



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

Estimates

THURSDAY, 2 JUNE 2011

CANBERRA

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SENATE
ECONOMICS LEGISLATION COMMITTEE
Thursday, 2 June 2011

Senators in attendance: Senators Abetz, Brandis, Bushby, Cameron, Cormann, Eggleston, Heffernan, Hurley, Joyce, Ludlam, Parry, Pratt, Williams and Xenophon

TREASURY PORTFOLIO

In Attendance

Senator Wong, Minister for Finance and Deregulation

Senator Sherry, Minister for Small Business, Minister Assisting on Deregulation and Public Sector Superannuation, Minister Assisting the Minister for Tourism

Department of the Treasury

Dr Martin Parkinson, Secretary

Outcome 1—Informed decisions on the development and implementation of policies to improve the wellbeing of the Australian people, including by achieving strong, sustainable economic growth, through the provision of advice to government and the sufficient administration of federal financial relations

1.1—Macroeconomic Group

Dr David Gruen, Executive Director, Domestic

Mr Tony McDonald, General Manager, Macroeconomic Policy Division

Mr Steve Morling, General Manager, Domestic Economy Division

Mr Simon Duggan, Principal Adviser, Forecasting, Domestic Economy Division

Mr Patrick Colmer, General Manager, International Finance and Development Division

Mr Bill Brummitt, General Manager, International and G20 Division

Mr Steve French, General Manager, Corporate Services Group

Mr Rob Donnelly, General Manager, Financial and Facilities Management Division

Ms Pamela Henderson, General Manager, Human Resources Division

2.1—Revenue Group

Mr Rob Heferen, Executive Director

Ms Brenda Berkeley General Manager, Indirect Tax Division

Mr Michael Willcock, General Manager, Personal and Retirement Income Division

Mr Trevor Thomas, Principal Adviser, Personal and Retirement Income Division

Mr Paul McCullough, General Manager, Business Tax Division

Mr Geoff Francis, Manager, Resource Tax Unit

Mr Hector Thompson, Manager, Industry Tax Policy Unit

Mr Tony Regan, Manager, Company Tax Unit

Mr Tom Reid, Chief Adviser, Business Tax Division

Mr Paul Tilley, Chief Adviser, Tax Systems Division

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

Mr Gerry Antioch, General Manager, Tax Systems Division

Ms Maryanne Mrakovcic, General Manager, Tax Analysis Division

Mr Phil Gallagher, Manager, Retirement and Intergenerational Modelling and Analysis Unit

Mr Colin Brown, Manager, Costing and Quantitative Analysis Unit

Mr Marty Robinson, Manager, Household Modelling and Analysis Unit

Mr Jyoti Rahman, Manager, Revenue Analysis Unit.

Mr Phil Bignell, Senior Adviser, Indirect Tax Division

3.1—Fiscal Group

Dr Martin Parkinson, Secretary

Mr Nigel Ray, Executive Director

Dr David Guren, Executive Director Macroeconomic Group

Ms Peta Furnell, General Manager, Social Policy Division

Mr Peter Robinson, Principal Adviser, Social Policy Division

Mr Chris Foster, Principal Adviser, Social Policy Division

Mr Damien White, Principal Adviser, Social Policy Division

Ms Luise McCulloch, General Manager, Industry Environment and Defence Division

Mr Rob Raether, Principal Adviser, Industry, Environment and Defence Division

Ms Meghan Quinn, General Manager, Macroeconomic Modelling Division

Ms Jan Harris, General Manager, Budget Policy Division

Mr Russ Campbell, Principal Adviser, Budget Policy Division

Mr David Woods, Principal Adviser, Budget Policy Division

Ms Angela Baum, Manager, Budget Estimates and Analysis Unit, Budget Policy Division

Mr Matthew Quilinan, Manager, Budget Priorities and Reporting Unit, Budget Policy Division

Ms Elizabeth Clegg, Manager, Assets and Liabilities Analysis Unit, Budget Policy Division

Ms Sue Vroombout, General Manager, Commonwealth-State Relations Division

Mr Steve French, General Manager, Corporate Services Group

Mr Rob Donnelly, General Manager, Financial and Facilities Management Division

4.1—Markets Group

Mr Richard Murray, Executive Director

Ms Sue Vroombout, General Manager, Retail Investor Division

Mr Geoff Miller, Principal Adviser, Markets Group

Mr Andrew Sellars, Manager, Financial Services Unit, Retail Investor Division

Dr Richard Sandlant, Manager, Financial Advice Reform Unit, Retail Investor Division

Mr Christian Mikula, Consumer Credit Unit, Retail Investor Division

Mr James Chisholm, General Manager, Corporations and Capital Markets Division

Mr Daniel McAuliffe, Analyst, Governance and Insolvency Unit, Corporations and Capital Markets Division

Mr Ronita Ram, Analyst, Corporate Reporting and Accountability Unit, Corporations and Capital Markets Division

Ms Alix Gallo, Manager, Financial Markets Unit, Corporations and Capital Markets Division

Mr John Lonsdale, General Manager, Financial System Division

Mr Justin Douglas, Principal Adviser–Banking

Mr Ian Beckett, Principal Adviser–Banking

Mr Jonathan Rollings, Principal Adviser–Superannuation

Ms Kanwaljit Kaur, Manager and Principal Adviser–Insurance

Mr Jerome Davidson, Senior Adviser–Insurance

Mr Paul McBride, General Manager, Competition and Consumer Infrastructure, Competition and Consumer Division

Mr Bruce Paine, Principal Advisor, Competition and Consumer Infrastructure, Competition and Consumer Division

Mr Brenton Thomas, Principal Advisor, Infrastructure, Infrastructure, Competition and Consumer Division

Mr Angela Woo, Principal Advisor, Cities, Housing and Planning Unit, Infrastructure, Competition and Consumer Division

Mr Simon Writer, Manager, Consumer Policy Framework Unit, Infrastructure, Competition and Consumer Division

Mr Andrew Deitz, Manager, Competition Law and Policy Unit, Infrastructure, Competition and Consumer Division

Foreign Investment and Trade Policy Division

Mr Jim Murphy, Executive Director, Markets Group

Ms Deidre Gerathy, General Manager, Foreign Investment and Trade Policy Division

Mr Frank Di Giorgio, Principal Advisor, Foreign Investment and Trade Policy Division

Mr John Hill, Senior Advisor, Investment Review Unit, Foreign Investment and Trade Policy Division

Ms Biljana Waldron, Manager, Investment Review Unit, Foreign Investment and Trade Policy Division

Mr Mike Rosser, Senior Advisor, Foreign Investment and Trade Policy Division

Mr Michael Parkes, Manager, Compliance and Real Estate Screening Unit, Foreign Investment and Trade Policy Division

Ms Angela McGrath, Manager, International Investment and Trade Policy Unit, Foreign Investment and Trade Policy Division

Mr Nhon Tran, Senior Advisor, Foreign Investment and Trade Policy Division

Standard Business Reporting Management Group

Mr Greg Divall, General Manager

Australian Government Actuary

Mr Peter Martin, General Manager

Mr Michael Burt, Senior Advisor

National Competition Council

Mr John Feil, Executive Director

Takeovers Panel

Mr Allan Bulman, Director

Mr Alan Shaw, Counsel

Corporations and Markets Advisory Committee

Mr John Kluver, Executive Director, CAMAC

Australian Accounting Standards Board

Mr Kevin Stevenson, Chairman

Mr Angus Thomson

Auditing and Assurance Standards Board

Mr Merran Kelsall

Superannuation Complaints Tribunal

Ms Jocelyn Furlan, Chairperson

Ms Fiona Power, Director

Australian Bureau of Statistics

Mr Brian Pink, Australian Statistician

Mr Peter Harper, Deputy Australian Statistician, Population, Labour, Industry and Environment Statistics Group

Mr Trevor Sutton, Deputy Australian Statistician, Social Statistics Group

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

Mr Denis Farrell, Acting Deputy Australian Statistician, Chief Operating Officer

Ms Jill Charker, Acting First Assistant Statistician, Population, Labour, Industry and Environment Statistics Group

Mr Michael Belcher, Chief Financial Officer

Mr Paul Lowe, Assistant Statistician, Population Census Branch

Ms Denise Carlton, Acting Assistant Statistician, Office of the Statistician

Australian Competition and Consumer Commission

Mr Graeme Samuel, Chair

Mr Brian Cassidy, Chief Executive Officer

Mr Scott Gregson, Group General Manager, Enforcement Operations Group

Mr Nigel Ridgway, Group General Manager, Compliance Operations Group

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

Mr Mark Pearson, Deputy Chief Executive Officer, Regulation

Ms Rayne de Gruchy, Deputy Chief Executive Officer, Competition and Consumer
Mr Adrian Brocklehurst, Chief Finance Officer
Mr Tim Grimwade, Executive General Manager, Mergers and Acquisitions Group
Mr Richard Chadwick, General Manager, Adjudication
Mr Richard Home, General Manager, NBN Engagement and Group Coordination Branch
Ms Michelle Groves, Chief Executive Officer, Australian Energy Regulator
Ms Michelle Patterson, General Manager, People Services and Management

Australian Office of Financial Management

Mr Rob Nicholl, Chief Executive Officer
Mr Michael Bath, Director, Financial Risk
Mr Pat Raccosta, Chief Financial Officer
Mr Andrew Johnson, Head of Reporting and IT
Mr Gerald Dodgson, Head of Treasury Services

Australian Prudential Regulation Authority

Dr John Laker, Chairman
Mr Ross Jones, Deputy Chairman
Mr Ian Laughlin, APRA Member
Mr Wayne Byres, Executive General Manager, Diversified Institutions
Mr Charles Littrell, Executive General Manager, Policy, Research and Statistics
Mr Ramani Venkatramani, General Manager, Central Region
Mr Keith Chapman, Executive General Manager, Supervisory Support

Australian Taxation Office

Mr Michael D'Ascenzo, Commissioner of Taxation
Mr David Butler, Second Commissioner
Ms Jennie Granger, Second Commissioner
Mr Bruce Quigley, Second Commissioner
Ms Francis Cawthra, Acting Chief Operating Officer
Mr Neil Olesen, Deputy Commissioner, Superannuation

Australian Securities and Investment Commission

Mr Greg Medcraft, Chairman
Ms Belinda Gibson, Deputy Chairman
Mr Shane Tregillis, Commissioner
Mr Peter Boxall, Commissioner
Mr Michael Dwyer, Commissioner
Mr John Price, Senior Executive Leader
Mr Warren Day, Regional Commissioner

Inspector-General of Taxation

Mr Ali Noroozi, Inspector-General of Taxation

Mr Andrew McLoughlin, Deputy Inspector-General of Taxation

Mr David Pengilley, Principal Adviser

Commonwealth Grants Commission

Mr John Spasojevic, Secretary

Mr Phil Parkins, Corporate Services

Productivity Commission

Mr Bernie Wonder, Head of Office

Dr Michael Kirby, First Assistant Commissioner

Mr Terry O'Brien, First Assistant Commissioner

Dr Ralph Lattimore, Assistant Commissioner

Committee met at 09:02

CHAIR (Senator Hurley): I declare open this public hearing of the Senate Economics Legislation Committee. The Senate has referred to the committee the particulars of proposed expenditure for 2011-12 and related documents for the Treasury portfolio. The committee must report to the Senate on 21 June 2011 and it has set 22 July 2011 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 governing estimates hearings. If you need assistance, the secretariat has copies of the rules. I particularly draw the attention of witnesses to an order of the Senate of 13 May 2009 specifying the process by which a claim of public interest immunity should be raised and which I now incorporate in *Hansard*.

The extract read as follows—

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)

The Treasury

[09:03]

CHAIR: The committee will begin consideration of the Treasury portfolio with questions for the Macroeconomic Group, and will then follow the order as set out in the circulated program. I welcome the Minister for Finance and Deregulation, Senator Penny Wong, and Dr Martin Parkinson in his new capacity as Secretary to the Treasury. Minister or Dr Parkinson, do you have an opening statement?

Senator EGGLESTON: Before we begin, Chair, do you mind if I just make a few remarks about a matter of some significance. This is your last day as chair of this committee, as you are retiring from the Senate. On behalf of the entire committee, I would like to thank you for the excellent job you have done over the years you have been the chair of this committee. This is a very busy committee. It is the busiest committee, we believe, in the Parliament of Australia and it has an enormous number of referrals to it. It involves a lot of time away from home and a lot of travelling and a lot of work preparing reports. You have been chair of it over the last three years in what has been a very busy period since this new government came in. Many issues from the first budget were referred to this committee. I would just like to say on behalf of the committee that we thank you very much for all you have done and we wish you all the best in your future endeavours.

Senator Wong: Hear, hear!

CHAIR: Thank you, Senator Eggleston, and thank you to the committee members for their support over the years as well. It has been a difficult time for all of us, I think—or a busy time for all of us.

Senator Wong: We are going to miss you, Chair. You probably will not miss us.

CHAIR: Maybe not!

Senator PRATT: We have had some extraordinary experiences in estimates in the last three years, and that has not always been easy for you as chair—not to mention the very large number of reports and inquiries that we have done in that time. As an incoming senator who has just done my first three years in the Senate and on this committee, I would really like to thank you for your mentorship and your leadership of this committee.

CHAIR: Thank you very much.

Senator CAMERON: Can I just add my thanks to the chair for the work that she has done. We have all worked hard to help you keep order!

CHAIR: I have noticed!

Senator CAMERON: With my experience around the committees, the economics committee is a tough committee and you have run it well. You have done a good job, and I would like to express my thanks for that and wish you well in the future.

Senator BUSHBY: As a permanent member of the committee, I would also like to associate myself with the remarks that have been made. The last few years have been a challenging time in this committee. There have been a lot of big issues that are important for the nation. Over that time, I have developed a high degree of respect for your ability not just to chair this committee through tough and challenging issues but also to get across the issues and to ask incisive questions that show that you really know what you're talking about. So thank you and best wishes for the future.

CHAIR: Thanks very much, everyone. That was very unexpected. We really should have done it for Dr Parkinson to welcome him to the Treasury portfolio. But we will now give you an opportunity to make an opening statement, if you would like.

Dr Parkinson: Thank you, Chair; I will be brief. I appreciate the opportunity to be here. I will assume that yesterday was a cameo and today is the first day. I look forward to working—unfortunately not with you, Chair—with your colleagues on the committee, a number of whom, such as Senator Abetz, Senator Xenophon and Senator Cameron, I have worked with in other circumstances. And I look forward to it. Thank you very much.

CHAIR: I would like to start off with the first question. Yesterday's national accounts had a fairly mixed range of indicators: things such as household savings were up to around 11.5 per cent, which is very high compared to the previous decade; but then coal and iron ore exports were well down in the March quarter. They were down \$5.3 billion, I think. That produced some real swings in there and some unusual figures. Can you comment on the evidence of what might happen in the future? Is there a likelihood of a rebound in some of those figures that have been depressed?

Dr Parkinson: Yes, thanks for that. I am happy to answer that question. The March quarter national accounts are entirely consistent with what we assumed or what we forecast to be the out-turn when we prepared the budget forecasts. The budget papers explicitly referred

to the fact that there would be a contraction of growth in the March quarter. It was marginally larger than what we had been anticipating at the time, but all within the sort of ordinary boundaries of possibility. But the underpinnings of the budget were still for a central forecast that had a very strong growth going on from here. So, as the Treasurer has said, yes, we have had a loss of production in the March quarter caused by the natural disasters. The loss of GDP is slightly larger because the production loss is around \$12 billion now rather than about \$9 billion, as we had been expecting. Part of that is just the delay in a number of areas, including coalmining in terms of dewatering mines and getting back into production. But there is nothing in the accounts that changes our perspective about what will happen next, which is that we will see subdued production in the March quarter, a little bit more of that as we go into the June quarter but then a strong rebound with very positive growth prospects in 2011-12 and 2012-13.

CHAIR: As for those positive indicators that you mentioned, can you advise what sort of certainty there is about projected investment? I know that there is an indication that there is a number of business investments coming down the pipeline. Can you say what certainty there is, especially given some indicators in Europe and other areas that things might be challenging over the next year or so?

Dr Parkinson: It is important to disentangle the drivers of the very large pipeline of investments that we have in front of us from the very short term risks that we confront—and those are real risks. But it is worth disentangling them. There is a very large pipeline of investment, particularly in mining, that is in the region of about \$380 billion over the next five years. Just in the year ahead, capital expenditure estimates that firms provide to the ABS imply that mining will grow from around \$51 billion in 2010-11 to around \$83 billion in 2011-12. So that is about a 60 per cent growth. What is driving that is actually an expectation of continued very strong growth in demand for commodities worldwide. We talk about China, but India and a range of other countries are emerging and growing very rapidly and improving the living standards of their people. Because those projects are for mines that exist for 20, 30, 40 and even 50 years, those projects will not be knocked off course by short-term disruptions.

Stepping back, though, you are right to focus on the fact that there are a series of risks, and we were very explicit about it in the budget papers. I talked about it again in detail in my Australian Business Economists speech. Amongst those are inflation in emerging economies, particularly China. But one immediate concern at the moment is what is happening in Europe with the sovereign debt issues confronting Greece and a number of the other peripheral countries and the potential implications of that for a spillover into the European banking sector.

CHAIR: Thank you, Dr Parkinson.

Senator ABETZ: Just a quick question about a question that was taken on notice—BET 211—at estimates 12 months ago, the answer to which was conveniently provided to us just after the February estimates so that it could not be pursued at the February estimates. I asked, in relation to a particular minute dealing with the impact of alternative company tax policies, if the minute was officially released to the public and, if so, by whom. The answer I was given was that there was an authorised release of the minute. So that is fine—it was authorised. But it conveniently does not answer the question of if so by whom. Can I please

have that answered and an explanation provided as to why we were not told by whom this leak or authorised release was made?

Senator Wong: Can we see a copy of that, Senator?

Senator ABETZ: I have given you the reference—question BET 211. Nobody has it? All right.

Senator Wong: If someone either from Treasury or from the committee could give me a copy of the answer, I would appreciate it.

Senator CAMERON: I am sure it was sitting on the desk of the secretary while he was dealing with the global financial crisis, just waiting for him to deal with this.

Senator ABETZ: The next answer was:

... The Treasury advises the government and will undertake any costing of a policy that the government asks it to examine.

So if you could tell us who or what person within government actually asked you to examine that particular opposition policy—if you could take that on notice. I assume that you will not have the answers to this, but if we can have an explanation as to why that information, which was so specifically sought, was quite frankly deliberately denied. If you could answer that I would be much obliged. I understand that the secretariat is arranging for that question and answer to be provided. I want to actually put on the record and in *Hansard* the obfuscation in relation to the information that was sought, which I think is quite material because it would indicate a manipulation of Treasury minutes being publicly released. And if it is such a good thing to publicly release the information and it is authorised, why hide the name of the person who actually did the authorisation?

