and they are included in the commitment.

Senator BUSHBY—Now is not the time to ask would I be interested in asking how much that—

Senator Wong—But you want to make sure that it is not rolled out. Are you not campaigning on that in Tasmania: 'We are the Liberal Party and we don't want you to have broadband.'?

Senator BUSHBY—We would love fast broadband down there, we just—

Senator ABETZ—The problem is that people are not signing up to it. That is your problem.

Senator BUSHBY—Yes.

Senator Wong—We saw so much of Senator Abetz during the election campaign.

Senator CAMERON—We make sure those folks in Tasmania do not miss anything!

Senator BUSHBY—I may not be using the right term to give me the information that I am looking for. Clearly, the money that will be used to invest in NBN Co. is money that goes through the government's hands. What other money that goes through the hypothetical hands of government does not show up in the government's real spending growth cap?

Mr Ray—The government's policy relates to payments.

Senator BUSHBY—Right.

Mr Ray—Other money which goes through the government's hands such as receipts or revenue or financing transactions are not in payments, other than if there is an interest cost associated with the financing transaction, and then that interest cost is in payments.

Senator BUSHBY—And the NBN Co. falls under a financing transaction—is that correct?

Mr Ray—To the extent that it is an equity injection, yes it does.

Senator BUSHBY—Not all financing transactions are equity injections?

Mr Ray—No.

Senator BUSHBY—Are there other transactions that would be considered financing transactions that are not equity injections and, if so, what?

Mr Ray—Helplines for students, for example.

Senator BUSHBY—Anything else?

Dr Henry—Issuing or repaying Commonwealth debt.

Senator BUSHBY—Okay. Is that an exclusive list? Could you take notice what else there might be?

Mr Ray—You want us to take on notice all potential financing transactions?

Senator BUSHBY—Just the types, not details. The minister for finance has made a number of comments relating to the budget treatment of the NBN in the press conference announcing the release of the implementation—

Senator Wong—This minister for finance?

Senator BUSHBY—The previous minister for finance, probably.

Senator Wong—Usually they say, 'Minister, you said'—and I thought, 'I'm in the third person.' I have not been in the third person for a while.

Senator BUSHBY—Unless you were the minister for finance when there was the press conference announcing the release of the implementation study.

Senator Wong—I missed the second part of the statement.

Senator BUSHBY—The then minister for finance made a number of comments relating to the budget treatment of the NBN in the press conference announcing the release of the implementation report. In particular I draw your attention to his claim that the implementation study 'confirms that the government contribution is an investment and not a grant' because 'it

will be earning a return and the government will get its money back'. It is to be accounted for as an investment and is therefore on the capital side of the budget and it is not recurrent spending, and it cannot be converted into spending without hitting the recurrent spend bottom line.

The budget papers provide that the government is treating NBN Co. as a public non-financial corporation under the government finance statistics. That is a reference at page 9-37 of Budget Paper No. 1. Is that correct, that it is being treated as a public non-financial corporation?

Mr Ray—Yes, that is correct.

Senator BUSHBY—What criteria must a government business enterprise satisfy to be categorised in that way?

Senator Wong—That precise question was asked, I think by Senator Cormann, in the Finance estimates and there was quite a lengthy answer as to what are the characteristics of a—is it PNFC?

Dr Henry—Yes.

Senator Wong—If you want that information I am happy to take it on notice and we can provide that lengthy answer that Finance provided.

Mr Ray—Again, it is in the GFS manual.

Senator BUSHBY—I am content with it being taken on notice. Is it an accurate statement of the government's position to say that, because its investments in NBN Co. are reasonably expected to return the government bond rate over the long term, this funding is treated as off budget?

Mr Ray—That goes to the earlier question of what is required for it to be a public non-financial corporation. Essentially, it needs to earn an economic return. It is actually to do with the activities of the entity rather than the return to equity that determine the definition.

Senator BUSHBY—Okay. How do you define 'economic return'?

Mr Ray—The language, again, is from the GFS manual. You are testing my memory but I think they have to charge 'economically significant prices'. I think that is the language.

Senator BUSHBY—So it does not even have to make a return in actual fact?

Mr Ray—Well, there are plenty of private corporations that make losses. The definition is around the activity of the entity. As I said, the language in the GFS manual is around charging economically significant prices. If you want us to go further, we would need to take it on notice. This is a very technical issue. We and Finance consult with the ABS around these matters.

Senator BUSHBY—Okay. In addition to the earlier question you have taken on notice with respect to what criteria a government business enterprise needs to satisfy, could you expand that to incorporate a summary explanation of that, that would be appreciated.

Mr Ray—Certainly. The two questions are really asking the same question.

Senator BUSHBY—Okay. So bear those two questions in mind when you answer. Who makes the ultimate determination of the budget treatment of this kind of government spending?

Mr Ray—The Statistician.

Senator BUSHBY—What if something emerged to give reasonable doubt that a project would not make an economic return?

Mr Ray—As I said, the definition does not go to economic return. It is about the activities of the entity and goes to whether it charges economically significant prices or not.