Senator Wong: I don't think that that was a question. That was another Senator Abetz special, Madam Chair, of giving us a long lecture which probably would have been better served in a press conference or in the parliamentary chamber. Is there a question?

Senator ABETZ: I want an answer, Minister.

Senator Wong: I do not believe that there was a question. It was the usual Senator Abetz diatribe asserting a whole range of things which are not—

Senator EGGLESTON: Point of order, Madam Chair: there was clearly a question.

Senator Wong: Deputy Chair, where is the question?

Senator ABETZ: Who authorised the release, Minister? If you can't read the question, if you can't understand it, so be it.

Senator CAMERON: Calm down!

Senator ABETZ: Coming from you, Senator Cameron, please!

Senator Wong: Settle down, Senator.

Senator ABETZ: I am accused of engaging in a diatribe when I am seeking an answer to a specific and deliberate question. Unless Treasury and the Treasurer could not comprehend the question, then I think I am entitled to assume—

Senator CAMERON: Now you are being condescending and stupid.

Senator ABETZ: that there was obfuscation.

Senator Wong: I was enjoying the sweetness and light with which we started, but 16 minutes in—

CHAIR: It never lasts long.

Senator Wong: it didn't last.

Senator ABETZ: Well, Minister, the problem always arises when you try to hide the secretary of the department from the committee or when you do not provide us with information. That is the problem.

CHAIR: Senator Abetz, Dr Parkinson made himself available yesterday and today.

Senator ABETZ: There is no criticism of Dr Parkinson in this.

CHAIR: Good.

Senator Wong: I am afraid I have to respond to that assertion. This is the problem when Senator Abetz chooses to put things on the public record which are disputed. No-one was trying to hide Dr Parkinson yesterday, and I am surprised that the opposition would want to return to that debate today. The position that I have put on the table is that historically the Treasury secretary has not been required for the entirety of the portfolio estimates—that is under both governments. Historically, the practice has been that the time for the Treasury secretary to attend has been agreed. It has generally been in the macroeconomic group. Dr Parkinson had indicated that he would attend then and he would also be prepared to take fiscal policy questions at that time. So no-one was intending to hide him. Coalition senators chose yesterday to have an argument about him coming at a different time.

Senator EGGLESTON: As is their right.

Senator Wong: I do want to put that on the public record because Senator Abetz is making a range of assertions that are not correct.

Senator ABETZ: Can I just have an answer please: by whom?

CHAIR: I think the minister was about to get to the second part.

Senator ABETZ: Oh, good!

Senator Wong: I would have to take that on notice, Senator.

Senator ABETZ: As I thought.

Senator Wong: Well, genuinely, Senator, I think this refers to something that occurred prior to the election. Is that correct?

Senator ABETZ: When you leave answers for over 12 months chances are that is right.

Senator Wong: I was not actually trying to be difficult. But obviously this precedes my position in this portfolio—in Finance in any event. So I do not have any knowledge that I can provide to you at this point.

Senator ABETZ: Of course, I accept that you are a representative minister here. But these were very specific questions, the answers to which were provided at a time that meant I could not pursue them at the next estimates, which was February. Then when this answer was provided it was clearly deficient. So if we can have an explanation as to why it was deficient and an actual answer, please.

Senator Wong: I will take that on notice.

CHAIR: Senator Cormann.

Senator CORMANN: Thank you, Madam Chair. Would the government be able to forestall the need for further interest rate increases by removing additional demand from the economy by running a tight budget policy?

Dr Gruen: I don't want to comment on the presumption of your question, which is that there are interest rate rises coming. That is very much a matter for the Reserve Bank and not for me to comment on. I would make the comment that if you take the Commonwealth and state governments together, we are looking at a fiscal tightening a little bit above four percentage points of GDP. It is about 4¼ percentage points of GDP over the next two financial years. The vast majority of that is contributed by the Commonwealth government, and that is an extremely rapid fiscal consolidation. It is the fastest fiscal consolidation that Australia has seen in the period in which records have been kept—so for the last forty years or so.

I think a fiscal consolidation that was significantly larger than that would risk slowing the economy significantly. If you just take the next two years, it is an extremely rapid fiscal consolidation. So if you ask the question, 'Are monetary and fiscal policies working in the same direction to restrain the economy?', then the answer to that question is that very clearly they are. Fiscal policy is acting to restrain the economy, and monetary policy is currently operating with interest rates that borrowers pay a little above their long-term averages. So both monetary and fiscal policy are acting to restrain the economy, as for that matter is the exchange rate. It is the case that the arms of macro policy are working in the same direction, and with a very substantial amount of the heavy lifting being done by fiscal policy.

Senator CORMANN: Well, obviously in the two years 2008-09 to 2009-10, spending in real terms went up by about 17 per cent. So now the spending growth from 2010-11 onward is off of a significantly inflated base. You are still spending about \$10 billion worth of stimulus spending next financial year. In that context, if the RBA sees the need to raise interest rates again, against a background of current budget settings, then surely there would be little risk of a moderate further fiscal tightening leading to a downturn in growth. You just talked about any further fiscal consolidation having an impact on the economy. But there is a broad consensus that there is an expectation of further interest rate rises by the RBA. Well, if the RBA sees the need for further tightening through monetary policy, why are you suggesting that a further moderate tightening would have a terrible impact on the economy?

Dr Gruen: I think that the word I used, Senator, was 'significant'.

Senator CORMANN: Sorry—significant, yes.

Dr Gruen: But look, I do not want to put words into the Reserve Bank's mouth. The macroeconomic settings are responding to the largest mining boom in our history. So we currently have mining investment running at about four per cent of GDP, with every expectation that it is going to rise significantly over the next two years. We have records that go back to the gold rush in the 1860s, and mining investment has never been anything like as high over that period back to the 1860s. Mining investment in Australia has never been anything like as high as it is now.

Senator CORMANN: The best terms of trade in 140 years.

Dr Gruen: Indeed.

Senator CORMANN: We agree with the Treasurer on that, which is why surely there should be more scope to run a stronger budget position.

Dr Gruen: I guess the way that I would analyse the effect of the budget on the economy is to look at fiscal policy's contribution to growth. I think that is the appropriate way to look at it. It is certainly true that both fiscal and monetary policy were eased very substantially in response to the global financial crisis. You quoted the growth rates of government spending there in the budget.

CHAIR: Sorry, Dr Gruen. The cameras are really close to the witnesses. It is distracting for us and it makes it a bit different. I would ask you to move away a bit.

Senator CAMERON: You've got a big long lens. You could go next door and still pick it up!

Senator Wong: Maybe you could just get a few shots and then, you know. What do you need? Do you need him or me?

CHAIR: If you want us to give you a couple of minutes to get close and then go, that would be good. It is very distracting for us.

Senator CORMANN: Hopefully I can get a clear run with my questions and answers.

Dr Gruen: I will try to take up where I left off. What I was saying was that I think that the appropriate way to look at how fiscal policy is contributing to the economy is to look at what it is contribution to growth. Treasury's estimates are that fiscal policy made a very significant contribution to growth in the global financial crisis. I might stand corrected, but the number that sticks in my head is that in calendar 2009, the contribution to growth from fiscal policy was about two per cent. Growth in that calendar year was 1.4 per cent. So fiscal policy contributed more than all of the growth in 2009. Moving forward, if we look at the estimates that are in the budget, the withdrawal of fiscal stimulus is expected to reduce GDP growth by about one percentage point in 2010-11 and about half a percentage point in 2011-12. So fiscal policy is making a significant contribution to restraining the economy, and I think that that is the appropriate thing for it to be doing. As I said, what we are looking at is the fastest consolidation since records began. I would leave it there.

Senator CORMANN: If you look at where our monetary policy is at in the context of our fiscal policy and compare it with the United Kingdom and the US, they have had record low interest rates for a very long time now—three or four years. In the context of significant fiscal stimulus spending, our official cash rate, our interest rate, went down to three per cent but then we have had seven successive increases. Ours is higher than any comparable country anywhere in the world. So clearly monetary policy in Australia started restraining the money flows into the economy much sooner than fiscal policy did, and still monetary policy appears to be doing more of the heavy lifting. Given all of the forecast of what lies ahead in terms of the decisions that the RBA is likely to make moving forward, in that context—

Dr Gruen: Can I just respond to that?

Senator CORMANN: Yes, sure. Please.

Dr Gruen: The RBA cut interest rates to three per cent and brought borrowing rates well below their longer-term averages, so that monetary policy was stimulatory at that time and for

some considerable period of the tightening, monetary policy was simply returning borrowing rates back to their longer run averages.

Senator CORMANN: And the banks, of course. There are some other interest rates rises on top of that at the retail end.

Dr Gruen: So, I am focusing on borrowing rates rather than simply the cash rate. But while borrowing rates are below average, monetary policy continues to be stimulatory. It is that when interest rates went all the way down to three per cent monetary policy was extremely stimulatory.

Senator CORMANN: In the UK it was half a per cent; in the US a quarter of a per cent.

Dr Gruen: Yes, well I am happy to deal with that. Unemployment in the US is currently, I think, nine per cent, and the net losses in jobs since the financial crisis started in the United States is a number like seven million. So they are nowhere near back to an employment level of where they were in 2007. It is the worst recession in the United States in the post war period.

Senator CORMANN: Sure. Indeed.

Senator CAMERON: Senator Cormann, can we just get to a position where if you ask Dr Gruen a question, I would like to hear the answer. I don't think you should run a constant barrage of questions.

Senator CORMANN: Senator Cameron, I only have a limited time, and I have a lot of stuff to go through.

Senator BUSHBY: Is that a point of order?

CHAIR: I think there has been of an exchange here, but Senator Cormann—

Senator CORMANN: I think that it is going quite well.

CHAIR: you did invite Dr Gruen to go down that path—

Senator CORMANN: And it is going quite well.

CHAIR: so you can't be unhappy that he is deliberating.

Senator CORMANN: I do not want to get an entire university lecture for every question. I want to actually go down a certain—

Senator CAMERON: It is not a university lecture.

Senator CORMANN: I think we were actually going quite well.

Senator Cameron interjecting—

CHAIR: Senator Cameron. Senator Cormann, you cannot stop Dr Gruen when ever you want to. If you ask a question—

Senator CORMANN: If we could have concise answers—

CHAIR: he needs to be able to round it out. Dr Gruen.

Senator Wong: Senator, I do not know if Dr Gruen has more to add, but I just wanted to make a few points in response to some of your assertions. You are drawing comparisons I think with the UK and the USA. As Dr Gruen pointed out, they have different unemployment levels to Australia's—they are significantly higher. Our net debt position is substantially stronger.

Senator CORMANN: Why did you spend so much if the situation here—

Senator Wong: Well, Senator, it is interesting, isn't it, that now you take this view. I would ask that you therefore are also upfront in saying that you would be happy to see 200,000 more Australians on the dole queue. Because that was the affect of the stimulus spending.

Senator CORMANN: Hang on, you are running an inconsistent argument.

Senator Wong: If I could finish.

Senator CORMANN: Our Reserve Bank had much more scope to do more through monetary policy at the time.

CHAIR: Senator Cormann, you are again not allowing for an answer.

Senator CORMANN: But I didn't ask the minister a question.

Senator Wong: I am responding to some of the things that you said, Senator, and I am entitled to.

Senator CAMERON: Just behave yourself at times.

Senator Wong: You talk about the fiscal consolidation. Three facts are important to remember. First is in terms of expenditure restraint. If you take the average real growth in expenditure that this budget demonstrates, it is on average one per cent per year. The last time a government restrained expenditure by that amount was in the 1980s. It has certainly never occurred under your government. So if you assert people are spending too much, you have to explain, Senator, how it is you spent so much more. Second, our tax to GDP ratio is better—that is, we are not taxing more; we are taxing less than in the last period of the Howard-Costello government. Also, if you look at statement 10, you will see that government payments as a percentage of GDP, which is a useful denoter of the size of government in the economy, actually falls by a full percentage point over the forward estimates period to 23.5 per cent, which is substantially lower than if you look at the average of the years prior to the global financial crisis under you. So by any measure, whether it is how much we are taxing, how much spending is growing and how much government spending there is as a share of the economy, you can see that this is a budget that is fiscally responsible.

Senator CORMANN: Dr Parkinson or Dr Gruen, I assume you have discussions. Can you talk us through the discussions that you would have within Treasury on the losers and winners of a different mix of fiscal and monetary policy? Because clearly, if you run a tighter fiscal policy that will have an impact on sections of the community, but so do higher interest rates. Higher interest rates obviously causes pain to those people paying back mortgages and those people borrowing money for business activities and so on. What sort of discussions on trade offs—

Senator Wong: So I assume, Senator, that you are going to pass all of our budget savings and the savings you are currently blocking.

Senator CORMANN: We are here to—

Senator Wong: This is the hypocrisy, Senator.

Senator CORMANN: I am going to sit there and answer questions one day, hopefully, but right now we are asking questions. I have just asked a question and I would like Dr Gruen or Dr Parkinson to answer.

Senator Wong: I would be interested to see a bit more hubris on that side! You are the second coalition senator—

Senator CORMANN: We are here to scrutinise your budget, Senator.

Senator Wong: in this estimates who has asserted he was about to become a minister.

Senator CORMANN: We are here to scrutinise your budget, and one day hopefully we will get the opportunity to answer questions.

Senator Wong: You are the second senator from the opposition during this estimates period who has been so arrogant as to assert that he was going to be a minister shortly. But that is a matter for you.

Senator CORMANN: I did not say that. I said ‘one day’—one day ‘hopefully’ is what I said, so don’t verbal me.

Senator Wong: I am happy for Dr Parkinson—

CHAIR: Senator Cormann, Senator Wong, can we get back to estimates.

Senator Wong: It is extremely hypocritical—

Senator CORMANN: You are wasting time—

Senator Wong: Can I finish?

Senator CORMANN: You are giving us gratuitous advice. Point of order, Madam Chair. The minister is giving gratuitous political commentary. I asked a very specific question of the Secretary to the Treasury and Dr Gruen about the trade-offs between monetary and fiscal policy in terms of their impact on different sections of the community. There is no need for the minister’s political diatribes. They are just here to waste time.

CHAIR: Senator Cormann, I think that she was responding to an interjection from you.

Senator Wong: I was. I will be very quick, Chair.

CHAIR: Yes.

Senator Wong: I do understand, and it is a question that Dr Parkinson or Dr Gruen are well equipped to answer. But I will just make this point: the opposition cannot continue to come into the chamber, assert the need for a tighter fiscal policy at the same time they are spending more. They are refusing to pass certain savings measures which have an impact on the bottom line and they have refused to back the government’s budget savings measures. You cant have it both ways, Senator Cormann. If you are one of the people on that side who recognise, like Senator Minchin, that the opposition at least has to have some consistency in policy, you would understand that the question such as the one you asked really cannot be taken seriously while your party continues to vote to blow the budget surplus.

Senator CORMANN: Thank you for your character assessment of the quality of my questions. Can we now get back to my question? So, Dr Gruen, what sort of discussions do you have about trade-offs between fiscal and monetary policy in terms of the impact it has on different sections of the community—that is, the impact of higher interest rates versus the impact of tighter fiscal policy?

Dr Gruen: You cannot answer these questions with a degree of precision, but it is certainly the case that broadly, as you say, monetary and fiscal policy have influences on different people and on different sectors of the economy. My sense of the macroeconomic

circumstances we are in is that, as I said, we are experiencing a very substantial mining boom. Having successfully emerged from the global financial crisis with limited damage to the unemployment rate, it makes sense now for both monetary and fiscal policy to be acting to restrain the economy. As I said, fiscal policy is making a very substantial contribution to that. It is my judgement that if you were to do significantly more there would be risks associated with that. I think the way the RBA characterise it is that monetary policy is mildly restrictive—they use language like that. I think that fiscal policy is imposing very significant restraint on the economy. The sort of fiscal consolidation we are talking about over the next two years is very substantial. So if you are asking me the question, 'Is monetary policy being asked to take too much of the load?' then I think the answer to that question is no.

Dr Parkinson: If I could just add to what Dr Gruen said. Listening to the question you have been asking, is it the case that you are asking whether we should not have a greater net contractionary effect, or are you asking about the same amount of contractionary effect but distributed differently, depending on the fiscal-monetary policy mix?

Senator CORMANN: I am asking about the mix between fiscal and monetary policy. Essentially, what I want to know, to sum it up, is: why does Australia have some of the highest interest rates in the developed world, and is one consideration the fact that the government is continuing to borrow huge sums of money in the capital markets, in competition with the private sector and at a time when our economy is already approaching its capacity constraints?

Dr Parkinson: I can give you a very short answer. In my view, I don't think that that is the case.

Senator CORMANN: Sorry, the question was 'why?' Why are our interest rates so much higher?

Dr Parkinson: It is the fact, as Dr Gruen said, that when you look at the United States you see an economy with nine per cent unemployment and very weak private demand. It is only just now beginning to pick up. When you look at the UK, it is in the same sort of situation. What we are looking at is an economy that is close to full employment—close to the NARU—where growth is trending back towards trend and where the level of GDP is trending back, in the next two years, towards where it would have otherwise been in the absence of the global financial crisis. The flip side of that is the extent the two arms of policy are being contractionary. As Dr Gruen noted, the Reserve Bank's view is that monetary policy is mildly contractionary. Fiscal policy, having been very supportive of the economy during the GFC—and, as the minister noted, protecting over 200,000 jobs—is now actually removing stimulus from the economy very rapidly.

Madam Chair, perhaps I may table this chart. What this chart does is show senators the underlying cash balance as a share of GDP for each year, and the line shows the cumulative effect, the rolling three-year impact. So that is showing you that, over a three-year period, the Commonwealth is consolidating by over four per cent of GDP or 3.8 per cent in two years. If you add in the states, as Dr Gruen said, we have a fiscal consolidation of 4.3 per cent of GDP in two years. The 3.8 per cent in two years at Commonwealth level is unmatched. This three-year consolidation is unmatched. That says to us that fiscal policy is leaning against the pressures quite firmly and monetary policy is mildly restrictive. Then you have to get into the question of, 'Let's say we did more on one, then how much could we take off another?'

Senator CORMANN: And the RBA ultimately make that decision by how they set interest rates moving forward, don't they? They look at your budget settings and then they will make a judgment, among other things—

Dr Parkinson: No, it does not because to the extent that the markets are correctly assessing where monetary policy will go, we build that into our economic forecasts. So we are assuming, based on what the markets are implying, where we are taking a future path of monetary policy. The bank looks at the fiscal policy position and takes that, and essentially, therefore, we are using the same set of assumptions.

Senator CORMANN: Sure. But one of the things that the RBA will be looking at is the fiscal settings in the budget, surely, in the context of its decision making around monetary policy?

Dr Parkinson: If you look back over time, I think it was the previous governor who made the comment that the sorts of changes you see year-to-year in fiscal policy do not actually have much influence on the way in which the bank thinks about monetary policy.

Senator CORMANN: Except that we had a 17 per cent growth in real terms, which was the highest for a very, very long time—since the Whitlam years, in fact.

Dr Parkinson: Undoubtedly so.

Senator CORMANN: And of course that is a unique set of circumstances. So it is not like a normal year-on-year change.

Dr Parkinson: Undoubtedly so, but, if we had not stimulated the economy in the way that we did, Australia would have faced dramatically higher unemployment. That is a given. To me, that is just absolutely indisputable. So, then, what you are really doing is having a discussion about where the burden is falling. The burden from monetary policy will fall on some parts of the economy and the burden from fiscal policy tightening will fall in different ways. And the composition of how you achieve your fiscal tightening will be just as important as the aggregate amount of fiscal tightening. So there is no simple trade-off.

Senator CORMANN: So, Dr Parkinson, you believe that there was no wasteful spending at all and that there could have been cuts without harming the economy?

Dr Parkinson: No. With all due respect, you are setting me up.

Senator CORMANN: I am not trying to set you up. I am asking you a question.

Dr Parkinson: You are going back into history. I am saying that where we are today, going forward—

Senator CORMANN: History is part of the budget too.

CHAIR: I think that Dr Parkinson was trying to make a point and trying to respond to your question.

Dr Parkinson: With all due respect, I think it was more of a political statement on the senator's part, so I will pass on whether I believe there was any waste.

Senator CORMANN: Dr Parkinson, sorry, also with all due respect, it is not a political statement. It is a genuine question. Do you think that there was no further scope to reduce spending in this budget without damaging the economy?

Dr Parkinson: I said in the ABE speech, and Dr Gruen has just used similar language now, that it is our view that further significant—and that is the word that I emphasise—consolidation would put the economy at risk.

Senator CORMANN: So there is no room for further moderate consolidation?

Dr Parkinson: There is always scope at the margin, but the sorts of consolidations that would not induce additional risk into the economy are not going to alter the future path of interest rates. I think that that is the critical issue.

Senator CORMANN: The fiscal consolidation in 2010-11 is projected to be 0.7 per cent, and I think that you have said that this was always in a retraction from GDP growth of one per cent in 2010-11. That is a pretty high multiplier. How do you come up with that?

Dr Gruen: I think that the number that you quoted was the payments growth.

Senator CORMANN: Yes.

Dr Gruen: There is action on both sides of the budget. So the fiscal position improves both because payments are being restrained and also because the flood levy and various other things raise revenue and will have some impact on economic activity. So there is action on both sides of the budget which is tending to contribute to slowing economic growth.

Senator CORMANN: Dr Parkinson, we did actually all read your speech in great detail and with great interest. I know that you have said something similar to what you said just now, that your own sense is that doing significantly more to tighten fiscal policy in the short run would inject another risk—that of slowing the economy excessively—and could undermine the prospects of achieving the promised fiscal consolidation. But your own budget forecasts assume that interest rates 'move broadly in line with market expectations' and those market expectations, of course, incorporate a number of interest rate rises over the next two years, don't they?

Dr Parkinson: The market has expectations of further tightening in monetary policy, yes.

Dr Gruen: Just to confirm, it would have been the interest rate expectations at the end of April, roughly, because that was obviously when we put the budget together.

Senator CORMANN: Okay. But given that the RBA's interest rate decisions will ultimately determine how much slowing the economy experiences, how can you say at the same time that a tighter fiscal policy would slow the economy excessively? Because if the mix was more on the fiscal than on the monetary side—

Dr Parkinson: You are assuming that if we were to tighten at the margins on fiscal policy that would change, at the margin, monetary policy. What I am saying to you is that the trade-off here is much grosser than that. You cannot finetune these things. That is the whole reason why we have been through 20 years of improving fiscal frameworks, independence in monetary policy and the like.

Senator CORMANN: No, independence of the RBA is very important.

Dr Parkinson: But essentially to assume that we can manage those trade-offs assumes greater capacity, with all due respect, with colleagues in Martin Place—

Senator CORMANN: But there is a relationship, isn't there?

Dr Parkinson: than they have or that we in Parkes Place have. We just can't do it.

Senator CORMANN: But having said all of that, fiscal policy settings clearly do have an impact on the job that the RBA might feel it has to do in the context of monetary policy.

Dr Parkinson: At a conceptual level, yes. At a practical level, the question is how much would any change in fiscal policy impact on monetary policy. I am saying to you that the sorts of changes that would be required in fiscal policy to change the path of future monetary policy would have to be very, very large. And in that case, all you are doing is redistributing the contractionary effects in a different way across the economy.

Senator CORMANN: Is part of your judgement, given the focus on the so-called two-speed economy, that a mix of looser fiscal policy—as I describe it and you say at the margins—than it could be and higher interest rates, and hence a higher Australian dollar, is better than a tighter fiscal policy and lower interest rates with a correspondingly lower Australian dollar?

Senator Wong: Sorry? What is the suggestion?

Senator CORMANN: Obviously higher interest rates are one of the things that drives into a higher Australian dollar.

Senator Wong: Senator, you know that governments don't set exchange rates.

Senator CORMANN: I know that totally. Of course I do. But I also know that your fiscal settings flow through the rest of the economy.

Senator Wong: So what is the proposition? Yes, but fiscal settings aren't driving where the dollar is.

Senator CORMANN: Well, that is what you are saying, Minister. I am not sure.

Senator Wong: The dollar, I would have thought, is more a function of where the global currency price is.

Senator CORMANN: Yes, sure.

Senator Wong: That is in great part a reflection—although I can't speak for the markets—of the markets, where our outlook is and where our terms of trade are, which, as you rightly pointed out, are at very high levels.

Senator CORMANN: Minister, there is a whole series of things that feed into the currency.

Senator Wong: I am just making the point that your proposition makes a whole range of assumptions, Senator. One of them is that government somehow can change the exchange rate by changing fiscal policy.

Senator CORMANN: No, that is not what I said, Minister.

Senator Wong: Well I am sorry, I thought that that was the assumption in the way you framed the question.

Senator CORMANN: No, that is not the assumption. The assumption is that there is a whole range of things that feed into economic developments. There are various things that feed into interest rates, and there are various things that feed into the level of the Australian exchange rate. Clearly the terms of trade is a very important factor, but our line of questioning here goes around the impact of fiscal settings on monetary policy, and ultimately the impact of monetary as one of the contributing factors on the value of the exchange rate. Given that

our interest rates are significantly higher than they are in comparable countries overseas, principally the US, clearly there is a relationship there. And I do not think that anybody would argue with that proposition conceptually. The question is to what degree this is something that Treasury is keeping an eye on in that context.

Dr Parkinson: Senator, as I have said to you, conceptually you are correct. The issue is actually a matter of practicality. There has been work done in Treasury in the past on some of these implications for interest rates of changes in other policy settings. Work by Blair Comley, the Secretary, Department of Climate Change and Energy Efficiency. There was also a more recent paper, which Mr McDonald can help with.

Mr McDonald: An update of that paper was done by two of my staff—Dr Yong Hong Yan and Dr Shane Brittle. It was published as a working paper.

Dr Parkinson: To give you an example: in the long run, this work finds that a percentage point of GDP increase in the stock of Australian government net debt increases the interest margin by three basis point—so three one hundredth of a per cent. Given that we are in a world where we have Commonwealth debt peaking at about 7 per cent of GDP, you can see that the sorts of numbers that you would have to begin engaging, in terms of a fiscal consolidation, to dramatically change the outlook for the pathway of monetary policy would have to be huge. In that situation, the parliament would have to consider a set of decisions around revenue increases—and let's be blunt—significant tax increases or very dramatic expenditure reductions, were the parliament to have any chance of being able to tighten fiscal policy sufficiently to influence the pathway of monetary policy. Now, I am not saying that deficits don't matter; quite the contrary, they do. That is the whole point about the emphasis on the speed of the fiscal consolidation. I am agreeing with you entirely on the conceptual point that you are making. I am just saying that as a matter of empirics and practicality, we cannot fine tune to the extent that you are suggesting.

Senator CORMANN: Thank you, Dr Parkinson. Budget Paper No.1 shows a medium term projection—that is, beyond the forward estimates—for net debt to be repaid by the end of this decade. However the budget surpluses through the forward estimates are actually relatively small, and if continued would obviously not be sufficient to eliminate the debt as projected. What annual surpluses are you assuming in order to justify the assertion in the budget paper.

Senator Wong: Can you just reference where in Budget Paper No. 1 you are looking, Senator.

Senator CORMANN: I am sure that it does not take you by surprise. The Prime Minister is on record as having said it a couple of times and it is actually mentioned in the budget papers.

Dr Gruen: Senator, I can give you an answer to that question.

Senator CORMANN: So you can tell me what the expectation is in terms of budget surpluses beyond the forward estimates.

Senator Wong: So it is the medium term fiscal outlook on page 3-25.

Dr Gruen: You can actually find the answer to your question on page 3-25.

Senator CORMANN: So what surpluses are required? Talk me through it.

Dr Gruen: Just to explain how this chart has been calculated, obviously it uses the forward estimates and then beyond the forward estimates we use intergenerational report-style modelling going out for the next 10 years. So it is not program by program detailed analysis out that far. It is an attempt to do what we do in the intergenerational report, which is to look at broad trends.

Senator CORMANN: But in order to make the assertion, which this graph makes, that net debt will be paid off by the end of the decade, you have to make some assumptions around what the surplus is going to be as a share of GDP—

Dr Gruen: And that is the chart above. Chart 3 on page 3-25.

Dr Parkinson: And directly above that it says, ‘On current projections, it is expected that the budget surplus will reach 1 per cent of GDP in 2017-18.’

Senator CORMANN: And what would that be in dollar figures?

Senator Wong: It depends what GDP is.

Dr Gruen: GDP by then is going to be of the order of \$2 trillion.

Senator CORMANN: So what will be the surplus?

Dr Gruen: In the order of—if I can get that right—about \$20

Senator CORMANN: A surplus of \$20 billion.

Dr Gruen: About that. Don’t hold me to this. We have an economy of \$1.3 trillion and it is growing in nominal terms by about five per cent a year. So we are talking about only five years of that, so maybe 16 or 17 billion might be closer—but we are talking about that sort of order of magnitude.

Senator Wong: That is at a point in time—17, 18 and one per cent. It is a rough calculation that he has just done. It is not a cumulative figure.

Dr Gruen: No, it isn’t.

Senator CORMANN: So essentially by 2017-18, in order to be consistent with this aspiration of repaying net debt by the end of the decade, we would be looking at a \$20 billion surplus—roughly.

Dr Gruen: In the order of \$15 to \$20 billion.

Senator CORMANN: In the order of \$15 to \$20 billion, and one per cent of GDP.

Dr Gruen: Yes.

Senator CORMANN: When was the last time a Labor government ran a surplus of one per cent of GDP?

Dr Gruen: Well, it is in the table, Senator.

Senator CORMANN: Yes.

Dr Gruen: It is in the table. The underlying cash balance in 1988-89 was 1.5 per cent of GDP and in 1989-90 it was 1.5 per cent of GDP.

Senator CORMANN: That is about what?—22, 23 years ago?

Dr Gruen: Before the early 1990s recession.

Senator Wong: Prior to the recession.

Senator CORMANN: The government estimates that the NBN will cost \$35.9 billion, but some industry experts have suggested it could cost twice that amount. If the cost of the NBN is higher than budgeted, then presumably the government's equity injections into the NBN would also have to be higher, requiring additional government borrowings. Would this compromise the projected repayment of net debt by the end of this decade? If the government is working on the basis that the NBN is going to—

Senator CAMERON: A scare campaign—

Senator CORMANN: cost \$36 billion. Industry experts are suggesting that the average would lead to a need for higher equity injections. That means higher borrowings—

Dr Parkinson: Senator I am having difficulty—

Senator CORMANN: I am trying very carefully—

Dr Parkinson: I am having trouble hearing. The combination of bells and—

Senator CORMANN: Obviously, the question I am asking about in terms of where that debt is likely to be by the end of the decade depends on how some of the major measures requiring government borrowings are going to track moving forward. There is a lot of commentary from industry experts that the NBN will cost way more than \$35.9 million; in fact, twice that amount—

Senator Wong: Well, Senator—

Senator CORMANN: How is that—

Senator Wong: You cannot ask him that, as the Secretary of Treasury. Senator, I have let this go, but some of these questions should have been asked of the Fiscal Group, as opposed to—

Senator CORMANN: Please, Minister!

CHAIR: No, Minister. We have indicated that we would have wide-ranging questions this morning.

Senator Wong: I understand that, Chair, and Dr Parkinson can do a very good job, as I am sure he will, but—

Senator CORMANN: That was the understanding, Minister.

Senator Wong: I am making the point that this is the macroeconomics.

Senator CORMANN: I understand that.

Senator Wong: Dr Parkinson said he would take additional questions on fiscal. The other point I am making—and this is more salient—is that I do not think you can ask a public servant to comment on what other people in industry say might happen to a government project.

Senator CORMANN: I can ask the Secretary of the Treasury about downside risk to the budget—absolutely. There is an assertion in the budget that the government net—

Senator Wong: But not on the basis of hypotheticals.

Senator CORMANN: debt is going to be paid off by the end of the decade.

Senator Wong: Hang on! They are different questions.

Senator CORMANN: There is a major infrastructure investment, which requires equity injections—

Senator Wong: Senator, can you stop talking for a minute so we can finish one point before we go to the next one please?

Senator CORMANN: Do not show your hand to me. You are being very condescending.

Senator Wong: No. I am asking if we could just deal with things in order.

Senator CORMANN: I am getting the hand treatment now, Minister, am I?

Senator Wong: No. I am just asking you—

CHAIR: Senator Cormann, if we could do things one at a time. Minister?

Senator Wong: Thank you. If we could just deal with one thing at a time. I understand you are asking Dr Parkinson two things. This is before you go on about mining investment, et cetera. You are asking him first about the impact on net debt; the net debt position of the NBN. If he can answer that, that is a perfectly legitimate question. You then roll it into a question which was essentially a range of assertions about the costing of the NBN, and then, assuming that those costings are wrong and assuming that what other people say is right, you ask him to comment on the effect on the budget. That is a hypothetical question and it is not appropriate. If you want to make a political proposition about the costing of the NBN, you make that. It is not a question for Dr Parkinson.

Senator CORMANN: Minister, I will put the question again. I am asking a very legitimate question about the downside risk for the budget in terms of the statement in the budget that the government net debt is going to be repaid by the end of the decade. Clearly, there is a significant infrastructure investment on the table, which is off budget, which requires significant equity injections—that is, government borrowings. Obviously, that is going to be directly relevant to whether or not the government is going to be able to meet its expectations in the budget papers to pay off government net debt by the end of the decade. I am interested to know, given that industry experts have raised serious doubts about the costing of the NBN—

Senator Wong: You cannot ask this.

Senator CAMERON: There is the expert. An economist—

Senator CORMANN: what the implication of that would be for the government being able to achieve its target of paying off net debt by the end of the decade? The question makes sense.

Senator Wong: No, Senator, you cannot do that.

Senator CORMANN: You are very touchy when it comes to this subject.

Senator Wong: No, I'm not touchy, Senator. I just do not think it is fair to put public servants in the position of—

Senator CORMANN: How about you let the Secretary answer the question?

Senator Wong: responding to political questions.

Senator CORMANN: It is not a political question.

Senator Wong: It is. You are saying: ‘Please, Secretary of the Treasury, take as read a range of industry views’—which you are not referencing—‘and assume those and tell me what the effect on the budget would be?’ It is not a fair question. It is a hypothetical

CHAIR: Senator Cormann, would you like to rephrase your question?

Senator CORMANN: Okay, Madam Chair. I do not understand why it is not a fair question.

Senator CAMERON: You can get Barnaby to help you.

Senator CORMANN: It is entirely fair to ask the question. I am sure that Treasury Secretary would be very eloquent and very capable of answering the question. Clearly, the assertion in the budget that the government net debt is going to be paid back by the end of the decade is based on a series of assumptions about what the borrowings are going to be in the context of major infrastructure projects such as the NBN. I want to understand how credible the assumptions are that have been used to cost the borrowings that are going to be required to fund the equity injections for the NBN in the context of industry experts saying that the NBN is likely to cost twice as much as the government has told us it was likely to be.

CHAIR: Senator Cormann, you can ask about the effect on the budget of the current costings of the NBN and you can ask a second question about what happens if the costings are higher. The minister's point is that you cannot—

Senator CORMANN: Why do we not let the Secretary answer?

CHAIR: put them together.

Senator CORMANN: Why do we not let the Secretary answer—because I know what the current impact is going to be.

CHAIR: I will ask Dr Parkinson perhaps to address the first part of the question first.

Senator CORMANN: The first part is in the budget papers. We know what the first part is going to be.

CHAIR: If you could put more clearly the second part of the question, rather than leaving it as a nebulous—

Senator CORMANN: It is not nebulous at all. I would like to know what the level of downside risk is going to be in the context of the very likely chance that the cost of the—

Senator Wong: At last! There is the problem.

CHAIR: This is the hypothetical.

Senator CORMANN: Is there something in contingency reserve for this, for the cost over-run on the NBN?

Senator Wong: I am not trying to be difficult—

Senator CORMANN: Well, you are being difficult, Minister.

Senator Wong: You always say that, Senator. If you thought I was being a pushover, then we would probably have a problem. If you put the question in the way the chair described it to you, I do not think I could reasonably interject and object. That is not what you are doing. You are asking him to take as read a ‘very likely’—to use your words, which we do not accept.

Senator CORMANN: I am not asking him to take it as read. He can dispute it, Minister. Dr Parkinson is very—

Senator Wong: That is not up to him. You should not be putting that. You can put that to me, or to Senator Conroy in different estimates. You should not be putting that to public servants.

Senator EGGLESTON: Why can he not put forward various scenarios?

Senator CORMANN: I think that the Treasury's Secretary, in putting the budget papers together, would be very interested in whether the assumptions at the basis of it, are sound and reasonable. He would probably be able to give me a very good explanation as to why he is satisfied.

CHAIR: But then, Senator Cormann, it belongs in a different estimates.

Senator CORMANN: No, it does not.

CHAIR: It belongs in the question about the budget estimate for NBN—not here.

Senator CORMANN: No, it does not. It has an implication for the assertion that we are going to pay back debt by the end of the decade.

CHAIR: Senator Cormann, I think it is clear we are not going to get anywhere here.

Senator CORMANN: We have not even given Dr Parkinson a chance to say something.

CHAIR: No. Because the question is being ruled out of order because it is hypothetical.

Senator CORMANN: What? It is not hypothetical.

Senator CAMERON: It is.

CHAIR: It is. That is my ruling.

Senator EGGLESTON: It is a series of discussions of scenarios.

CHAIR: Could you either rephrase the question or move on to the next topic.