Senator BUSHBY—I guess you would be thinking you are fairly safe in assuming that the NBN would charge economically significant prices. I am not suggesting it will not. I would have thought it would be a disaster if it did not. How often does the department review the determination that a project satisfies the government business enterprise requirements?

Mr Ray—It is not about a project; it is about the activities of the entity.

Senator BUSHBY—But do you keep an eye on entities to make sure that in all respects they continue to satisfy the criteria?

Mr Ray—Principally, the Statistician keeps an eye on it, as does the Auditor-General. But Finance, principally, and also Treasury, do watch these things, particularly if governments over the years change the nature of the business of the entity.

Senator BUSHBY—At the last estimates I asked you to comment on the other column of the Commonwealth's holding of investments, loans and placements. The question was taken on notice and I think you said 'happily' taken on notice.

Mr Ray—Yes.

Senator BUSHBY—I have not had a chance to check today, because I have been in here all day, but as far as I am aware it has not yet been answered.

Mr Ray—I think that is correct.

Senator BUSHBY—Is there a reason why it has not been answered?

Mr Ray—I think it is being processed.

Senator BUSHBY—We have had a very poor return in a number of areas in this economics committee. The original date for the return of answers to questions was 30 July.

Senator Wong—When was the election called?

Senator BUSHBY—That was extended to 20 August. We have advice from the Clerk of the Senate that says that the intervention of the election does not affect those dates.

Senator Wong—It probably does not affect it in terms of the Senate's standing orders, but as a matter of practicality there was an election called. Were you perusing answers to questions on notice during the election campaign? I doubt it.

Senator BUSHBY—Absolutely, if they came through.

Senator Wong—That is true.

Senator BUSHBY—You never know what they might say.

Senator Wong—Fair enough.

Senator BUSHBY—In fact, the government was in caretaker mode from the date the election was called, so presumably government—

Senator Wong—Yes, ministers were busy making sure that questions on notice were answered when there was an election campaign on.

Senator BUSHBY—Are you saying the hold-up was in the ministerial offices rather than in the offices of Treasury? Similarly, you failed to answer a question on notice re non-equity investments. Is it the case that that has been answered the last 24 hours?

Mr Ray—I would not describe it as a failure to answer.

Senator BUSHBY—It is a failure to answer within the time lines.

Mr Ray—There are a number of these questions on notice and they all have the same status.

Senator BUSHBY—It is difficult enough when they come in a few days before estimates, but if we have to go into the next estimates without the benefit of the answers to questions that were taken on notice at the estimates before it makes it very challenging for us to do our job.

Senator Wong—I also recall the Senate being asked to deal with some 300 amendments to the Work Choices legislation with about 36 minutes notice.

CHAIR—That is one of your famous non-sequiturs.

Senator BUSHBY—Thank you very much for that, Minister.

Senator Wong—It was a non-sequitur.

Senator BUSHBY—A couple of other questions on notice were not answered. One was a question regarding the accounting treatment of cash held for imminent draw-downs not being recognised as current liabilities on the balance sheet. There was also one on the complete list of spending that had been deferred, together with the amounts and time lines. I do not believe either of those has come through in the last 24 hours.

Senator Wong—I think Mr Ray has conceded there are a range of answers which have not yet been filed with the committee. Obviously we will attend to that.

Senator BUSHBY—Okay. How much has been paid out in interest by the government since the budget went into deficit that could be attributed to debt financing of government activities?

Mr Ray—That is a very complicated question because it would mean that we would need to unpack the interest bill—

Senator BUSHBY—What is the overall interest bill, to start with?

Senator Wong—Your question was in relation to deficit.

Senator BUSHBY—That is right. I understand the reality of how the financing works. Even in times when you are running a net surplus you do not actually owe any debt. There is debt on the books at times, and I understand that would incur some interest. But I am

interested in the consequences really of the interest paid against the net debt that we have experienced since we went back into that position.

Mr Ray—That is in the final budget outcome. A part of the problem is that the budget went into deficit part way through a financial year as well. I think the safest thing is to take it on notice. I need to check whether we can actually do it but it would involve this unpacking.

Senator BUSHBY—If you cannot unpack it, you can give me the unpacked information rather than come back and tell me that you cannot unpack it.

Senator Wong—Hang on, the unpacked information would be a completely different question, which you acknowledged in the previous interchange.

Senator BUSHBY—Then I will ask both questions and ask you to take them both on notice. What is the date of return of questions on notice?

CHAIR—It is 10 December.

Senator BUSHBY—I remind you of that date, 10 December.

Mr Ray—The budget went into deficit in 2008-09. We actually had negative net interest in 2008-09. It illustrates the difficulty of answering this question.

Senator BUSHBY—Can you in your answer provide details of how much interest was earned in 2008-09 and 2009-10 and how much interest was paid out in 2008-09 and 2009-10?

Mr Ray—We can do that easily because that is actually published in various documents.

Senator BUSHBY—Do you have the actual figure for 2009-10 yet? Is that published?

Mr Ray—The actual figure from 2009-10, the net figure is \$2.4 billion.