Senator CORMANN: How confident are you, Dr Parkinson, of being able to reach the projected paying off of government net debt by the end of the decade, given the risks associated with the investment in the NBN?

Dr Parkinson: Senator, I think the way to answer this is to say that lots of things can influence the capacity to pay off net debt by the end of the decade. Were we to find that the economy grew faster, or that terms of trade were stronger so incomes were stronger, or that firms did not draw down the large stock of accumulated losses that we anticipate they will draw down, everything else being equal—and this is the caveat—the budget position would be healthier all the way through, surpluses would be larger and ipso facto the net debt would be paid off quicker. If, on the other hand for whatever reason, government were to find itself in a situation where interest rates were higher, outlays were larger, revenues were weaker, or other investments that were off balance sheet were different to what they had assumed, then you could have higher levels of net debt and hence take longer to pay it off. You would have to be very careful about working out if it was because the budgetary position was different, whether this was a temporary phenomenon or a permanent phenomenon and, if it was temporary, whether it was simply a timing issue; that is, a deterioration this year was offset by better outcome next year. There are lots of things that will influence it. How confident are we? We make the best projections that we can on the information available to us.

Senator CORMANN: Thank you very much, Secretary. I very much appreciate that answer which, as I expected, was as usual very eloquent. Secretary, the return to surplus—

Senator Wong: Senator, if I may—

Senator CORMANN: Are you going to comment on me complimenting the Secretary on his eloquence now too?

Senator Wong: No. I just wanted to perhaps be of assistance, to say that the one per cent surplus is one of the touchstones in the government's fiscal rules. The commitment the government has given in the range of fiscal rules that we have articulated publicly over two budgets, and delivered on in this budget, is that once the budget returns to surplus, and while the economy is going at or above trend, it will retain the 2 per cent cap on average until surpluses are at least one per cent of GDP. It is, I suppose, an anchor is one way of describing it—one of the touchstones of the fiscal strategy.

Senator CORMANN: Thank you, Minister Wong. Dr Parkinson, the return to surpluses appears to be critically dependent on the terms of trade remaining at close to 140-year highs. Looking at the budget papers, only a relatively small four per cent decline in the terms of trade from that forecast in the budget would eliminate the estimated amount of surplus in 2012-13 and 2013-14. Would it be more prudent to assume a sharper reduction in the terms of trade as the budget's central forecast, given that the current terms of trade are at a very rare and exceptionally high level?

Dr Parkinson: I think that goes to one of the central questions confronting Australia. We are faced with a once-in-a-lifetime shock to our economy. Were we to assume that this was not permanent, how would you then run policy, assuming that you could? Clearly, if you ran tighter fiscal policy as a result you would have to ask yourself the question: to what end? If you thought that this was a purely temporary phenomenon, that would be a sensible thing to do. If you thought this was going to last a couple of years then there would be a strong case for trying to run tighter fiscal policy and boost national savings and then draw that down over time. Take the other extreme: this is permanent; that is, it is at this level forever and a day. Then that would be quite an odd thing to do because the entire wealth of your economy is lifted up and you are saying, 'Let us pretend we do not actually have all of that wealth.' The situation we are in is that we know we are going through a major transformation of the global economy. We are benefiting from that. Our belief is that that is going to be very, very long-lived. That is why we are taking down the terms of trade by around 20 per cent over 15 years in the projection period.

Will that be the right number? Who knows? To say that we will face dramatically lower terms of trade on a permanent basis from the near term has to assume that the massive transformation in the global economy stops. It could. Wars can do that—different things. Revolutions can do that—but revolutions in multiple countries would be required. Unless you are prepared to start forecasting those sorts of things, then you may as well assume that the terms of trade are going to stay high. Then you are in the world of saying, 'Should I run it down by 20 per cent over 15 years, 20 per cent over 10, 20 per cent over 20, or not at all?' Frankly, we are just trying to make a conservative assumption.

Senator CORMANN: But you do not actually—

CHAIR: Senator Cormann, we—

Senator CORMANN: I have just started on terms of trade. Might I just finish? There are two or three questions.

CHAIR: We are at the morning tea break. You can resume after morning tea break.

Senator Wong: We are all conchie and we just want a cup of coffee.

CHAIR: Yes, exactly.

Proceedings suspended from 10:16 to 10:31

CHAIR: We will make a start again. We are continuing with the Treasury macroeconomic group, and Senator Cormann was continuing.

Senator CORMANN: Before the break, Secretary, you talked about—I do not mean to verbal you; it is just because it was 15 minutes ago—a dramatic reduction in the terms of trade not being justified. Is that a fair representation of what you said?

Dr Parkinson: Yes.

Senator CORMANN: Nobody is talking about dramatic in the short term, but you do not have to assume a dramatic reduction in terms of trade before there is an impact on the expected surplus by 2012-13 and 2013-14. What is the basis for the assumptions on the terms of trade in the budget; and why have you picked the assumption that you have, which is a 20 per cent reduction over 15 years?

Dr Gruen: Obviously, we are not the only ones making forecasts for the terms of trade. Our forecasts over the next few years are pretty much in line with those of the RBA and they are lower than consensus forecasts and lower than the forecasts that you can derive from the commodity price forecasts that ABARE produces. So we would characterise our terms of trade assumption as conservative. If you go back to before we had this big run-up in the terms of trade, we used to simply forecast that the terms of trade stayed at the level they reached at the end of the forecast period. We have moved away from that assumption because we recognise that global demand has risen very strongly and supply has not had time to catch up. So for a long time we have been building into our forecasts a trend decline in the terms of trade, which we think is a reasonable and prudent thing to do—and that is why we do it. But we would be the first to recognise—we make this point in every budget—that there is a margin of error around these things; there is no question about that. I think we make a specific statement along those lines in budget statement No. 2—that there is no question that there is a margin of error. This is duelling budgets here. So we say in budget statement No. 2 that there is a range of risks. The high terms of trade also present risks. While the terms of trade are expected to remain at historically high levels, the prospect of heightened volatility and large adjustments becomes more significant the further away prices for Australia's key non-rural commodity exports are from sustainable long-run levels. So it is our central forecast, but we recognise that there are risks.

Senator CORMANN: By how much did you upgrade your terms of trade expectations in this budget?

Dr Gruen: Relative to MYEFO?

Senator CORMANN: Yes.

Dr Gruen: I have the precise numbers. In the current year, it is of the order of five per cent and then, in subsequent years, not all of that is given back.

Senator CORMANN: Is it significant to have that sort of upgrade in a six-month period in your expectations regarding terms of trade?

Dr Gruen: Nothing like as significant as the upgrades that we experienced every six months from about 2005 to 2008.

Senator CORMANN: But that was a particular period.

Dr Gruen: It was. But we had that period in which our terms of trade forecasts right across the forward estimates went up very much more substantially than has happened this time.

Senator CORMANN: You say that there is a margin of error. Can you quantify that margin of error?

Dr Gruen: In the budget papers we do not quantify the margin of error. Obviously there is a margin of error that is smaller in the near term and bigger further out—that is certainly true—but we have not quantified it, no.

Senator CORMANN: What is the margin of error in the final two years of the forward estimates?

Dr Gruen: We have not quantified that.

Senator CORMANN: But you must have an internal sort of margin of error that you work with. You said that it is not published in the budget papers, but that does not stop us from asking about it.

Dr Gruen: We have done analysis on this, but I do not have a number like that. I made the qualitative statement that the margin of error rises through time, but I do not have that to hand.

Senator CORMANN: So it is smaller in the early years and it goes higher in the latter years. So clearly we have a reasonable expectation over the next 12 months as to what is likely to happen.

Dr Gruen: Yes.

Senator CORMANN: Of course, the further you go, the less accurate your forecast is going to be. That is not a criticism; that is just the nature of life.

Dr Gruen: In fact, we have stopped calling them forecasts.

Senator CORMANN: You call them 'projections' now, I understand.

Dr Gruen: That is right.

Senator CORMANN: When we talk about a margin of error, are we talking about two, three or four per cent? I am trying to get a handle on the scope of your margin of error.

Dr Gruen: It is precisely because we do not think that we can forecast that far out that we do something a bit different. On economic growth, we have stopped trying to forecast beyond the forecast period and simply use trend growth. For unemployment, we assume that it returns to the NAIRU. But for the terms of trade, because we are in these unusual times we have built in some conservatism. So this is our best estimate in order to produce the fiscal accounts. Do you want to add something to this, Simon?

Mr Duggan: I have just one point to make. You have referred, Senator, to the change in our forecast from the MYEFO to the budget and Dr Gruen referred to the four per cent figure.

In between times we have had the floods and the cyclones, which had a very substantial impact on coal prices in particular. So, if the inference is that the change in our forecast from MYEFO to budget in any way gives you a guide as to the variability of the terms of trade going forward, I would just make the point that we had a very wrenching natural disaster and that had a very big impact. We do not forecast those things to happen in the future. So it is very difficult to know from this point what the variability of the terms of trade forecast would be, which is precisely why we have the qualitative statement that we do and couch this as a risk rather than a quantitative estimate of what that variability might be.

Senator CORMANN: Sure, you couch it as a risk. You have variability on the upside in a six-month period between MYEFO and the budget and then you base your forward estimates and your projections over the budget forward estimates on very high terms of trade continuing and say that, the further you go forward, the more the margin of error grows larger. Then I look at a variation of five per cent on the upside and I see that a variation of less than that, four per cent down, would essentially do away with the surplus. I am just trying to get a sense as to how robust your forecast is.

Dr Gruen: Can I make a comment about our sensitivity analysis? Over time we have made this analysis more sophisticated, but it remains limited in an important sense. So the sensitivity analysis we publish in the budget to do with a possible four per cent decline in the terms of trade assumes—we make this very clear—that it is not offset at all by any change in the exchange rate or interest rates. As we were discussing earlier today, there is a strong link between the terms of trade and the exchange rate, so we think it is likely that the exchange rate would come down—therefore, the effect on the underlying cash balance would be smaller than we have published. In response to that comment I can imagine you saying, 'Well, then why don't you do that?' Why don't we build in the exchange rate?

Senator CORMANN: That is a very good question, Dr Gruen.

Dr Gruen: I thought you would be interested in the answer. As I said, doing these sensitivity analyses is a complicated exercise and in future we may build in further sophistication. But there is a real question about how far you want to take this. In other words, if we were to also build in a change in the exchange rate, should we also assume that there would be a change in interest rates? How complicated do we want to make this scenario? Where we are at the moment is that this sensitivity analysis is significantly more sophisticated than it was, let us say, five years ago—we did not do sensitivity analyses of this depth—but it may be that we should think about further refining the sensitivity analysis.

Senator CORMANN: You raise a very good point because your expectation around the terms of trade then also drives what your expectation is going to be in terms of the exchange rate, which drives flow-on consequences in terms of the expectations of other aspects of how the economy is going to perform.

Dr Gruen: Yes. There is a subtlety there, too. Over the forecast period, we just assume the exchange rate stays where it is. I can explain why we do that. Our forecasts are similar to other people's forecasts which are in the public domain, so we presume that the market is aware of them and has already moved the Australian dollar to where it thinks it is consistent with where the terms of trade are likely to be in the near term. So that is the logic of what we do. Beyond the forecast period—as we have been talking about, we have a long-term trend decline in the terms of trade of 20 per cent over 15 years—given the strong relationship

between the terms of trade and the exchange rate, we thought it was more consistent for us to build in the empirical relationship between the terms of trade and the exchange rate over the projection period, and that is precisely what we have done for the first time in this budget. So we build in a gradual decline in the exchange rate over the projection period because we think it is an improvement on our previous methodology.

Senator CORMANN: How accurate have your forecasts of the terms of trade been in the past? We know that MYEFO obviously underestimated them. But if you look at the last four or five budgets, how accurate do you usually get your terms of trade expectations?

Dr Parkinson: Rather than putting Dr Gruen on the spot, I think there have been two interesting periods in Treasury's forecasting history.

Senator CORMANN: I am trying to assess how much credibility—

Dr Parkinson: Yes. There was one in the early 1990s, when inflation started to come down and we did not believe it and we kept overestimating inflation. The second was in the period since 2003 on the terms of trade where we have chased them up.

Senator CORMANN: Hopefully, you will not be chasing them down, though.

Dr Parkinson: No. I do not have any great fear that we will be chasing the terms of trade down in a long-term sense. We are always at risk of short-term volatility. I am sure that the committee has discussed this in the past. There has been mention of revenue surprises in the region of \$334 billion during the period from 2003 onwards basically linked back to the terms of trade being underestimated. We have to do a bit of a mea culpa here because, notwithstanding Treasurer Costello's best efforts, \$314 billion of that money was spent. How it is spent is important. I am sure that, if we had known in 2003 what was to play out, Treasurer Costello would have been better armed to get some of the reform he may have wanted. So it is something we are very conscious of because it is not just a case of getting forecasts wrong, with implications for the budget bottom line; to the extent that we get these things consistently wrong it does restrict the ability of governments to be forward looking and visionary in terms of some of the things they might want to do. So we are very conscious of this issue.

Senator EGGLESTON: A 20 per cent decline in the terms of trade is a major decline and must indicate some structural change. Where do you see the decline occurring? Is it in mining exports, or other parts of the economy? Do you think it might be related to the development of iron ore in West Africa?

Dr Parkinson: The terms of trade are just the price of our exports over the price of our imports.

Senator EGGLESTON: I know. Do you think the price of iron ore will drop because of competition, for example, coming from West Africa?

Dr Gruen: We have built into our forecasts the idea that global supply, which would include West Africa, will grow. Therefore, our terms of trade forecasts embody a gradual decline in the price of iron ore and other commodities. You ask the question: are the sustained high terms of trade generating structural change in the Australian economy? The answer is that they very much are. Our modelling suggests that that will continue over the next decade. Given our terms of trade forecasts, our estimates are that the trend of structural changes we are seeing in the Australian economy—which are declines in the share of the economy of

manufacturing and other trade-exposed industries; we have seen significant declines in those industries over the recent past—will continue, if not accelerate, over the next decade.

CHAIR: Have you finished, Senator Eggleston?

Senator EGGLESTON: I think the Secretary is just going to add a comment.

Dr Parkinson: Perhaps I could add to what Dr Gruen has said. The increase in world supply does not have to come from outside Australia. Our terms of trade can be pushed down by an expansion of supply within Australia. So the very large expansion of supply that is occurring in WA in iron ore and in Queensland in coal and gas will have just as much an impact on global prices as if that gas comes from Qatar or the iron ore comes from West Africa.

Senator Cameron interjecting—

Dr Gruen: Can I make a response to Senator Cameron's point? Structural change is always a difficult thing for societies to deal with, but it should be much easier in an environment with low unemployment than it would be in an environment with high unemployment. So, given that Australia is facing this significant structural change, I think it is significantly easier—it is not pleasant for the people involved—given that there are alternative employment opportunities elsewhere in the economy.

Senator PRATT: I want to ask some questions, connected to the terms of trade, about the dollar. I think you have said that Treasury's forecasts are consistent with those of the Reserve Bank and other commentators. I do note that they are considerably different from the forecasts that the Western Australian government put in its budget. It painted in its budget papers a fairly optimistic outlook for the economy, not inconsistent with the critique you have put forward this morning, and yet they have forecast the dollar in 2014 being at US76c. If we did get to the Australian dollar being worth US76c, what would the economy look like? Would it fit with an optimistic view of the world?

Dr Gruen: I think we would have to ask the question why the dollar had got to 76c. If the dollar had got to 76c because the Australian dollar had weakened against all currencies, that would, for example, probably reflect a collapse in global commodity prices. If, on the other hand, the Australian dollar had got to US76c because the US had recovered and it had just picked up, that would be very positive for global economic activity. So it would depend very much on what were the underlying drivers. Can I make an observation, in passing, on WA?

Senator PRATT: Yes.

Dr Gruen: As Mr Ray may have discussed yesterday, we understand that WA has used higher commodity prices in some areas than we have and a significantly lower dollar. While that is not the way that we would do our forecasts—

Senator PRATT: Why not?

Dr Gruen: Because we do them in a way which we think is internally consistent. We have always said that the WA government has to make its own decisions about how it prepares its forecasts. So I do not want to say anything here that suggests that they have done anything wrong. It has made a set of assumptions—

Senator PRATT: They are assumptions that conveniently prop up the bottom line of their budget.

Senator Cormann interjecting—

CHAIR: Senator Cormann, please!

Senator PRATT: No; but I think you will find that Treasury has been historically far more accurate than the state government with these questions.

Dr Parkinson: Can I just respond to Senator Cormann? We are on the public record with the reason why we do not publish these numbers. We do not publish them because they are confidential and drawn, in part, from discussions with business. So they are commercial-in-confidence and it is not our intention to change that.

Senator CORMANN: I do not accept that because—

Dr Parkinson: It was the same under the previous government.

Senator CORMANN: the government is—

CHAIR: Senator Cormann, you have had over two hours of questioning and Senator Pratt—

Senator PRATT: I would say that, because you go about creating your numbers in that way, it has made them historically more accurate perhaps than those of states like Western Australia. What kind of variation would we have seen in our numbers?

Dr Parkinson: I stand to be corrected, but I am not aware that we undertake an exercise of assessing the validity of our forecasts against those of any state.

Senator PRATT: No; but it would be an interesting exercise, given that it is my understanding that our figures have been historically far more accurate than the figures of the Western Australian Treasury. Does the assumption regarding the dollar impact on revenues? We had some discussion of this in the previous groups. WA, if its assumption of the dollar is not correct and it does not raise as much revenue as it says it will, in terms of our own terms of trade and dollar value, where are our exposures—given that we have the whole of the economy in terms of our revenue raising capacities? A high dollar versus a low dollar does what for our revenue? I should have asked this of earlier groups; I do appreciate that.

Dr Parkinson: There are two issues. One is what the impact is on the broad economy and the other is what the specific impact is on outlays on revenue and, hence, net terms on the budget.

Senator PRATT: Yes.

Dr Morling: I might answer at least part of that. A higher exchange rate is contractionary on the economy but, as Dr Parkinson was saying earlier, it depends on where the impulse has come from that caused the exchange rate to be at that level in the first place. So we feed the impact of the exchange rate on the broader economy through a whole range of channels. It affects the propensity to import goods. It affects the cash flow. It affects the payments on external debt. So it has broad impacts broadly through the economy.

Senator PRATT: So it is contractionary in a general sense in government revenue terms, the higher the dollar is for us at a Commonwealth level as well as for a state like WA in general terms?

Dr Morling: All other things being equal, a higher dollar will be more contractionary for the economy than a lower dollar, so a weaker economy would feed through into a lower

revenue stream. But you have to take that step backwards, which I mentioned before, and look to see what the impetus was. For example, if the dollar is higher as a result of higher terms of trade, we get the positive influence on the economy and revenue through that channel, which then is partly offset by the contractionary response of the dollar, which then takes some of that out.