Senator BUSHBY—That would be an outward flow, presumably.

Mr Ray—Yes. Total interest received was \$4.4 billion. I hope this is going to work out. Total interest on debt was \$6.4 billion. Then there are other financing costs of \$1.2 billion.

Senator BUSHBY—What would they be comprised of?

Mr Ray—I need to take that on notice. There are syndication fees and all sorts of things.

Senator BUSHBY—Okay. What about 2008-09?

Mr Ray—It would be in the 2008-09 final budget outcome and we do not have that with us.

Senator BUSHBY—Could you take it on notice. And what are the projections for interest payments for the current financial year?

Mr Ray—Interest receipts are about \$5 billion and interest paid is about \$9 billion.

Senator BUSHBY—Do you have a figure there?

Mr Ray—Yes, it is \$5.073 billion and \$9.240 billion. The most recent published estimates are in PEFO.

Senator BUSHBY—If you could take on notice the questions I asked looking at unpacking it, I would appreciate that.

Mr Ray—Sure.

Senator BUSHBY—That is the end of my questions.

CHAIR—As there are no further questions for Fiscal Group, we will take a break. Thank you to Fiscal Group for coming in this evening. We have just got the agreement of the committee to table the Macquarie document.

Proceedings suspended from 9.25 pm to 9.42 pm

Commonwealth Grants Commission

CHAIR—We welcome witnesses from the Commonwealth Grants Commission. Do you have any opening statement that you would like to make?

Mr Spasojevic—We have no opening statement.

Senator WILLIAMS—I am new to this committee, so I have some basic questions; excuse my ignorance, please. When was the Commonwealth Grants Commission formed?

Mr Spasojevic—In 1933.

Senator WILLIAMS—I thought it was after the Second World War, but it was before the Second World War. Of course, in history you would see that the more densely populated states such as Victoria and New South Wales had the wholesale sales tax—it might have been to varying degrees back in those days. In those days, of course, those more densely populated states would pay more wholesale sales tax to the government, and hence the distribution way back to 1933. What I am saying is that you would take from the bigger tax-earning states and distribute money according to whatever your program or formula was.

Mr Spasojevic—Not quite. When the commission was formed, it only took claims from claimant states to get revenue from the Commonwealth budget. So, in a sense, the revenue came from the Commonwealth budget only for claimant states. That situation continued until 1980, and after 1980 there was a more general distribution from a fixed pool of money.

Senator WILLIAMS—Which would include general revenue plus indirect taxes—that general pool of revenue?

Mr Spasojevic—Not in 1980, no. It was just a pool of money coming out of the Commonwealth budget. It was not tied to any particular source of revenue.

Senator WILLIAMS—So what is horizontal fiscal equalisation?

Mr Spasojevic—Horizontal fiscal equalisation is a process whereby the Commonwealth distributes money amongst the states so that they all end up with the same fiscal capacity, so that if they all made the same effort to raise revenue from their own sources, they would be able to provide a comparable level of services to their residents.

Senator WILLIAMS—What is each state's current return of GST receipts in percentage terms?

Mr Spasojevic—I cannot answer that question because I do not know how much GST is collected in each state.

Senator WILLIAMS—Do you know it as a percentage?

Mr Spasojevic—No.

Senator WILLIAMS—Is there a limit to how low the percentage of an individual state's GST receipts can fall?

Mr Spasojevic—No.

Senator WILLIAMS—No limit?

Mr Spasojevic—No limit.

Senator WILLIAMS—Has consideration ever been given to having floor or a ceiling on the percentage return to each state of its GST receipts?

Mr Spasojevic—Not that I am aware of.

Senator WILLIAMS—What effect does horizontal fiscal equalisation have on states' incentive to grow their economies and revenues organically? That is, horizontal fiscal equalisation acts as a tax on success.

Senator Wong—I am waiting for Senator Bushby to defend the interests of Tasmania.

Senator BUSHBY—There is a reason why a senator for New South Wales isn't here!

Senator Wong—You are, I am noting, conspicuously silent.

Senator WILLIAMS—I am sorry, Mr Secretary—we have some rude interjections, haven't we!

Mr Spasojevic—All states retain an incentive to grow their own tax bases because they are always better off should they do so, even though part of the gain may be redistributed to other states.

Senator WILLIAMS—How do the CGC's terms of reference compare with how tax revenues are allocated in other federal countries—for example, Canada or the United States?

Mr Spasojevic—I think the general view amongst the practitioners of the somewhat arcane art that we practise at the CGC would be, 'We have the most sophisticated and comprehensive process of any federation.'

Senator WILLIAMS—Being a senator for New South Wales, I have heard the complaints, for many years, of how New South Wales collects far more GST than others. I think the figure, going back some time—I forget which premier it was; it might have been Morris Iemma—was that \$1.3 billion or \$1.5 billion or some figure like that was basically collected in New South Wales and distributed to other states such as Queensland. What are those figures these days? Can you give me, not dollar for dollar, a general idea of the states that give money away to smaller states. Obviously, you would have Victoria, New South Wales being in surplus and having to contribute some money. Would that be correct?