Dr Parkinson: Going back to your WA point: to the extent that mining company profits might be specified in US dollars, if the Australian dollar is weaker and everything else is set in US dollar terms, then that will have obvious implications for the dollar-A value of those company profits. It will push up the dollar-A value of the same US dollar amount.

Senator PRATT: In terms of the motivation for how we forecast the dollar and what that does to our bottom line in terms of our national account forecasts, Treasury forecasts, versus what the state government is doing, I am still trying to get my head around the different factors and motivations as to what they can prospectively do to the bottom line of both budgets.

Dr Morling: I can say that, at least for the Commonwealth budget, our motivation is to try to have the most accurate set of information that we can have. There is a very large literature that says that it is very difficult to forecast the exchange rate over short time horizons. The reason is, as Dr Gruen has said, that the information is already incorporated—

Senator PRATT: So why would you just have it plunge by 30c over a short time horizon then?

Dr Morling: I think the Western Australian explanation they have published is that they take it back to some sort of historical average over that period. We have tried to align our medium-term profile for the exchange rate, not so much taking it back to some sort of longer run historical norm but to align it with where we think the profile for commodity prices will be, given that historically it seems to have lined up quite well with developments in terms of trade.

Senator PRATT: But, as I would understand it, it is also very convenient for the bottom line of their budget because it is about \$60 million per cent in royalty revenues that they receive the lower the dollar is.

Dr Parkinson: I have no idea about their budget, Senator.

Senator PRATT: Okay. It is just that it comes full circle for us because we have quite a significant national debate going on at the moment about where Western Australia sits in the Federation and how much it is taxed. But if it is frankly making up things that are not going to come to pass, then that has significant ramifications for the nature of that debate.

Dr Gruen: Senator, could I add something to what Dr Morling said. As he said, the way that the Western Australians do their exchange rate forecast is to bring it back to an average over a long period of time. They do that relatively quickly, over three or four years. Going back to something that Dr Parkinson said, our assessment is that the next 10 years do not look like the past 10 years, in the sense that we think that the Australian economy is in the midst of a long-lived change in the terms of trade.

So our view is that the appropriate way to think about the exchange rate is to not rely on long-run, historical experience because we do not think we are going back to that any time soon. Our terms of trade forecasts have the terms of trade for the next 10 years well above

their history over an extended period of the past. As various people have said, there is a strong relationship between the exchange rate and the terms of trade. So we think that the most defensible position is to argue that the exchange rate is likely, on average, to be well above its average over the past 10 years because we think the next 10 years do not look like the past 10 years.

As we have said, our terms of trade forecasts over the next 10 years are way above their average over the post-float period or over the pre-mining boom period. There is a very strong, empirically robust relationship between the terms of trade and the exchange rate. We think the appropriate forecasting assumption, or the appropriate assumption in the projection period for the exchange rate, is to tie it to the terms of trade rather than to some long-run past average.

Senator PRATT: Given that, it can be quite significant for the nature of the discussion that we have as a federation about the different revenue bases that are available to the states?

Dr Gruen: I do not have any comment on that.

Senator PRATT: To not take it from a political view, how do we deal with that from a good economic management policy position?

Dr Parkinson: One of the things that we have done historically is to utilise the Commonwealth Grants Commission, and recall that the antecedents of the Grants Commission are actually in Western Australia's threat in the past to secede. The Grants Commission basically has been a way of redistributing resources historically from the eastern states to the smaller states and to WA. Western Australia has grown dramatically now and is a contributor to the flows back to the smaller states. That horizontal fiscal equalisation principle that underpins the Grants Commission is one way of actually ensuring that that distribution of resources is evened out across the economy. There are other ways in which that happens. The exchange rate means that the benefits of the mining boom are distributed to consumers through lower import prices, even though they have very severe impacts on, for example—

Senator PRATT: There are a lot of Victorians and Queenslanders also working in Western Australia at the moment.

Dr Parkinson: That is true. But it does have very serious impacts on other sectors of the economy, for example, tourism and manufacturing.

Just going back to the Grants Commission, the Grants Commission will look at Western Australia's revenue-raising capacity relative to that of the other states and take that into account in the way in which it redistributes income. So to the extent that Western Australia 'makes a mistake' for whatever reason in its forecast today, the Grants Commission will see through that.

Senator PRATT: Good. I think that is the point that I wanted to arrive at. I think that is logically correct, despite the politics that have been bandied about on that discussion. As I understand it, one of the questions the Grants Commission now needs to look at, other than just the equalisation of resources across states, is states like WA can contribute a lot more to the whole of the nation provided they do have the capacity to continue to underpin their development. I think that is clearly one of the questions currently before the Grants Commission.

Dr Parkinson: It will come up in the context of the horizontal fiscal equalisation review being conducted by Mr Bruce Carter and former premiers Greiner and Brumby.

Senator PRATT: Thank you very much. Thank you, Chair.

CHAIR: Senator Cormann.

Senator CORMANN: Thank you, Madam Chair. I am looking at the macroeconomic implications of the budget measure in relation to small business depreciation, with accelerated initial deduction for motor vehicles, which the government has announced will take effect from 1 July 2012, where small businesses will be allowed to claim up to \$5,000 as an immediate deduction for motor vehicles. Given the measure provides a tax benefit to small businesses but does not begin until after the coming financial year, does Treasury foresee any risk to motor vehicle dealerships that small businesses will stop purchasing new vehicles during the coming financial year, especially in the second half of the year, to wait until the deduction comes into effect?

Dr Parkinson: I think that would be a question that would have been better directed to our Revenue Group colleagues, how they actually forecast the revenue collections—

Senator CORMANN: I am not asking about the revenue collection. I am asking about the impact of this.

Senator Wong: He is getting there.

Dr Parkinson: I am trying to get there—in a macroeconomic sense. It is not to diminish the size of the initiative but, in a macroeconomic sense, in a \$1.4 trillion economy, it is neither here nor there. We do not forecast in that way. We do not get down to that level of detail.

Senator CORMANN: We have seen these sorts of things in the past where government measures can have distorting effects on the market. And do not underestimate—we had this discussion yesterday with some of your colleagues—the enthusiasm of the Australian people to take advantage of a tax concession. For a tax concession being available over 12 months from now, for that to drive behaviour which will have an impact in an economic sense—

Dr Parkinson: At the margin, you are absolutely correct. We have a fantastic example of it in the introduction of the GST. To avoid the impact of the GST on building costs, people bid up demand for building services so much that they paid more to get their work done before the introduction of the GST than it would have actually cost them if they had waited until after the introduction of the GST. You can see that phenomenon through history, not just here but in lots of other countries.

Senator CORMANN: Why would you introduce a measure like this with a 12-month delay when it is going to have an impact on dealerships and businesses across Australia? It is potentially going to dry up—

Dr Parkinson: Senator, you are making a number of presumptions. Yes, it will have an impact at the margin. How material is that impact? I do not know.

Senator CORMANN: What is the definition of 'the margin'?

Dr Parkinson: It is imperceptibly away from where you are now.

Senator CORMANN: Except if you are a dealership that all of a sudden sees a significant drop in customers.

Dr Parkinson: Absolutely.

Senator CORMANN: It is not a marginal impact on them.

Dr Parkinson: No, but economically it is a marginal issue.

Senator CORMANN: Looking at it from Canberra, it is marginal?

Senator Wong: No, Senator, hang on.

Dr Gruen: You asked about the macroeconomic effect. That is the macroeconomic effect, looking at the macro economy, whether you did it from Canberra or anywhere else.

Senator CORMANN: Because at the macroeconomic level, a small dealership around the place and the impact it has on them does not really matter?

Dr Gruen: Sorry, Senator, you asked about the macroeconomic impact. We were trying to respond by giving you what the macroeconomic impact would be. That does not diminish individuals at all.

Senator CORMANN: You do not think the deferral effect would be significant?

Dr Gruen: Macroeconomically, no.

Senator CORMANN: What about microeconomically?

Dr Parkinson: For any individual dealership, you would have to have some sense of the number of people who were expected to make such a purchase in 2011-12 and who would be likely to delay it to 2012-13, the distribution of those people across the country, the relative competitiveness of your 'small dealership' vis-a-vis a large dealership, and the magnitude of that against developments in the total motor vehicle market. Frankly, it seems to me that all of that is going to get swamped by the macro-level changes in motor vehicle sales in Australia.

Senator Wong: If I could respond to the very political assertion that was made—

Senator CORMANN: Here we go! When I ask questions it is political, is it?

Senator Wong: You made a political—

Senator Cameron interjecting—

Senator Wong: Come on, Senator, I have been pretty quiet.

Senator CORMANN: I thought I had given you an incentive, Minister.

Senator Wong: No. I have been pretty quiet while you have not been political. But you made an assertion about the government's attitude towards small business. I will just make the point about what this is part of. This is part of—

Senator CORMANN: I did not make an assertion about your attitude.

Senator Wong: You did.

Senator CORMANN: I made an assertion about the potential consequences of a budget measure.

Senator Wong: You suggested that the government was distant from small business. I just want—

Senator CORMANN: I did not make an assertion—

CHAIR: Senator Cormann, can you let the minister finish.

Senator CORMANN: I did not make an assertion about the government's attitude to small business.

CHAIR: Senator Cormann, can you let the minister finish and then you can respond.

Senator Wong: Why do you keep interrupting me?

Senator CORMANN: Why do you keep interrupting me?

Senator CAMERON: Here comes the cavalry! You're okay—Barnaby's here to help you.

CHAIR: Minister, would you continue, please.

Senator Wong: Thank you. This is part of a number of measures from the previous budget, from recollection, as well as in this budget that you would need to consider. First, the government is abolishing, consistent with the Henry review, the entrepreneurs tax offset. We made clear why we are doing that and the rationale for that, which the Treasurer has spoken about but is also contained in the Henry review, is that this is not a well-targeted and not a particularly efficient tax expenditure.

Second, the accelerated deduction that you are talking about is an aspect of a pre-existing policy that the government has already put in place, that is, that any new business asset worth less than \$5,000 can be immediately written off from the 2012-13 income year. This is a pre-existing measure which obviously is of assistance to small business. So I think your comments ought to be taken in light of the broader range of policies on the tax front in relation to small business that the government has put in place.

Senator CORMANN: Minister, thank you for that. Of course the measure is that, as of 1 July 2012, small businesses will be allowed to claim up to \$5,000 as an immediate deduction for motor vehicles, with the remainder of the vehicle's value to be pooled in a general small business pool and to be depreciated at 15 per cent in the first year and 30 per cent in the year after. I understand the point you are making about building on a previous measure. However, there are no two ways about it, these sorts of measures clearly can have implications for real businesses.

Senator Wong: So the proposition, Senator?

Senator CORMANN: The proposition is that consumers will defer purchasing decisions in order to benefit from an additional tax effect. That is going to be a distortion in one part of the market, specifically the car dealership market.

Senator Wong: I do not have officials at the table who have direct carriage of this particular policy or, more importantly, its implementation. What I would say is this: your proposition appears to be that this is a good idea but you should do it earlier. I would say to you, well—

Senator CORMANN: Or maybe if you want to do it from 1 July 2012 you should announce it next year.

Senator Wong: Can I finish? Can I finish please!

CHAIR: Minister.

Senator Wong: I am just getting tired of it.

Senator CAMERON: It is a talk-a-thon from over here.

Senator EGGLESTON: Estimates are about our talking.

Senator Wong: Estimates are not a love-in, Senator, I accept that, but I can barely get any words out before he interjects again.

CHAIR: To take up Senator Eggleston's point, estimates are for opposition's questioning, but questioning also implies an answer. I think the minister has not been given a chance to answer.

Senator Bushby interjecting—

Senator CAMERON: You've had a master class from Senator Fisher, haven't you?

Senator Joyce interjecting—

Senator Wong: I am sorry, Senator Joyce?

CHAIR: I think you should ignore that interjection, and all interjections, and continue with your answer, Senator Wong.

Senator Wong: Senator, as I said, I do not have the officials at the table who have carriage of the implementation of this. There are a range of tax benefits for small business in this budget and in the previous budget. If your proposition is that this should start earlier, what I would say to you is that you would need to address that also in the context of the broader fiscal strategy, and you do not. What you are talking up again is more expenditure whilst you are blocking savings. It is no wonder that your propositions would lead us to having no surplus. That is the position of the coalition.

Senator CORMANN: Minister, you are inappropriately verballing me. I have never, in anything that I have asked, made any suggestion whatsoever that you should start it earlier. What I have asked is why it was announced when the measure is only to take effect 12 months from now, given the implication and the distortions that it has the potential to create out there in the marketplace. That has nothing to do with the suggestion that you should have done it earlier. It might also have something to do with the suggestion that you should announce it at the time that you are actually ready to implement it and not more than 12 months before.

I just observe again that we were told that the secretary would be in a position to answer questions widely across the whole Treasury portfolio on the basis that he was only available to be here this morning.

Senator Wong: And he is. I am just making the point that you have asked a detailed question about the implementation of one of a few hundred, from memory, budget measures that are in Budget Paper No. 2.

Senator CORMANN: I was not asking a detailed question about implementation. I was asking a very generic question about impacts on market dynamics of a particular tax measure. It was not a detailed question.

Senator Wong: And you have had an answer. You have had an answer about the macroeconomic effects.

Senator CORMANN: That is right. I accept that the secretary answered it. The budget papers forecast a decline in the unemployment rate to 4.75 per cent by the middle of 2012 and 4.5 per cent by the middle of 2013. Given that Fair Work Australia is currently going through the 2011 annual rates review, what assumptions have Treasury made about minimum award wage outcomes in arriving at this unemployment rate forecast?

Mr Duggan: It is not something that we take into account explicitly, but it is implicitly in our forecasts, minimum wage increases. We do not look at subsectors of the economy and

forecast wages on that basis. We think about wage trends in general. We do not have, as I said, an explicit forecast but it is implicitly within our wage forecasts.

Senator CORMANN: What is your implicit forecast if you have not got an explicit forecast?

Mr Duggan: Our implicit forecast is that wages in the economy will grow by four per cent, that is, wages in the broader economy, of which the minimum wage of course is part.

Senator CORMANN: Your expectation is that it is going to be four per cent across the economy in aggregate.

Mr Duggan: In aggregate.

Senator CORMANN: Then it will just play itself out. Does Treasury have a view whether large increases in statutory minimum wages have particular employment effects?

Dr Gruen: Treasury's view is that if increases in the minimum wage were sufficiently large they could have an adverse impact on employment, yes.

Mr Duggan: To add to that, our wages models and the theory will tell you that it is real wages that matter, not nominal wages. So a substantial increase in real wages would have an impact on employment.

Dr Gruen: Yes.

Senator CORMANN: Sure, but so—

Senator CAMERON: All this is arguable. There is other analysis that says it actually helps to stimulate the economy if you lift the basic wage.

CHAIR: Senator Cameron, you are on next.

Senator CORMANN: We have got the voice—

CHAIR: Senator Cormann has the questioning at the moment.

Senator CORMANN: We have got the voice from my left over there from New South Wales—

Senator JOYCE: A carbon tax will make the economy grow.

Senator CORMANN: It will all work towards your preselection, I am sure, Senator Cameron. So you say you agree that increases in the statutory minimum wage—and you qualify it to 'increases in real wages'—can have negative employment effects.

Dr Gruen: Sorry, Senator, the original question was something like 'large' increases. You have dropped that word.

Senator CORMANN: Did I say 'large increases'?

Dr Gruen: You used a word like that.

Senator CORMANN: Yes, large increases, okay. The reason I dropped that word is that I was corrected by Mr Duggan over there who said increases in real wages rather than increases in wages nominally. Do increases in real wages have an effect on employment?

Dr Gruen: Between us we can agree that large increases in real wages would have an impact, an adverse impact.

Senator CORMANN: What is the definition of 'large' in that context, in your mind?

Dr Parkinson: It would depend on the circumstances, Senator. In an environment where we are faced with high levels of unemployment, then 'large' would be actually relatively small. In a world where there was an economy at or close to full employment, 'large' would be larger.

Senator JOYCE: It is like a catheter.

Dr Parkinson: Sorry, Senator Joyce?

Senator CAMERON: I would like to see the section continue to be—

CHAIR: I ask both Senator Joyce and Senator Cameron to allow Senator Cormann to continue his questioning.

Senator CORMANN: In relation to minimum wages, is it correct to say:

Those who earn near minimum wages are disproportionately female, unmarried and young, without post-school qualifications and overseas born.

Senator Wong: What are you reading from?

Dr Gruen: Senator, what are you quoting from?

Senator CORMANN: I am going to get to that.

Senator Wong: No, Senator, that is not fair. If you are quoting from documents, you should give people the courtesy of saying from where.

Senator CORMANN: Do you agree—

Senator Wong: That has been a practice in this committee. I can recall Senator Brandis, when he was chair, having a go at me and others on the opposition, as we then were, saying, 'I am not having a witness in my committee being asked to comment on a document without being referred to it.' I am going to take the same approach as the opposition did when they were in government.

Senator CORMANN: I will rephrase the question, Minister. Do you agree with the proposition that those who earn near minimum wages are disproportionately female, unmarried, young, without post-school qualifications and overseas born?

Dr Gruen: There may be other people here who are experts on the cohort that is near the minimum wage. I am not. I cannot really comment on that.

Senator CORMANN: Are you able to comment on whether, due to low labour force participation rates in the poorest households, minimum wage workers are most likely to be in middle-income households?

Senator Wong: Senator, please give people the courtesy of—you are obviously quoting from a speech or something—

Senator CORMANN: No, I am asking some questions.

Senator CAMERON: No, you are not.

Senator CORMANN: It is a question. They stand by themselves.

Senator Wong: If this is a variation of the Senator Abetz very lengthy 'who said that?'—which those of us who have been in the Senate for a number of years have seen on many occasions—perhaps we could at least cut to the chase. If you tell us what you are reading from, it gives us the context. If people can answer questions, we will.

Senator CORMANN: The question stands by itself, Minister.

Senator Wong: This is childish.

CHAIR: It does not relate to the expertise of the officers in question, it relates to—

Senator CORMANN: It relates to the employment forecast and how Treasury gets to it.

Senator Wong: Why won't you give us the courtesy of letting us know where you are reading from? What is the big secret?

Senator CORMANN: It is very simple, Minister. I am very happy to give you my whole file if you give me yours. Then we will go through your QTBs and you can go through mine. I am very happy to give you my files.

Senator CAMERON: Oh, come on!

Senator CORMANN: I am very happy to give you my files as long as we do an exchange.

Senator Wong: That is a diversion, and you know it.

Senator CORMANN: It is not a diversion.

Senator Wong: It is. Senator, all I am saying—

Senator CORMANN: You are wanting me to hand over my file to you, but you are not prepared to give me yours.

Senator Wong: All I am saying is that this is not a forum in which we do what senators might do in the chamber, where we read things and guess who said that. Senator Joyce quotes Senator Wong back at her and Senator Wong quotes Senator Joyce back at him. That is for politicians in the chamber. I think public servants, if they are being asked to comment on a document, are entitled at least to know where you are quoting from.

Senator CORMANN: I am not asking them to comment on a document.

Senator Wong: You are.

Senator CORMANN: The question stands.

Senator Wong: You are reading bits of a document—

Senator CORMANN: I am reading from my prepared questions.

Senator Wong: and you are asking them to comment. You are reading parts of a document and you are asking them to comment on it.

Senator CORMANN: You do not want Treasury to answer my question?

Senator Wong: I am saying it is not fair. I do not understand what the—

CHAIR: Minister, we will give Senator Cormann time to think about his question and we will go to Senator Cameron.

Senator CAMERON: Thanks.

Senator CORMANN: You are obviously not prepared to talk about unemployment figures.

Senator CAMERON: In relation to—

Senator Wong: We are very happy to talk about what the unemployment rate would have been if we had followed your advice and not put stimulus into the economy.

CHAIR: I have gone to Senator Cameron now.

Senator CAMERON: I want to quote from the ABC *PM* program back on 9 February 2010 where the then spokesperson for the opposition, Senator Joyce, said this:

We're going into hock to our eyeballs to people overseas. And you've got to ask the question how far in debt do you want to go? We are getting to a point where we can't repay it.

Dr Parkinson, are we getting to a stage where we cannot repay our debt?

Dr Parkinson: No, Senator.

Senator JOYCE: You said—

Dr Parkinson: A question was raised yesterday, Senator, and I answered it then.

Senator JOYCE: You said it would be a big problem, didn't you?

CHAIR: It is Senator Cameron's question.

Senator Wong: Who is asking questions?

Senator JOYCE: What is the debt, Mr Parkinson?

CHAIR: Senator Joyce! Senator Cameron has the questioning.

Senator CAMERON: Senator Joyce, I know you—

Senator JOYCE: Find out, Mr Parkinson.

Senator Wong: On a point of order, Chair, this is unfair to the witness. We have Senator Joyce barking at the Secretary to the Treasury. If Senator Joyce wishes to ask questions, can I ask that he wait until you give him the call.

Senator JOYCE: I can lend you my BlackBerry, if you like, to help you.

CHAIR: Senator Joyce!

Dr Parkinson: Senator Joyce, I actually do not need that. If you bothered to read the budget papers, you would find the answers yourself.

Senator JOYCE: Oh, right! No, I was asking for the gross debt, Mr Parkinson. It changes every Friday.

CHAIR: Dr Parkinson, can I ask that you not engage with the senator who was not given the call.

Dr Parkinson: My apologies, Chair.

CHAIR: Senator Cameron has the call.

Senator CAMERON: Thank you very much. I know Senator Joyce has been sent here to help Senator Cormann out.

Senator Wong: Actually I reckon he was doing fine.

Senator CAMERON: They have got their economics team in place.

Senator JOYCE: I think Senator Cormann is quite capable of looking after himself.

Senator CAMERON: What is happening?

CHAIR: Senator Cameron, you invited the comment. That is what happened. Just ask your question.

Senator CAMERON: Dr Parkinson, we had a debate earlier about the implications of fiscal consolidation. There were two issues. I am not sure we answered both of them. I think you spoke about the implications of a significant fiscal consolidation. One of the arguments that were put forward was for a faster fiscal consolidation. What is the difference between a 'significant fiscal consolidation' and a 'faster significant consolidation'?

Dr Parkinson: Over the same time period, you could think of 'faster', if you are looking at a two-year period, as doing more in the first year than you are proposing to do in the second. I have assumed when people are talking about a fast fiscal consolidation what they are really asking for is a more significant one, that is, you get back to surplus earlier and with a larger surplus.

Senator CAMERON: Are the implications of a significant and/or faster consolidation the same in terms of its effect on employment, investment, confidence? Do all these things come into play?

Dr Parkinson: Without knowing what any individual has meant when they have said 'faster', yes, I would say they would be the same.

Senator CAMERON: Has Treasury done any estimates in terms of a faster or a more significant consolidation of employment, business confidence and investment?

Dr Parkinson: No, Senator.

Dr Gruen: We have got estimates of the subtraction from growth of the withdrawal of fiscal stimulus. We do have those estimates in the budget. If you were to do it more rapidly, then those numbers would be bigger and probably roughly linearly so.

Dr Parkinson: Perhaps if I just come back for a moment, Senator: in the *Australian Business Economists* speech I made the point specifically, on page 17:

The withdrawal of fiscal stimulus results in a detraction from GDP growth of 1 per cent in 2010/11. If we had chosen to withdraw that stimulus more rapidly, the detraction—

of necessity—

would be greater still. And it is unclear whether a faster *ex ante* consolidation would have resulted in a consolidation of the same magnitude because—

everything else being equal—

actual growth would have been weaker in 2010-11 than the 2¼ per cent now in prospect.

You cannot have it both ways, in a sense. That is not to say that there are not occasions when fiscal consolidation can be stimulatory. In countries where they have unsustainable fiscal positions, it can boost confidence that governments are beginning to tackle problems. No respected commentator would say that Australia has an unsustainable fiscal or debt position.

Senator CAMERON: Just on that point, could I take you to page 113 of Budget Statement No 1, chart 3, the net debt for Australia. I am not sure whether we are missing something because, given Senator Joyce's view that we are in imminent danger of default, where does that put these other countries, Canada, Germany, the US, the UK, France, Italy and Japan, some of whom are up to 160 per cent of GDP in net debt?

Dr Parkinson: We know the situation confronting a number of these countries. Japan has a very serious debt problem, combined with a rapidly ageing population, which it needs to deal with. Italy, as you know, along with Greece, Portugal and other members of the EU,

periodically is questioned about its fiscal sustainability. And we know that the United States' fiscal position, even though it is not obvious from this period out to 2016, is very serious because—

Senator JOYCE: Just on that, I cite Dr Ken Rogoff's study on escalation of public debt since 1997. Do you have any comment on how Australia managed to come third after Iceland and Ireland? Australia had the third greatest increase in public debt—

CHAIR: Senator Joyce, I was prepared to give you a bit of a defence—

Senator JOYCE: I just want to know whether Dr Martin Parkinson knows about Dr Ken Rogoff; maybe he does not.

CHAIR: It is going into a long question, so I will put you down for the call after Senator Cameron.

Senator JOYCE: Maybe he does not want to answer it. Maybe he thinks it is all under control—like *The Wreck of the Hesperus*.

Senator CAMERON: There are two big fear campaigns out there. One is that we are going to end up not being able to pay our debt and the other one is that our budget is not going to be in a position where we are operating in an economically responsible way. Could I take you to chart 2 on 1.12.

Senator JOYCE: Dr Parkinson, can you explain exactly what—

Senator Wong: Chair, point of order.

Senator CAMERON: I know Senator Joyce would love to have a comeback.

Senator JOYCE: I am just unsure of what net debt means. I thought Dr Parkinson might like to explain it to us—

CHAIR: Senator Joyce! Minister, you have a point of order?

Senator JOYCE: because I do not think anybody else knows what it means either, Dr Parkinson.

Senator Wong: Senator Joyce, you do not need to behave like this; you really do not. If you want to have questions—

CHAIR: Minister; what is your point of order?

Senator Wong: He is interjecting and asking more questions. Perhaps we can just finish with one senator with the call and then, if Senator Joyce is the one who you want to go to next, he can have the call and we can deal with his questions then. Maybe you can write them down and you can remember them and you can ask them—

Senator JOYCE: If you could get back to the net figure, that would be great. Can you do that? Is it possible; do you know?

CHAIR: I was talking to another senator, so I am not really sure of where we are. Dr Parkinson, were you in reply?

Senator Wong: He was answering a question from Senator Cameron.

Dr Parkinson: Chair, Senator Cameron has asked a question; Senator Joyce has asked a question which can be answered very quickly. The point I would make, though, is that we had a very reasonable discussion yesterday about issues. We have had a very reasonable

discussion this morning about issues. I have actually liked the tone of the conversation to date. Senators have the right to ask me questions in any form and with any tone that they wish to. But, if we are to have a productive working relationship, I would appreciate it if our behaviour was mimicked on the other side of the table. I say that, Chair, purely as an observation, because witnesses do not ask questions.

CHAIR: I must say, Dr Parkinson, that I doubt that the civility on your side of the table will ever be matched by the civility on our side of the table, but we will all live in hope. Senator Cameron.

Senator CAMERON: Except from me, Dr Parkinson. Chart 2 on page 1-12: I am just looking at the UK, for instance. Their budget deficit is about 10 per cent of GDP. Rather than, as Senator Joyce indicated last year, when he was the shadow finance spokesman, that we are up to our eyeballs in hock, how can the UK continue to make investments in reducing the carbon footprint and take strong positions—a conservative government, may I add—in investing in reducing the carbon footprint of the UK?

Dr Parkinson: It is a matter for individual governments in different countries to decide what their priorities are.

Senator CAMERON: I am asking you in general. With a significant budget deficit, you can still make investments for the future, can't you?

Dr Parkinson: You can. Obviously, to the extent that those investments expand your productive capacity or reduce the impact of things that would otherwise slow your future growth, that is an investment in the future. But I just go back. You do not have to pose that question in the context of a country with a deficit. It is a matter for the political class in each country to decide on the mix of revenues and expenditures that they wish and, hence, their deficit position. The UK has obviously chosen, because it has decided that it is in its national interest, to reduce its carbon footprint.

Senator CAMERON: I go to page 3-25. We had some discussions earlier about the medium-term fiscal outlook and the underlying cash balance.

Dr Parkinson: Yes.

Senator CAMERON: Regarding those other countries that Budget Paper No. 1 deals with extensively, what would their chart look like in relation to that?

Dr Parkinson: In terms of?

Senator CAMERON: The underlying cash balance.

Dr Parkinson: Underlying cash balance is a concept that we use for our budget bottom lines. Different countries may use different measures. But, as you can see, chart 3 is simply a mirror image of chart 2 on page 1-12. This shows our online cash balance moving back into surplus from 2012-13. So if you take any of these other countries that are in chart 2 on page 1-12, none of them get back to balance in the period out to 2016. Their equivalent lines would be below the horizontal line until at least 2016 and, even then, the closest you get is Canada, followed by Germany. You find that the US, the UK, Japan and France are still quite some way away.

Senator CAMERON: So we are in a very enviable position in terms of our net debt, our budget balance and our unemployment rates; they are all far superior to these other advanced economies.

Dr Parkinson: Absolutely. As I have said publicly in the past, our position is enviable because governments of all political persuasions over the last 20 years have committed themselves to sensible medium-term fiscal and monetary policy frameworks and have pursued productivity and participation enhancing reforms.

Senator CAMERON: So we are not doomed to default on our debt and we are in a good economic position?

Dr Parkinson: We are not doomed to default on our debt and we are in a good economic position.

Senator CAMERON: Could I go to the issue of the investment in training that is in the budget. What does the Treasury see the benefits being of that \$3 billion investment in training? What are the productivity benefits of that huge investment in training?

Dr Parkinson: Over time, to the extent that that results in a more skilled, more flexible and more adaptable workforce, it should result in improvements in productivity at the margin—we talked about the margin before—and, in the face of an ageing population and a decline in our trend potential growth rate, that should work to ameliorate some of that impact.

Senator CAMERON: Thank you.

CHAIR: Senator Joyce?

Senator JOYCE: Are you aware of the paper that was put out by Dr Ken Rogoff from Harvard University?

Dr Parkinson: I know Professor Rogoff. I am not aware of the specifics of the paper but, from what you said a moment ago, I think I can deal with the question.

Senator JOYCE: He talked about the escalation of public debt since 1997, which, miraculously enough, was when the Labor Party came into power.

Dr Parkinson: 2007?

Senator JOYCE: I am sorry; correction: 2007—noting that you are starting from a much lower base, and I acknowledge that and have in media releases. The greatest escalation of public sector debt was in Iceland, Ireland and then Australia. You do not think that that is anything to be concerned about—our escalation of public debt?

Dr Parkinson: No, because the escalation in public debt is the change; it is not the level. If you were to say to me that Australia had the highest level of public debt in the world—

Senator JOYCE: No, I never said that at all.

Dr Parkinson: No, I am not suggesting that you did. If you were to say that to me, I would start from a position of much greater concern than I start with, on the basis that the change in our public debt has been significant.

Senator JOYCE: My concern is about the trajectory and where it ends up. Have you, through your predictions in the last few years, ever been under in either your deficit or your debt? Have you ever made a prediction where you actually came in under, in the last four years?

Dr Parkinson: Very much so. At the time of early 2009—my colleagues will correct me because, as you know, I was not in this job at that stage—Treasury was expecting Australia's debt level to reach considerably higher than what is now in prospect. I cannot recall the figures off the top of my head, but it is an order of magnitude higher.

Dr Gruen: The deficit and net debt forecasts in the 2009 budget, if you had net debt peaking well above where we think it will now be, into double digits rather than the 7.2 per cent—

Senator JOYCE: What is our gross debt, as we speak right now?

Dr Gruen: Our gross debt? Could I just finish that. In the 2009 budget, the projections were that net debt would peak in 2013-14 at 13.8 per cent of GDP.

Senator JOYCE: We have not arrived there yet, have we?

Dr Gruen: No, but you asked the question as to whether there were recent periods in which our projections—

Senator JOYCE: No. What I am saying is: have you ever arrived at a spot yet in the last four years where the actuals turned up, and the actuals were below what your budgetary items were beforehand?

Senator Wong: Just let me get the question clear. You are asking Treasury if, over the last four decades—

Senator JOYCE: No, the last four years.

Senator Wong: Four years. The difficulty, Senator—

Senator JOYCE: Have you ever arrived at a spot when your actuals were tabled where they were actually below your budget in either deficit or debt?

Dr Gruen: We probably should take that on notice.

Senator JOYCE: I can help you.

Dr Gruen: You can help me?

Senator JOYCE: The answer is no.

Dr Gruen: So why did you ask me the question?

Senator JOYCE: Because I wanted you to put it on the record.

Dr Gruen: I am sorry, Senator. I guess—

Senator JOYCE: My next question is: can you explain—

Senator CAMERON: Let's move on; that is a good idea.

Senator JOYCE: This question is: what is our gross debt right now?

Dr Parkinson: Our gross debt, and you know that gross debt is—

Senator JOYCE: Australian government securities outstanding.

Dr Parkinson: It is under our current debt cap, which is \$200 billion.

Senator JOYCE: But what is it?

Dr Parkinson: As of today?

Senator JOYCE: Yes.

Dr Parkinson: I do not actually have the numbers in front of me, but it is in the high 100 billions.

Senator JOYCE: The very high 100 billions; it is \$192.6 billion.

CHAIR: Senator Joyce—

Senator JOYCE: What I want to know now—

CHAIR: we have a number of senators waiting to ask questions.

Senator JOYCE: because you always talk about net debt, can you please explain how you get from your gross debt, with figures, back down to your net debt? What exactly are you taking off to get to your net debt? Do not just tell me, 'Oh, non-financial assets.' What are they?

Senator Wong: This is 9-31, Senator; statement 9 on page 31 of Budget Paper No. 1. There is a table as well.

Senator JOYCE: What are they?

Dr Parkinson: It says:

... selected financial assets (cash and deposits, advances paid, and investments, loans and placements). This includes financial assets held by the Future Fund which are invested in the asset classes ...

Senator JOYCE: Future Fund; very good.

Dr Parkinson: Excuse me, Senator.

Senator JOYCE: Future Fund. What is the Future Fund for?

Senator Wong: Senator, let him finish.

Senator CAMERON: Chair, Senator Joyce is getting very agitated.

CHAIR: Senator Joyce, again, I was talking to another senator at the table and I am not sure what happened. Perhaps you would let Dr Parkinson finish his answer. You are asking these questions and the officers at the table take it in good faith that you want an answer, so please let them answer.

Dr Parkinson: Net debt is selected financial liabilities less selected some financial assets. As I was saying, those assets are cash, equity instruments of another entity, contractual right to receive cash or financial asset, a contract that will or may be settled in the entity's own equity instruments—or, put it another way, it is cash and deposits, advances paid, investments, loans that have been made and it includes financial assets of the Future Fund, which are invested in these asset classes.

Senator JOYCE: The biggest place they are held is in the Future Fund, isn't it? That is correct, isn't it?

Dr Parkinson: It would depend on any particular point in time. That should be—

Senator JOYCE: The vast majority of the money that you net it off against is the money that is in the Future Fund.

Dr Parkinson: That should be the case—

Senator JOYCE: It is the case.

Dr Parkinson: but there will be times during the course of the year where the Commonwealth will have very high cash holdings at the Reserve Bank.

Senator JOYCE: When we are trying to cover public servants' liability for superannuation for what their entitlements are, where is that money going to come from?

Senator Wong: Senator, it is interesting that you should ask that because your party is calling for an increase in indexation, which is to public sector superannuation, which is not funded, which will increase the unfunded liability about which you are now asking questions. So I am going to say—

Senator JOYCE: No. What I am saying is that, if you—

Senator Wong: No, Senator. I am going to respond to this because—

Senator JOYCE: Well, you are not actually responding; you are—

Senator Wong: I am because I think that, for you to come in here and criticise an unfunded liability which your party is voting to increase, it really demonstrates the complete lack of sensible fiscal and economic policy on your side of the table.

Senator JOYCE: Any time you want to get back to the question—and the question is predominantly about the Future Fund. The Future Fund is there to cover public servants' superannuation liability, isn't it?

Senator Wong: You have just voted, as I understand it, in the House to increase it.

Senator JOYCE: That is the question. If you want to answer that question, you are entitled to. The Future Fund is there to cover public servants' superannuation, isn't it?

CHAIR: I do not know that Dr Parkinson is responsible for the Future Fund but—

Senator JOYCE: He must have some idea about it.

CHAIR: if he wishes to answer that question, he can answer it.

Senator JOYCE: Yes?

Dr Parkinson: The original intent was to begin to cover the future liabilities of—

Senator JOYCE: Which at the time, if I remember correctly, was a \$120 billion liability. If we are going to be using the public superannuants' money to pay our debt, surely we are just increasing the liability back into the money that we owe the public superannuants?

Senator Wong: Sorry?

Senator JOYCE: Oh!

Senator CAMERON: That is how I feel too, Barnaby!

Senator Wong: He is doing better than me. I can't understand that.

Dr Parkinson: Senator, I do not want to put words in your mouth, so please tell me if I am wrong, but I think you are asking: aren't net financial liabilities, which are total liabilities less financial assets, because they include non-debt liabilities such as accrued superannuation and long service leave, a better measure of our debt position? Is that really what you are asking?