Mr Spasojevic—It is not so much a question of surplus, because we are talking about the distribution of the GST pool.

Senator WILLIAMS—I worded that wrongly. When it comes to the federal government collecting GST in those states and handing it back to the states, obviously there is a lot more GST collected in New South Wales than in South Australia or Tasmania?

Mr Spasojevic—I would believe that is the case, though I have no figures on how much GST is collected.

Senator WILLIAMS—You do not have figures on that? It is more a question for Treasury, obviously.

Mr Spasojevic—To my knowledge, there is no breakdown of the collection of GST by state. Woolworths hands in one GST return for its national operations; it does not split it up by which state it was collected in. Nor can we figure out where the exports come from by state, so it is impossible to do the calculations.

Senator WILLIAMS—If you went on, basically, the GDP of each state with turnover of goods and services, it would be an indication, even though some are exempted of course—various products, fresh food et cetera.

Mr Spasojevic—I believe that is how state treasuries do those estimates, but I am not aware that there is any definitive calculation.

Senator WILLIAMS—So, to put it in simple terms, you are handed a bundle of money from the federal government that you just redistribute to the states?

Mr Spasojevic—What we are asked to do is to give the relative share of the GST bundle which will be collected in a future year and to say how that should be distributed amongst the states. So we actually never get the money.

Senator WILLIAMS—And that is on a percentage basis of the divvying up of that the GST amount?

Mr Spasojevic—Basically, it is a sharing.

Senator WILLIAMS—And, in that share, for example, you may give something like 12 per cent to Western Australian and 14 per cent to Victoria?

Mr Spasojevic—Something like that.

Senator WILLIAMS—For interest's sake, do you know those percentages? Do you know the percentages of that divvying up for each state?

Mr Spasojevic—I do not have those numbers, because what happens is that, after we make our recommendations in February, they are taken by the Commonwealth and more recent population numbers are then imputed into the numbers we give them, and that determines the final share. That is contained in Budget Paper No. 3, which I do not have with me, unfortunately.

Senator WILLIAMS—In relation to New South Wales and Queensland, would there be more levelling of that ratio over the years as the population in Queensland grows as 500 people a week move from New South Wales to Queensland and hence extra federal seats are established in Queensland and taken from New South Wales? You would see a similar sort of balancing in that dividend percentage, would you?

Mr Spasojevic—That is correct. Over time, what we see is that the proportions going to New South Wales and Queensland have moved in the direction of their population shares.

Senator WILLIAMS—That is about it from me.

Senator BUSHBY—In view of the minister's suggestion, I thought I had better ask a few questions just to—

Senator Wong—I really will not hold it against you, Senator—I promise.

Senator BUSHBY—I think it is important to defend Tasmania and other states such as South Australia which are, I believe, probably on the same side of the ledger as Tasmania.

Senator WILLIAMS—It is a trap for you, David.

Senator BUSHBY—What are the principles underpinning the process? When you are asked to have a look at how to divvy up the GST cake, so to speak, what sorts of considerations do you look at in determining how that share might end up looking, with the possible consequence that one state may end up with a greater share per capita than another state?

Mr Spasojevic—The process that the commission goes through is to look comprehensively at the structure of state budgets. So, in terms of their expenditure, we would ask by each major expenditure head—for example, schools and education—how much more or less than the average per capita a state would need to spend to be able to provide the average service. We might take into consideration the distribution of schoolchildren and whether one state has higher or lower intrinsic costs that it has to meet. So we go through all the expenditure items. We then look at all the revenue items that states collect and ask how much each state would have collected had it followed the average tax policy. We look at the distribution of other Commonwealth payments. We look at how much investment a state would need to undertake to give it the average capital stock on a year-to-year basis and we do the same thing for their financial assets. Then we do an adding-up, so to speak, so that we put them all on the same position at the end of the distribution of the GST.

Senator BUSHBY—And that is ultimately the end aim of the horizontal fiscal equalisation.

Mr Spasojevic—That is the end aim—correct.

Senator BUSHBY—It is to put them all on the same footing—

Mr Spasojevic—Correct.

Senator BUSHBY—and, in accordance with a fairly long-held position of government, that is the intention of the process.

Mr Spasojevic—That is correct, yes.

Senator BUSHBY—And that is because there is a view that people in all states should be treated equally in that sense or should have access to equivalent services.

Mr Spasojevic—That is an imputation of the policy objectives. It is a common policy of the Commonwealth and the states. It was recorded in the Intergovernmental Agreement on Federal Financial Relations, to which all states and the Commonwealth are signatories.

Senator BUSHBY—When was that signed?

Mr Spasojevic—It was signed in 1999, just before the GST came in, because it was constructed consequent to that. It was re-signed in 2009.

Senator BUSHBY—But it reflected earlier agreements as well, only in respect not of GST but of other transfers—in terms of the ultimate outcome?

Mr Spasojevic—You are testing my memory, but I believe that in the States (Personal Income Tax Sharing) Act 1976 it was embedded in legislation, and it had been agreed at the 1976 premiers conference.

Senator BUSHBY—So that was the first time that horizontal fiscal equalisation was applied in this manner?

Mr Spasojevic—That was the first time it was applied generally to all the states. Before that, we had a claimant state situation where states who thought they had a particular fiscal problem would claim money from the Commonwealth and the commission would raise them to a level comparable to the other states. But it was a raising of the weakest rather than a levelling of all states.

Senator BUSHBY—But, in a sense, reflecting the same underlying philosophy.

Mr Spasojevic—Probably the philosophy was developed in the thirties and then embedded in the legislation after the event.

Senator BUSHBY—Thank you.

CHAIR—I think that is all we have for you. Thank you for coming in this evening.

[9.54 pm]

Australian Office of Financial Management

CHAIR—Thank you for coming in a little earlier, Mr Hyden. Do you have an opening statement that you would like to make?

Mr Hyden—Thank you. I would just like to say that our annual report for the last financial year was tabled in the parliament on Monday. It provides a comprehensive picture of our activities in the AOFM over the last year.

Senator BUSHBY—I anticipate that you may expect the question, but have you updated the graphs for each line offered through the AOFM and the rates achieved as we have in past estimates?

Mr Bath—Yes, I have.

Senator BUSHBY—Do you have copies of those with you?

Mr Bath—I have a copy. Do you want me to table it?

Senator BUSHBY—I imagine they are all in different colours?

Mr Bath—Yes, they are.

Senator BUSHBY—So we will probably have difficulties photocopying them and distributing them.

Mr Bath—There are several lines.

Senator BUSHBY—I know—exactly. I think I may have asked at the last estimates whether it was possible to break it up into a number of graphs.

Mr Hyden—I am unaware of that.

Senator BUSHBY—I apologise if I did not ask, but I certainly was thinking about it. In future I will continue to ask for this graph. How many lines are on that page? How many lines do you currently offer?

Mr Bath—The yule curve is quite flat at the moment, Senator, so you will just have to bear with me while I try to separate them.

Senator Wong—Is it possible to take this on notice?

Senator BUSHBY—Yes. Essentially, without—

Senator Wong—I think you are asking for disaggregated—

Senator BUSHBY—I am asking for disaggregated graphs—something that is a bit easier to read.

Mr Bath—There are 14 lines, and I have got more lines there.

Senator BUSHBY—Maybe if you could put it into two graphs so there are seven in each, and if you introduce new lines—

Mr Bath—I am happy to give you the data and perhaps you could use excel to draw the graphs that you care to. You lose a lot of the detail in the colour if you break it up. I fear that if I give you what you ask for we will be here again in another three months and you will say, ‘Can I have it a different way?’

Senator BUSHBY—Okay.

Mr Bath—I am happy to give you the data, and perhaps you could slice it and dice it however you like.

Senator BUSHBY—I get your emails advising of the results of every tender that you put out, and I have always intended to get my staff to actually start mapping it as it comes in, but—

Mr Bath—This is a different chart. This is not a chart of our individual tender results; this is a chart of market yields each day. We do not issue every bond every day—

Senator BUSHBY—No, I know that.

Mr Bath—We issue one or two bonds a week.

Senator BUSHBY—Okay, it is probably worth exploring that.

Mr Hyden—I might say that this data is published on the RBA’s website.

Senator BUSHBY—Yes, I have had a look at that data on the RBA website as well. When you put your tender out and you get a result, you do not know what the yield is going to be when you go to tender, do you? It depends on the bids that people put in as to how it ends up? That is correct, is it not?

Mr Hyden—It is correct, yes.

Senator BUSHBY—So how do the yields that end up on those tenders that are accepted relate to the yields that you have got mapped in that graph?

Mr Bath—The graphs that we provide are I believe end of day revaluation yields, so they are the secondary market yields at probably 4.30 pm of each closing day, whereas we tend to

run our bond tenders at 11 am. So the market is a 24-hour market from about 8.30 am on a Monday morning until very early Saturday morning I believe now. You have to take certain snapshots in order to get daily revaluation rates and it is those rates that we give you but we do not run our bond tenders at 4.30 in the afternoon because all the bond traders would be packing up and heading home. We tend to want them to be at their desk and ready to buy our bonds so we tend to run the bond tenders when they are going to be there.

Senator BUSHBY—That makes sense. If you could provide that data to the committee on notice, I will see what we can do with that. I would be interested in a copy of the graph that you have brought along, even if it is in black and white for the moment.

Mr Bath—I have a coloured chart that you are welcome to have.

Senator BUSHBY—Just one?

Mr Bath—Yes.

Senator BUSHBY—If you give it to me though, you have to give it to the committee.

Mr Bath—I see.

Senator BUSHBY—You mentioned that the yield curve is fairly flat at the moment. I was going to ask whether the costs of funds are generally going up, steady or falling?

Mr Bath—As I said, the yield curve is flat. What has happened is that short bond rates have gone up slightly whereas long bond rates have fallen slightly.

Senator BUSHBY—Has that made them converge?

Mr Bath—Yes, that is essentially what a flat yield curve means.

Senator BUSHBY—But across all lines?