Senator JOYCE: I am saying that, when you take into account the net figure, which no-one can ever reconcile on the spot—we can always understand our gross position because it is there within Australian government securities outstanding; it is on the front page of the AOFM website, and I am glad it is—but when you reconcile back to this magical net figure, which no-one can ever do, as it is just an assumption that is made by people, in that

assumption, the largest section of what you net off is actually money from the Future Fund which is put aside to cover public servants' superannuation. So you are merely taking to pay off one debt and increasing your liability in another area, because you cannot use the money twice.

Dr Parkinson: Is that a question or a statement?

Senator JOYCE: It is a question or a statement. If it is not correct, correct me.

Dr Parkinson: I am trying to distil what your point is. I think what you are saying is that net financial liabilities, which take account of the things that you have just raised, are a preferable measure than net debt.

Senator JOYCE: The discussion was about net debt. Do you take into account an amount which, in netting off, would just otherwise become a liability in another sector, an unfunded section of another part of your budget papers?

Dr Parkinson: No. I said to you that, in the definition of 'net debt', that does not take account of the superannuation liabilities, and net financial liabilities do. All of this is laid out in very clear language on page 9-31 of the budget papers.

Senator JOYCE: Do you believe that the trajectory we are on with the debt is a healthy trajectory, Dr Parkinson? Will you be happy to come in here in three years time and tell me what you said this year was right, that you are happy with the trajectory we are on?

Dr Parkinson: If we deliver the fiscal consolidation, which takes us to 2012-13, and then, as I have said publicly, we build on that and continue fiscal consolidation, pay off our net debt, improve our net worth position, yes, we are in a good position vis-a-vis other countries.

Senator JOYCE: So each week, when we are drawing down—and the bill rolls beyond tomorrow, I suppose—it never concerns you when the Australian Office of Financial Management shows Australian government securities outstanding going up by \$1 billion, \$2 billion or \$500 million a week? That never concerns you, Dr Parkinson?

Senator Wong: Senator, that is why the government is undertaking the fastest fiscal consolidation on record to bring the budget back into surplus—

Senator JOYCE: That takes me back to my former question, Minister—

Senator Wong: I had not finished, Senator.

Senator JOYCE: that we never actually get our targets.

CHAIR: Senator Wong?

Senator Wong: I had not finished, Senator—and why we have a fiscal strategy which deals with a range of parameters, which are about improving the position of the budget, including restraint on expenditure, a commitment to hold those restraints until the surplus reaches one per cent of GDP over the medium term and not increasing the tax to GDP ratio from that which was in place under your government. So there are important parameters and disciplines that we are imposing on the budget which guide fiscal policy to deal with the fact that we do want to return the budget to surplus and improve over the medium term the net financial position of the federal government. You may wish, Senator, and those on your side do, to dismiss the global financial crisis as—as I think the shadow Treasurer described it—'a hiccup'. It was a very significant event and the government made the right decision to go into

deficit in order to support the economy. We can have an argument about that, but we believe that we made the right call and I think the figures demonstrate that.

Senator JOYCE: It is always the same, isn't it? Every year, we have a promise of some position that we are going to get to and, the next year, all we have a discussion about is the excuse for why we never arrived there.

CHAIR: That is not a question. Have you finished, Senator Joyce?

Senator JOYCE: Yes.

CHAIR: Senator Ludlam.

Senator LUDLAM: I want to ask—I do not know whether it has been canvassed very much this morning—about the tax forum coming up in October. If that has not been addressed—

Senator Wong: No, it has not while I have been here. But it might have been done in revenue, when I was not here.

Dr Parkinson: That would have been the revenue group last night.

Senator Wong: I am sure that the secretary can assist as much as he can.

Senator LUDLAM: Could you tell us what preparation you are putting in place in advance of that? I understand that it is going to be a two-day summit for later in October.

Dr Parkinson: That is right. We are doing work in the department and are in discussion with the Treasurer about issues that might be covered in the forum. We are talking to a range of interested stakeholders about what their views of things that might be covered could be. I think the Treasurer is on the public record as saying that it is the intention to put out a framing paper prior to the summit and to encourage other interested parties, whether they are attending or not, to either respond to that paper or put forward their own submissions, the idea being that there will be a rich array of background material for the participants at the forum prior to the forum itself.

Senator LUDLAM: Who do you define as an 'interested party'? This thing is probably going to impact everybody in Australia, one way or another.

Dr Parkinson: That is right. At this stage, we are in very preliminary thinking about which sorts of groups might be represented at the forum, but we are talking to anybody either who wishes to knock on our door or who we know has an interest in this. We have started talking, but we are nowhere near complete. So it is the usual suspects, in other words.

Senator LUDLAM: Are you able to tell us when you think the Treasurer's discussion paper would be expected to appear?

Dr Parkinson: No, I cannot. But—

Senator Wong: Why don't we take that on notice, Senator?

Senator LUDLAM: Yes.

Dr Parkinson: The only reason is that I just cannot recall. I am pretty sure that the Treasurer has indicated when it will come out, but I cannot remember the exact date that he has given to it.

Senator LUDLAM: The minister has taken that on notice, thank you. It is budgeted to cost about \$900,000 and that is being pulled out of the ATO's budget. This might seem a little trivial, but what will the ATO not be doing regarding that \$900,000?

Dr Parkinson: You would have to ask the ATO.

Senator LUDLAM: Okay, it is not your concern. One of the issues covered quite extensively in the Henry tax review, about which there has been almost no commentary or movement since, is housing tax reform. I wonder whether that is an issue that will be on the table during the summit.

Dr Parkinson: As I have said, the government will be putting out a framing paper. The Treasury envisages that other stakeholders who prepare their own papers will raise any issues that are of interest to them. So I think, as the Treasurer has indicated, it is not the government's intention—nor does it have the capacity—to prevent people from raising any issues they wish.

Senator LUDLAM: I enjoyed your post-budget speech, but I note that housing was one issue that you did not really cover in great detail. I am not being ironic.

Dr Parkinson: No, I am just thinking that there are a lot of things that I did cover in it and many more that I did not.

Senator LUDLAM: Yes. But would you care to share your thoughts on that now? Given that we have such enormous housing stress, does that impact materially on productivity and, given that it was not something that you touched on in detail in your speech, do you have any thoughts on housing tax reform or housing stress in general?

Dr Parkinson: No, I would prefer to raise those when I have had more—

Senator LUDLAM: You do not want to drop any bombshells in an estimates committee?

Dr Parkinson: I would prefer not to.

Senator LUDLAM: To be a bit more specific, though, to your knowledge, has Treasury ever analysed, for example, the impact of the first home owners scheme on house prices or the inflationary impact of the first home owners scheme?

Dr Parkinson: In the past—and recall I have only been in the job for three months—my understanding is that that has been the case—that is, in the far distant past. I have a recollection of some of that material appearing in the public domain. In the recent past—I can take that on notice.

Senator LUDLAM: If you could. I refer you to an article that ran in the *Financial Review* on 27 May this year. It claimed effectively—they have a graph that runs back to 1980 that shows, I think fairly conclusively—that the first home owners scheme has a direct inflationary impact on the housing market. I just wonder whether you could go back and see whether Treasury has done any thinking recently—I know a lot of that is state spending—or whether you have any position papers, statements or research on that?

Dr Parkinson: I am happy to do so.

Senator LUDLAM: That would be greatly appreciated. One thing that you did mention in your post-budget speech was the impact of natural disasters on this budget, which is substantial. You have emphasised that the economy is in transition. You speak about innovation and flexibility. With your background—I know you have had a great deal to do

with climate policy—do you see a figure in that order as being effectively a permanent new line item in every budget from here on? Presumably, we have not seen the last of the kind of damage that was inflicted over this summer.

Dr Parkinson: Senator, I am not going to draw a direct link between climate change and the things that we have seen over this summer. I think it is inevitable, given what the science of climate change tells us, that we will face impacts on the budget in future of climate events—whether they be natural disasters in the form of bushfires or flooding or the like, or whether they are the destruction or the damage to infrastructure of the sort that we saw in the heatwaves a couple of years ago with Basslink and the suburban rail networks in Melbourne and Adelaide, or whether it is the impact on economic activity of sustained drought that is climate related. I am not going to try and suggest that any individual instance is climate related.

Senator LUDLAM: It almost does not matter. In a sense, the fact is that—

Dr Parkinson: I actually agree with you; it does not matter.

Senator LUDLAM: It is occurring and it is doing enormous damage to the budget bottom line as well as people's lives and communities. You do not want to be drawn on whether we want to sheet it home to climate change or not—that this might be a perpetual budget line item.

The last thing I wanted to ask you about is this: most of your post-budget speech relates to mining boom mark 2, how it is different to the first mining boom, and where to from here. You raise a couple of red flags but ultimately I think your conclusion is that we just need to ride the wave and restructure and make the best of it. How much thinking has Treasury done—recognising you have been there only a couple of months—on what happens if, for any reason at all, China is not able to continue running these extraordinary growth rates and the boom comes off for any reason?

Dr Parkinson: You said I raised some red flags but then moved on. I raised those red flags because I think there are serious risks to the backdrop against which Australia will have to operate. They are risks, in a way, that are outside of our control and they are risks around a very positive central forecast.

The issue of China is particularly intriguing. I have seen references that seem to imply that, because there is a risk that something might happen in China at some stage into the future, Australia should not somehow be trading with China. I think that is just a fundamental misunderstanding of what is happening. In an export sense, in the past we have been far more dependent on the UK as a market than China. We have been far more dependent upon Japan. Indeed, Japan is not much different to China in size as an export market for us now.

The difference is that the emergence of China and India and other countries has changed the global backdrop for demand for commodities in the first instance. This will change over time the demand for our mining resources.

Even if we chose not to trade with China, chose not to export any of our energy or mineral resources to China, their demand would be filled by someone else. Because we have a great comparative advantage or competitive advantage in this area, we would simply divert our exports to a third party.

If something were to happen in China, it would affect global prices and that would affect us anyway. The impact will come back to us. Whether it comes back directly through our export flows, or indirectly through its impact on commodity prices and global economic activity, it is unavoidable. In that sense, it is no different to the fact that even though the United States was never a very large export market for us—because the US is so large—if the US stumbled then we got an immediate hit. One of the great puzzles over time has been the way in which the Australian economy and the US economy mirrored one another in the absence of weaker direct export links.

The issue is not our engagement with China. The issue is actually China's emergence and importance in the global economy. In that respect we need to think of China as being akin to the United States. The idea that somehow our future is something that is a gift to us from China is no different to saying that in the past some of our prosperity and troubles have been a consequence of the US's role in the global economy. What I said in the ABE speech was that we need to recognise, therefore, that we will be dependent on the success of policy making in other countries. That is what happens when you have a globally integrated economy.

Senator LUDLAM: My proposal was not so much that we stopped trading with China—

Dr Parkinson: No, I was not trying to put words in your mouth. I have seen all sorts of claims made about somehow we have hooked ourselves to the band wagon of China, or because of China we should run tighter fiscal policy. People did not say that because the Australian economy will stumble if the US stumbles we should run tighter fiscal policy. We have to run tighter fiscal policy for the reasons we decide ourselves, the same way we have to run our own monetary policy and our own structural policies.

Senator LUDLAM: The direction that I am heading in more is the so-called Dutch disease. What damage are we doing to other sectors of our economy given the explosive growth of China that the mining industry is tracking? That is actually reducing resilience in the economy. If China does come off the boom and, heaven forbid, they go back to running growth rates of five or six per cent rather than eight or nine, we have done structural damage to the Australian economy in the meantime.

Dr Parkinson: They have to go back to it. They have to go back to running growth rates of five or six per cent over time. That will actually be part of the mark of success. As they continue to grow, as they become a larger and larger economy, as their relative living standards rise, their growth rate will slow. The difference is that then you will have slower growth rates on a much bigger base. It does not mean that slower growth in China in the future—I am not talking about tomorrow, but off into the future—means there are less benefits for Australia. I find this whole discussion about the importance of mining quite bizarre—

Senator PRATT: I think there are three Western Australians at the table.

Senator LUDLAM: That was not a warning; that was just an acknowledgment.

Dr Parkinson: Sorry. The reason I say that I find it is a bit bizarre—

Senator PRATT: I do not disagree.

Dr Parkinson: is because we are talking about eight per cent of GDP. It is a very important eight per cent of GDP, but there is a very important 92 per cent of GDP which is out there.

Senator LUDLAM: You should tell that to the Minerals Council—

Dr Parkinson: For some reason we have stopped talking about it.

Senator LUDLAM: We have not.

Dr Parkinson: We have to be thinking very carefully about how we exploit the benefits of this once-in-a-century transformation that is occurring globally, and we happen to be in a phenomenal position. To do that, unfortunately, there is going to be quite significant dislocation in parts of the economy. One of those areas, as Senator Cameron knows, is an acceleration of the long-term trend decline that we have seen in manufacturing. We have seen it in Australia in exactly the same way as we have seen it in other advanced economies.

Dr Gruen: Perhaps I can just add to what Dr Parkinson was saying. It is directly relevant to the issue of Dutch disease. The idea of Dutch disease, not surprisingly, comes from Holland. They discovered a natural gas field which they exploited through the 1960s and the 1970s. The exchange rate was driven up. In fact, part of what happened with Dutch disease was that Dutch manufacturing was hurt. It was a much bigger share of the economy than manufacturing is now. The fear was that the natural gas field would be exhausted after some reasonable period of time and that the industrial structure of the economy, which was consistent with Holland's longer term comparative advantage, would be damaged. That was the nature of the argument.

What Dr Parkinson was saying—and I think it is important to understand it—is that Australia's circumstances are, in an important way, different from that. There is no question that we have got a mining boom now, but the mining boom is, to a considerable extent, a consequence of the re-integration into the global economy of a third of the global population. So China and India together are a third of the global population. The process of them re-integrating into the global economy is a process that will not take one or two decades; it is likely to take much of this next century.

At the moment, and for some time, the big manifestation for that for the Australian economy is a mining boom. The other thing that is happening is that for China and India and, for that matter, other countries in Asia, there are huge increases in their middle class. There is an enormous increase in the number of people in the middle class in China and India and elsewhere. In fact, in budget statement 4 we show some really quite dramatic graphs. The projections show there will be an enormous middle class in these countries, and much bigger than the middle class in the US or in Europe.

Why am I saying this? The point is that if we look to our future, 10, 20, 30 years hence, it is likely that those people will have demands for things from all sorts of countries. But they are almost certainly going to have demands for all sorts of things from us. The point is that this re-integration of a third of the global population is likely to change Australia's comparative advantage for a very long time. It is not like once the mining boom is over we just want to return to the industrial structure we had in 2000. It is likely that there is going to be a profound change in ways that are not completely predictable now. There are likely to be significant changes in Australia's industrial structure which will be consistent with making the best of the Asian century.

Senator CAMERON: That really is great encouragement for a 55-year-old fitter in the western suburbs of Sydney or anywhere else who might never work again. That is the problem.

Senator LUDLAM: You cannot get somebody to work on a farm in WA at the moment who can earn \$150,000 driving trucks to—

Senator Wong: Senator, this is one of the big policy challenges of this period in our history. Part of the difficulty is thinking through sensibly, hopefully absent a pretty agro political debate, what are the right policy options to deal with it. You have a set of policy options—and the government has obviously made its position clear about that—about how you try and effectively turn the sale of these non-renewable resources into an income stream. Then you have a set of policy questions about how do you manage the effect of the current terms of trade and the growth in mining and resource investment on the rest of the economy in a way that is sensible. The government has put forward a reduction in the company tax rate, investment in skills and investment in participation as ways forward, but the challenge is: how do you manage this in a way that is not actually going to simply impose greater costs on those sectors of the economy which are not in the resources sector?

Senator LUDLAM: That is why I am asking the questions.

Senator Wong: I am trying to make a point here which is that there is no easy fix.

Senator LUDLAM: No. They are hard questions. I understand that. I am not coming seeking some kind of magic bullet. Just to briefly rain on the parade, I think everybody in the room will be aware that the Australian dollar is now very closely tracking global trade volumes and also—

Dr Gruen: Sorry, Senator. Could you say that again?

Senator LUDLAM: I have been quite struck in the last couple of weeks by the very close degree to which gross world trade, the Australian dollar and world oil prices are now effectively locked together. Those three indicators, over the last four or five years—

Dr Gruen: Gross world trade—

Senator LUDLAM: Yes, world trade volumes. I can get a citation from the IMF that might be helpful so that you are not working in the dark. Let us pare it back a second. The Australian dollar, world oil prices and global GDP, if you like, appear to be very, very closely in sync at the moment. The Australian dollar is now traded as a proxy for trade with China or for Chinese growth. What has struck me the most is that world oil prices now appear to be tracking that as well. As the economy roars back to life globally, world oil prices are zooming up at the same time. That, to me, seems to be completely unsustainable.

I have spent the last two weeks trying to get anybody at all interested in the concept of oil depletion. Treasury is my last hope, really. I am wondering, Mr Parkinson, whether you have done any analysis at all on the impact of oil depletion on global trade?

Dr Parkinson: Do you mean peak oil?

Senator LUDLAM: I do, directly, yes.

Dr Parkinson: No, we have not.

Senator LUDLAM: You have not. You really were my last hope. It is very, very difficult to get anybody else excited about the idea.

Dr Parkinson: There have been a number of studies around that have looked at this, but I do not know whether the IEA has done anything.

Senator LUDLAM: The IEA said conventional oil peaked in 2006. That is why I am finding it difficult to understand why there is very little sense of urgency within the Australian government or, if there is, it is very well concealed.

Dr Parkinson: They said 'conventional oil'—

Senator LUDLAM: That is correct.

Dr Parkinson: I am not aware that we have done any work on this issue.

Senator LUDLAM: Could I invite you to do so? I think it is highly significant that world oil prices are now tracking economic growth.

Dr Parkinson: What we might do is ask ABARES whether they have done any work. We will ask on your behalf. If they have we will ensure that it gets passed to you.

Senator LUDLAM: I am reasonably familiar with ABARES's history of extraordinary failure to predict world oil price movements. I am not sure that they would be the best authority. I would probably go straight over their heads to the IEA. If you have not done it, that is the answer. I will leave it there. Thanks, Chair.

CHAIR: We have another 10 minutes. Senator Bushby?

Senator BUSHBY: Thank you. Thank you to Treasury officials for assisting us today. There are just a couple of things I wanted to follow up from earlier. We were talking earlier about the rapid consolidation of the government's fiscal position. Dr Parkinson then had a discussion with Senator Cormann about whether there is a trade-off between monetary and fiscal policy in terms of consolidation. Dr Parkinson, at one point you indicated that there was a need for a decision to be made about who wears the burden about whether you seek to impose the consolidation through fiscal measures or through tightening monetary policy. What do you mean by who would have to wear that burden?

Dr Parkinson: Senator, all I meant was that monetary policy will have different sets of impacts. For the same contractionary impact on the economy, everything else being equal, monetary policy will hit people differently to fiscal policy. It will hit a different group of people. Even when it hits the same group of people, it will hit them in differential ways. There is not just one way the contractionary effect of fiscal policy will impact on individuals or firms. It will depend on the composition of your fiscal tightening.