Mr Bath—That is correct; that is what a flat yield curve means.

Senator BUSHBY—Are you saying that a flat yield curve means that across all lines they are showing similar characteristics?

Mr Bath—Similar yields, yes. So a steep yield curve typically would have a short dated bond with a yield very close to the overnight cash rate set by the Reserve Bank and a long bond yield that might be one or two per cent higher than that is what we would call a steep yield curve. A flat yield curve would be all at essentially the cash rate. Sorry, I cannot refer to the chart because I have given it to the secretariat.

Senator BUSHBY—That is all right. I understand what you are saying.

Mr Bath—And an inverted yield curve would be the opposite to a steep yield curve where the long bond yield is lower than the cash rate and the short bond yield is still close to the cash rate.

Senator BUSHBY—Since the last estimates how have the yields performed: are they going up or down?

Mr Bath—A picture paints a thousand words. You will see in a moment that the short rates have risen slightly since June and the long rates have fallen slightly since June, so they have

all converged on about five to 5¼ per cent, although I am at a bit of a disadvantage now that you have the chart and we don't.

Senator BUSHBY—The original will come back to you. It certainly has converged a lot.

Mr Bath—A way that helps me is to think of this chart as a mountain range where the horizontal axis is through time. Think of it as a contour map looking up a mountain range, so when the yield curve is steep you will get the lines far apart—a little bit like isobars or a topographical map—whereas when they are converged, like they are now, that is essentially telling you that the yield curve is very flat.

Senator BUSHBY—What do you think the reason is for that convergence? What is the characteristic of the market that is actually causing that to happen?

Mr Bath—Demand for long bonds has improved. Demand for our bonds has been quite strong and that has driven long bond yields lower. Short bond yields tend to track the cash rate. When expectations of monetary policy changes are such that rates are expected to rise then the short bond yields tend to rise more and, because the long bond yield is more sensitive to longer term inflationary expectations, the fact that in the short term monetary policy is expected to tighten by the market then there is considered to be a dampening effect on demand and that tends to be reflected in a flatter yield curve or lower longer bond yields relative to shorter bond yields. So what you are seeing there is characteristic of the sort of yield curve you would see when the central bank of any country is in a tightening cycle.

Senator BUSHBY—Okay, that explains that. I presume there has been no change to the limit on borrowing since the last estimates because it would have had to go through parliament. Does it still stand at \$200 million?

Mr Hyden—That is correct. It is \$200 billion.

Senator BUSHBY—Did I say \$200 million? Is this based on gross borrowings?

Mr Hyden—The coverage of it is defined in the legislation. It covers almost all Commonwealth government securities on issue—that is, the stock of debt that is outstanding, with some small exceptions relating to stock that was issued before the legislation came into effect.

Senator BUSHBY—Has there been any change in your predictions of the anticipated gross value of securities that will be outstanding at the end of the financial year? The last time you were here, about four months ago, it was about \$209.4 billion market value.

Mr Hyden—The only change would have come from the economic statement by the government and then the subsequent PEFO. I do not think that changed it significantly.

Mr Bath—Not significantly.

Mr Hyden—We did not change our issuance program as a result, so that means that it is the same.

Mr Bath—In the short term, over the next year or so, it has hardly changed, but there may be a different peak.

Senator BUSHBY—If you could have a look at it: what I am interested in is what it will be at the end of the financial year and also what it will be when it is anticipated to peak. I note

that as at today on your website the total Commonwealth government securities on issue are \$167,401,000,000. Is that correct?

Mr Bath—I think that would have been correct as at 15 October. We update the website weekly.

Senator BUSHBY—I had a look at it on Tuesday and again today, and it has not changed, so that explains why.

Mr Bath—I beg your pardon?

Senator BUSHBY—I had a look at it on Tuesday and it is the same today as it was then, so that explains why.

Mr Bath—Yes, but we only update it weekly. We update it on the 15th and the 22nd. Today is the 21st, so, assuming that you checked it any time between the 15th and the 21st, it will not have changed.

Senator BUSHBY—How much is it rising by per week on average?

Mr Bath—It varies from week to week.

Senator BUSHBY—How much did it rise last week?

Mr Bath—I do not have last week's tenders in front of me. We would have issued \$500 million of long bonds and \$700 million of shorter bonds, so that is \$1.2 billion. I am not sure how many T-notes we issued; I think it might have been \$1 billion. That would be \$2.2 billion. I am not sure whether we had any maturities of T-notes that week. Certainly we do this week. If you are looking at the stock, you have to take account of maturities. For example, this week we have \$5.5 billion maturing tomorrow. The week-on-week movement this week would actually be lower because we are issuing, I believe, another \$2 billion or thereabouts of T-notes and T-bonds this week and we have \$5.5 billion of maturing T-notes, so the stock would fall by a few billion dollars.

Senator BUSHBY—As part of your forward program, you would know that \$5.5 billion is maturing this week—

Mr Bath—Yes, we keep good track of—

Senator BUSHBY—and, to make sure that the government has access to cash as it needs it, you would be ensuring that you are putting out there enough new stock or new securities to tender to cover those needs?

Mr Bath—Yes. We manage the government's cash position.

Senator BUSHBY—Looking at the beneficial ownership information on your website, it appears that in September there was a substantial increase in Australian ownership of securities moving from 20 per cent to 26 per cent, which was the highest level of ownership by Australians in the past 12 months. Correspondingly, there was a fall in unidentified ownerships from 61.7 to 56.1. Are these two events related? Regardless, are you aware of any reason for this change?

Mr Hyden—The short answer is: yes they are related—that is, the rise in the first figure corresponds, broadly, to the fall in the second. But, going to the reason for it, we had

substantial maturities of stock in August. It appears likely that the proportion of that stock that was held by domestic custodians affected that result. So the retirement of the maturity of the stock brought a change in the composition of the beneficial ownership of it, which is reflected, then, in the September figure.

Senator BUSHBY—Did it cause a change in the composition because some of the stock that was retired was unknown, which then reduce the overall level of stock at that point, which left Australian beneficiaries holding a larger proportion of stock, or was there a corresponding increase in Australian beneficiary owned stock at that time as well to replace that which matured?

Mr Hyden—We do not have direct knowledge of that. It is just informed speculation, if you like, as to what might lie behind the figures. But I think it is likely that, this being stock that was maturing that had been held for a long time—so it is different to the newly issued stock that we have been issuing over the last couple of years—it would have reflected some of the ownership pattern that applied earlier.

Senator BUSHBY—So, possibly, it was stock that you had held for some time, predating the requirement that you ask voluntarily where the country of beneficial ownership is. It may have matured, decreasing the unknown somewhat, and an element of the newer stock that was bought may well have volunteered where the country of beneficial ownership was. Presumably, that could explain it. I am just trying to work out why there was such a big jump in one month. I understand that it is a complex outcome of a change of maturing securities and new securities that are going out there, but I am trying to get a handle on why we had a six per cent increase in Australian owned stocks that we knew of that month and a fall in those stocks where we do not know the country of beneficial ownership.

Mr Hyden—In simple terms, it would look as though that might be explained by a larger proportion of the maturing stock being held by domestic nominee companies and custodians in Australia than for the newer stock that has been taken up in the last couple of years.

Senator BUSHBY—Okay. I will move on from there. I saw that your annual report came out on Monday, and I managed to obtain a copy. At page 32 of that report, you note that the Australian Custodial Services Association has advised it cannot provide beneficial ownership details, because of fiduciary and contractual obligations to its clients, unless there is a clear legal or regulatory compulsion to do so. I also note that it held around 63.2 per cent of CGS, or Commonwealth guaranteed securities, as at 30 June. Does this account for all of the unknown beneficial ownership of these securities?

Mr Hyden—It accounts for all of this line, domestic custodian nominee companies. I think that is the figure that you refer to.

Senator BUSHBY—I note that it says that they held 62.3 per cent of CGS, or Commonwealth guaranteed securities. I was comparing that to information that you have on your website, which indicates that with roughly 60 per cent, on average, of securities on issue the country of beneficial ownership is not known.

Mr Hyden—Yes.

Senator BUSHBY—I was wondering whether that 62 per cent that is noted in your annual report correlates with the 60-odd per cent on your website and, as a result, all those securities that we do not know the country of beneficial ownership of are actually held through that company.

Mr Hyden—The 62 per cent is the same as on the website. It refers to both CGS and state government debt that has a Commonwealth guarantee that is held by these custodial firms. There is a significant amount of guaranteed state government issued debt that is included in the register.

Senator BUSHBY—If such a clear legal or compulsory compulsion, as referred to in your report, did exist, would it then remove all obstacles to that association providing this information?

Mr Hyden—I am not sure that I can speak on their behalf. What I have quoted in the report is what they have said to us or put to us.

Senator BUSHBY—I will move on from beneficial ownership. On RMBS, where is the investment strategy currently at? Last time you were here you talked to us about the arrangements you had made with Suncorp. I believe you have done something similar with ING. Could you update us as to the outcome of that?

Mr Bath—Yes, we have done several deals of a similar ilk to the deal that we did in May with Suncorp. I do not have every transaction in front of me, but they are on our website.

Senator BUSHBY—Okay.

Mr Bath—I beg your pardon, I might be able to give those to you. We have done one with Suncorp; one with Members Equity Bank; one with Bendigo and Adelaide Bank; one with MyState Financial; one with Liberty Financial, which did not have quite the same structure; one with the Bank of Queensland, one with Macquarie Bank; one with FirstMac, again with not quite the same structure; another with Members Equity Bank; and another with ING Bank, which is the last one. That takes us up to just over \$11.5 billion.

Senator BUSHBY—It was about \$9 billion last time, so is it roughly \$2 billion involved in those deals that you have just outlined?

Mr Bath—That sounds about right. In the third quarter of 2010 we settled \$2.242 billion of investments. So far in this quarter we have done just the ING deal, which was \$250 million. That is the amount that AOFM invested. The market is improving, and also part of our strategy was to deliberately buy a smaller portion of each transaction. The total issuance in the third quarter was \$6.9 billion, of which 2.24 was the number I said that the AOFM has bought.

Senator BUSHBY—So 6.9 was the total—

Mr Bath—For Q3. And that is the highest RMBS issuance in a quarter since the program started.

Senator BUSHBY—You mentioned in passing that the market is improving.

Mr Bath—It is improving in the last short while, probably since we last spoke in June. It has not been a uniform improvement over that time, there have been fits and starts, and a lot of that is to do with the travails in Europe and the second—

Senator BUSHBY—There was a big hiccup in the second quarter of this year.

Mr Bath—Yes, there was a bit of an overhang of that, so it has not been a perfect straight line since we last spoke. Particularly in recent weeks there has been a bit of an improvement in secondary market pricing, but also—and this is another measure of how we think things are going—the proportion of each transaction that we are asked to buy has been lower.

Mr Hyden—Also, the total volume that has been invested by private investors has increased. That is an important measure of—

Senator BUSHBY—So these deals that you have entered into since June—I recall that with the Suncorp deal that was a new approach that you were taking and that actually occurred because Suncorp approached you about a different way of—

Mr Bath—No, that is not quite right.

Senator BUSHBY—Not quite right?

Mr Bath—No. We came up with something—

Senator BUSHBY—It was a reverse something strategy.

Mr Bath—No, Senator.

Mr Hyden—That is different.

Mr Bath—The reverse inquiry channel—

Senator BUSHBY—The reverse inquiry channel—that is it.

Mr Bath—is the channel under which nearly all the transactions since the beginning of this year have been executed. There have been a few that we have done under what is called our serial pipeline channel, where we have agreed for five issuers to buy a series of investments. But that is not what happened in May with the Suncorp deal. What happened back in April-May was that we sensed that the market had slowed down, that buyers and sellers had become further apart, and we saw it as our job to get them back together again. So we did two things. The first thing we did was deliberately look to structure a transaction where we would buy, if you like, the slowest third of the capital to be repaid, and that created a larger tranche of securities that would have a relatively fast repayment speed and for which, we sensed, there was an investor base that was ready to buy. We said to ourselves, ‘Well, the next suitable candidate that puts a proposal to us, we’ll ask them to consider changing to suit our strategy,’ and that happened to be Suncorp. That is what happened.

Senator BUSHBY—Are the alliances you outlined earlier a similar deal, with the two-stage—

Mr Bath—When I listed them out, I said that some of them were slightly different structures.

Senator BUSHBY—Yes, some were slightly different—but basically similar to that, apart from the ones which were a bit more different.

Mr Bath—Yes, apart from the ones that I said were different. The ones that I did not say that about are the same as the Suncorp one. That is correct, yes.

Senator BUSHBY—You say the market is improving at the moment. What do you see as your role in the coming months? What is your strategy? Do you think it is improving to the extent that you might not need to continue with the same will level of activity and can wind back at all?

Mr Hyden—We will continue to watch the market, obviously. We will assess individual proposals that are put to us. Some issuers may feel they can issue without recourse to us, and we would encourage that, but we will continue to respond positively to proposals so long as we feel that they are needed to support the objective of competition in lending for housing.

Senator BUSHBY—Up to the ceiling of the \$16 billion you have available?

Mr Hyden—Yes.

Senator BUSHBY—Have you sold any more of the RMB securities, over the \$80 million that you had sold at June this year?

Mr Hyden—No, not since last time.

Senator BUSHBY—Okay. And what sort of return are you making on the RMBS at the moment?

Mr Bath—We are earning about 130 basis points, or 1.3 percentage points, over the bank bill rate. So, for the financial year that just finished, I think it was 5.2 per cent across the year.

Mr Hyden—That is correct. That compares with 4.8 per cent in the previous year, so it is up slightly, reflecting the movement in rates.

Senator BUSHBY—And 5.2 per cent is probably covering the cost of finance, on average. I had a long discussion with Mr Ray from Fiscal Group about how you would actually assess that, but it is probably not costing the government any money to have those sitting in there.

Mr Hyden—It is broadly in line with the overall cost of physical debt in our portfolio, you could say, should one try to match it with new debt. But I think that gives you a broad impression.

Mr Bath—To give you an idea of the margin, Senator, we are earning about 1.3 per cent over the bank bill rate. If we were to enter into interest rate swaps against our physical debt issuance, so that we could compare term debt that we are raising with floating rate debts, we would be able to raise debt at about 40 to 50 basis points under the bank bill rate. So, theoretically, our margin could be as much as 180 basis points. However, we are not using interest rate swaps to reduce that mismatch. We are quite happy to—

Senator BUSHBY—The purpose of the exercise is not to make money; it is to support the security of the RMBS market.

Mr Bath—That is right.

Senator BUSHBY—Okay. I am happy with that. Thank you.

CHAIR—Are there any further questions for AOFM? No. In that case, thank you for coming this evening. Thank you, Minister. And thank you to Broadcasting and Hansard for your help over the last two days, and of course our secretariat. The committee will now adjourn.

Committee adjourned at 10.25 pm