Senator BUSHBY: Absolutely. There are a lot of options you can do it within the scope of government.

Dr Parkinson: You could do it by revenue increases or outlays decreases, or some combination within revenue increases. If you do it, for example, by changing personal income tax rates you will get a differential impact than if you do it through some other form of tax. With outlays, you get a differential impact if you cut pensions than, for example, if you cut industry assistance.

Senator BUSHBY: If you are concerned that an economy may be reaching its capacity and, as government regulators, you are looking at how you might address that, there are options through fiscal measures where you have a number of different approaches you can take which will have a number of different impacts. There is not just only one way that a

government of the day could look at it. There are a whole range of factors they can play with which will deliver the desired outcome of contracting the economy but varying possible impacts that it may have on different sectors of the economy and different categories of people.

Dr Parkinson: That is correct.

Senator BUSHBY: On the other side, if you are looking to achieve the same effect through monetary policy, it is probably a more direct impact and there is less flexibility in terms of how you might share that burden. It is more of a blunt instrument—to use a term that is often used about interest rate changes?

Dr Parkinson: In a way, yes, though for quite some time we have tended to think that you are better off—the way I tend to think about monetary and fiscal policy is that fiscal policy is best used to help support the expansion of the supply side of the economy and monetary policy is best used to help manage the demand side of the economy. That does not mean a fiscal policy does not have a role in managing the demand side. That is exactly the discussion we were having before about the importance of fiscal consolidation.

You are right: in the budget you can see measures to improve prospects for infrastructure investment, to improve skills and to improve participation. There are all those you can think of as elements of a strategy to expand the supply side. At the same time, you are making decisions to spend money on those things and you are consolidating, so you are making decisions to actually cut elsewhere in the economy. You are trying to expand the supply side at the same time as you are trying to get fiscal policy to restrict activity—or to lean against growth.

Senator BUSHBY: As we mentioned, the government has chosen a number of measures to try and achieve that outcome. There are a number of options that a government of any day could look at—

Dr Parkinson: That is correct.

Senator BUSHBY: to comprise the mix that would then lead to the outcome that our government might be trying to deliver. The particular mix that the government has chosen it has chosen for its own reasons, no doubt on the basis, to some extent, of advice received from Treasury. A different government or this government could have chosen to try and deliver that with a different suite of measures within its budget.

Dr Parkinson: Absolutely it could have.

Senator BUSHBY: I understand, and I agree, in terms of a trade-off between monetary and fiscal policy, it is not a simple direct relationship where you can say, 'Well, if you cut \$10 billion worth of spending that is equivalent to so many basis points.' It is not a simple thing. We have had that discussion before, Dr Gruen. You are saying that beyond the margins, if it is actually a substantial change, there is a relationship between what might happen.

I guess—and correct me if I am wrong—the way I see it is that ultimately the Reserve Bank, when it is making its decisions on where it would like the economy to be—and it does that 12 times a year—has at its disposal the knowledge of the fiscal settings that a government sets annually in its budget and then with changes during MYEFOs and things like that which happen less often. In doing so, when it looks at it, it will say, 'This is where the economy is at.' It will look at a whole bunch of indicators and also the fiscal position. Ultimately, it will take

all that into account when it decides what to do with its official cash rate. Is that a correct summation?

Dr Parkinson: That is correct.

Senator BUSHBY: In that sense, to some extent—and I guess the question is: to what extent?—fiscal settings by government can impact on decisions that the Reserve Bank Board then makes on the official cash rate.

Dr Parkinson: That is correct, in the sense it has been taken as given. The discussion we were having before was more about to what extent can changes in fiscal policy give you scope for significant changes in the forward profile of monetary policy. The point I was making is that the sorts of changes that we might be talking about in the context of a discussion around faster fiscal consolidation are highly unlikely to be significantly large enough to change the outlook for monetary policy. It is not the case that you could not do it, but the case would be that you would have to do something very, very dramatic to clearly change the forward pathway of monetary policy.

Senator BUSHBY: To quote Dr Gruen from earlier today: 'The fastest consolidation since records began is not likely to have had any impact.' The fact that that is what the government has decided to do—to quote the government and Dr Gruen—is not likely to have had any impact on decisions that the Reserve Board will make over the next 12 months in terms of where it might set the official cash rate.

Dr Parkinson: Just going back to the way you framed it a moment ago, the board will take account of the fact that this is the fastest fiscal consolidation, in the 40-odd years for which data is available, in thinking through the implications of other developments. They take it into account, but if you are asking the question: does the fact that it is the fastest fiscal consolidation mean that interest rates will be a quarter of a percentage point or half a percentage point higher or lower than they otherwise would have been—

Senator BUSHBY: I acknowledge that you cannot see—

Senator Wong: Senator, also—

Senator BUSHBY: Sorry, minister; yes, go ahead.

Senator Wong: If I could just add to Dr Parkinson's answer: you may have referenced the Reserve Bank's own comments on this. They are independent. They obviously have their views. I cannot recall if it is a statement or the minutes, the bank reference, the fiscal consolidation—

Dr Parkinson: The minutes of the last board meeting also reference the consolidation.

Senator Wong: The SoMP, the last one for May, says at page 34:

More broadly, with the budget projected to return to surplus over the next few years, the impact of fiscal policy will be contractionary.

I am not sure I can add to the words of the independent Reserve Bank.

Senator BUSHBY: No, and that is what I would expect. The question that I have then is: if the budget had withdrawn even more of the stimulus money, which would have been even more contractionary and, depending on the size of that, no doubt would have exposed the economy to increased risk—the degree of the size of that risk, I guess, is open to debate, but it would have exposed the economy to increased risk—that similarly would have been

referenced by the Reserve Bank when looking at what they might do with the official cash rate.

Dr Parkinson: That is right. It would be taken into account when thinking about it.

Senator BUSHBY: But, as I mentioned before, not in a clear—

CHAIR: Senator Bushby, it is now 12.30. We will suspend for lunch. We are to have a brief private meeting.

Senator Wong: Is macro required after this?

CHAIR: Yes, for another hour.

Senator CORMANN: We have a few things on the Parliamentary Budget Office which will probably go to corporate and things on—

Senator Wong: PBO is finance. I think we have carriage of that, Senator.

Senator CORMANN: I have some corporate questions because there has been some commentary by Treasury's views on the Parliamentary Budget Office.

Senator Wong: Sorry?

CHAIR: If you could discuss this privately. The committee will now suspend.

Proceedings suspended from 12:32 to 13:30

CHAIR: We resume with the Treasury Macroeconomic Group. Dr Parkinson, I understand that you have a statement.

Dr Parkinson: Yes, thank you, Chair. Senator Joyce, when he was here, made some comments around a number of issues which I just thought I should correct for the record. Senator Joyce implied that we always ended up coming to these estimates to explain why the numbers turned out to be bigger than had been forecast. We had a look at the record. I have a couple of examples. The first is the 2007-08 underlying cash balance surplus—and Senator Joyce was talking about this in terms of debt and deficit. In the 2007-08 budget, the estimate for the budget bottom line was a surplus of \$10.6 billion or one per cent of GDP. That rose in the 2007-08 MYEFO, in the 2008-09 budget. In fact, the 2007-08 final budget outcome was \$19.7 billion or 1.7 per cent of GP surplus, rather than one per cent.

I will give you another example. In the 2009-10 budget, net debt was forecast to be \$53.7 billion or 4.6 per cent of GDP. In fact, the outcome was \$42.3 billion or 3.3 per cent of GDP. Indeed, this year, for 2010-11, at MYEFO in 2009-10 it was estimated that net debt would be around seven per cent of GDP. The budget handed down a couple of weeks ago suggests 5.9 per cent of GDP. We will know the actual outcome shortly, but it is unlikely to deteriorate by a per cent of GDP in that period. I think it was inaccurate to suggest that the numbers went in one direction only or consistently.

The second point that he made was in reference to Professor Rogoff's paper. I need to be careful. I do not know whether he implied or I inferred that the cumulative increase he was talking about was in dollar terms. We have looked at that paper. The Rogoff piece is actually looking at the percentage increase in debt. That is really important to recognise, because if you add \$5 billion to a \$10 billion debt you have a 50 per cent increase. If you add \$5 billion to a \$100 billion debt you have a five per cent increase. Australia started this period with very low levels of debt. The fact that we have the third highest percentage increase, as the Rogoff

paper suggests, does not imply, as was being suggested, that Australia is facing a debt crisis. Thank you for allowing me to clarify that, Chair.

CHAIR: Thank you, Dr Parkinson.

Senator XENOPHON: Dr Parkinson, I will carry on from what you referred to as your cameo appearance yesterday in relation to issues on climate modelling. Whilst this topic goes within the Fiscal Group, I note your willingness to explore these issues further.

Dr Parkinson: I will see what I can do to help.

Senator XENOPHON: Well, maybe not willingness but your availability to provide further information on that.

Dr Parkinson: Recall, Senator, that the modelling has been done in Treasury. I was Secretary of the Department of Climate Change, so I have not had direct involvement in the Treasury modelling recently. I will keep all the answers to a high level.

Senator XENOPHON: I was going to say that my questions will be at a high level, but I am sure that the minister will disagree with that. I am more interested in the architecture of the scheme and alternative approaches. Are permit imports something that is still up in the air, given your understanding as to whether permit imports would be included in any interim carbon tax?

Dr Parkinson: While you have a fixed-price period, whether it is fixed price as an emissions trading scheme or fixed price as a carbon tax, you cannot actually import permits. If the permit price is above the fixed price, nobody will want them. If the import price is below the fixed price, that is all they will want. So if you were having a fixed price period then you would not allow imports during that period.

Senator XENOPHON: I was not quite clear on this yesterday. It was not your answers, but I was not quite clear about whether permits would be allowed. But it would be fair to say that importing permits would be inconsistent or create difficulties for a fixed price carbon tax.

Dr Parkinson: Absolutely.

Senator XENOPHON: That is helpful to me in trying to understand the policy framework. But if you are not importing permits does that mean that the carbon tax will need to be higher or will it mean that the targets will be lower, that something will have to give in relation to that?

Dr Parkinson: We talked about this yesterday. Say you have the same end point target and you prohibit imports for the entire period. Let us say we are working out to 2020 and we are talking about the bipartisan five per cent below 2000. If you prohibit imports through that entire time then what you are guaranteeing is that the carbon price, the permit price or the carbon tax, has to be at least as great as the price you would have if you allowed for imports. I say at least as great because it cannot be any lower than if you had allowed imports because people would not have bought the imports. If purchasing imports allows you to buy cheaper abatement overseas and you prohibit that then doing the same amount of abatement in net terms in Australia rather than doing it spread wherever the abatement is cheapest must mean that you end up paying more. If you are not prepared to do that then something has to give. Either the price has to give or the target has to give.

Senator XENOPHON: Or that might mean that down the track, when there is an emissions trading scheme, there will be more catching up to do, potentially.

Dr Parkinson: That is right. That is why I said if you have a fixed price period for the entire period. If you have a fixed price period for a relatively short time—

Senator XENOPHON: That is three to five years, or three years or so.

Dr Parkinson: It is whatever time you might pick. Remember in the CPRS we had one year. But if you have it for a relatively short period of time and during that period you are setting a price broadly equal to what you think you would have got if the market had been open to imports then you do not actually have any great catch-up to do once you move to the floating period. Essentially, if in setting your fixed price you are replicating what the market would have given you then there is no catch-up to do. If your fixed price is higher than what the open market would have given you then you have imposed a cost on yourself that you did not have to. If your fixed price is significantly lower than where the market price would have been then you have catching up to do because you will not have done as much abatement.

Senator XENOPHON: It is going to be a key part of the architecture and how the scheme is designed to determine what the outcomes will be.

Dr Parkinson: That is correct.

Senator XENOPHON: I appreciate that. I make no secret of the fact that I, along with the former opposition leader, commissioned Frontier Economics to do some work on this. In a recent paper that they provided to the new taxes committee chaired by Senator Cormann they expressed a view that if the interim carbon tax is set at a similar level to the permanent price in the CPRS and if Treasury modelling is to be believed this would put Australia on track for emissions seven per cent above 2000 levels by 2020. I do not know whether you want to take that on notice or whether, in terms of general high-level principles, you are in a position to comment on that.

Senator Wong: This is the Frontier Economics paper?

Senator XENOPHON: This is the paper called magic pudding—

Senator CAMERON: The magic pudding economists.

Senator XENOPHON: I just wanted to say 'magic pudding' before Senator Cameron did. This is the paper that was called magic pudding economics.

Dr Parkinson: If you will allow me to, I will take that on notice.

Senator XENOPHON: That is fine.

Dr Parkinson: I have not read the paper.

Senator XENOPHON: If you could, I would appreciate that. Further to that, President Obama, in his 2011 State of the Union address, proposed a clean energy standard. The Resources for the Future group, which I have referred you to—

Dr Parkinson: Which we talked about yesterday.

Senator XENOPHON: Yes. They are providing some input to the Productivity Commission and they talked about revenue recycling. There would be some benefits in terms of less revenue recycling, which would have a positive economic outcome and you could

maximise environmental benefits, as I understood the RFF approach. I have your letter to Senator Cormann in his capacity as chairman of the new taxes committee.

Senator Wong: The never-ending committee.

Senator CORMANN: It is a very important committee.

Senator Wong: It is a never-ending committee. How long has it been going now—three years, is it?

Senator CORMANN: In various iterations we have been watching you in this policy area for a while, Minister.

Senator Wong: It is very good for you. You get to be the chair and wander around the country.

Senator CORMANN: And scrutinise government activity.

Senator CAMERON: It has not done much constructive work.

CHAIR: I think we should go back to Senator Xenophon.

Senator Wong: Sorry, Chair. You are right. I will be quiet. I apologise.

Senator CORMANN: It is good to know that you are watching us, Minister.

Senator Wong: I just think it is interesting.

Senator EGGLESTON: There was a superannuation committee which Senator Watson from Tasmania chaired which kept going for about 12 years. I think that is probably the yardstick.

CHAIR: Senator Xenophon, would you like to continue with your question?

Senator XENOPHON: Dr Parkinson, to paraphrase Keynes, in the long run all committees come to an end.

Dr Parkinson: All committees come to an end. We may die before the committees finish their work.

Senator XENOPHON: That is right. In your letter to Senator Cormann dated 19 May, you set out, I think quite fairly, the extensiveness of the economic modelling done since 2008. I do not dispute that. I guess the question is about alternative approaches. I refer to the clean energy standard that President Obama set out in his State of the Union address and the Frontier Economics approach, which is an intensity based system with an absolute cap. Is it your understanding that there has been extensive modelling done of that or that the modelling focused on the government's CPRS?

Dr Parkinson: Senator, you know that I chaired the Prime Minister's Task Group on Energy Efficiency.

Senator XENOPHON: Yes.

Dr Parkinson: We did some modelling on a national energy efficiency approach, the so-called NEESI. Clearly, within the confines of a broad package there are initiatives that can help get to areas where a carbon price cannot. There are two points that I would make. One is reflecting on where you went with some of my colleagues yesterday. It is undoubtedly the case that if you are able to remove distortions in the tax system as part of your response you can gain some additional benefits.

Senator XENOPHON: This is the tax interaction effect, the multiplication.

Dr Parkinson: I am dredging my memory, but I think it was the Congressional Budget Office in the United States, in 2005 or 2006, that, when thinking about the design of emissions trading there, made the point—

Senator XENOPHON: You know you are making me have to read it now, don't you? Now you have mentioned it I will have to look it up.

Dr Parkinson: You are forcing me to read both Frontier Economics and Resources for the Future.

Senator CAMERON: Don't waste your time, Dr Parkinson. Take it from me!

Senator XENOPHON: Dr Parkinson, I think it is a fair swap. You can ask me 20 questions on it.

Senator CAMERON: Malcolm Turnbull took my advice and stopped being a puppy dog.

Dr Parkinson: The particular CBO report that I am thinking of makes the point—forgetting about the distributional impact on households—from a pure economic efficiency approach. I think it was suggesting that using the revenue to eliminate things such as payroll taxes could actually be enhancing economic efficiency. That did not go to the question of what would be the price impact on households, but it was making a similar point to what you were talking about yesterday.

Senator XENOPHON: So in any design of an emissions trading scheme or a carbon tax, what priority will be given to the tax interaction effect? How front and centre is that in any design package?

Dr Parkinson: I think it is fair to say that there are lots of issues being considered in the design of potential compensation responses. A range of issues will come up there.

Senator XENOPHON: Can I just raise this issue as a result of what President Obama has said and what the Congressional Budget Office has said, and in the context of China looking at an intensity based scheme. Obviously it is not a capped scheme. I understand that they are looking at reducing the energy intensity of certain industries.

Dr Parkinson: Can I just clarify that the Chinese government has committed itself to improvements in emissions intensity per unit of GDP and indeed has kicked that off with its new five-year plan. But, in addition, it has commissioned 13 cities and provinces to explore the use of market based instruments, including cap and trade.

Senator XENOPHON: Sure, although as I understand it, the primary focus is an intensity based per unit scheme.

Dr Parkinson: No. The focus today at a national level is on reducing emissions intensity per unit of GDP, but, at the same time, they are preparing the ground and they have sent eight cities in five provinces, the 13 together, to experiment with different approaches, using market mechanisms, including cap and trade. The NDRC, the National Development and Reform Commission, have been very clear that that is what they have been tasked to do.

Senator XENOPHON: Given both the emissions trading approach and the intensity approach, which seems to be an interim measure, and given what is being proposed by President Obama, is that relevant in the design of any scheme, given what our major trading partners may be doing?

Dr Parkinson: No.

CHAIR: Senator Xenophon, we are getting dangerously close to climate change policy discussion here rather than tax. We had this discussion yesterday.

Senator XENOPHON: It is nearly over for me. I was going to ask about the fiscal implications of that for the design. That was the context, Dr Parkinson. I was not being mischievous.

Dr Parkinson: I was not assuming you were. It is not actually relevant to us. If we have a cap and trade scheme where we can import permits, those permits do not have to arise from other emissions trading schemes. There are different ways in which permits can be generated that we can accept into our scheme. How we decide to do that is a matter for us.

Senator XENOPHON: Do you mean imported permits or permits being generated?

Dr Parkinson: Imported permits, yes. For example, we could simply import clean development mechanism permits. Or we could allow the importation of permits from a country that has an emissions trading scheme—for example, New Zealand.

Senator XENOPHON: How far advanced are New Zealand at the moment? Are they up and running?

Dr Parkinson: They already have a scheme running.

Senator XENOPHON: They are up and running and they are trading permits?

Dr Parkinson: Yes.

Senator XENOPHON: I will read the Congressional Budget Office report.

Dr Parkinson: It is not that worth while.

Senator XENOPHON: No, I will.

Dr Parkinson: It was an interesting exercise a number of years ago.

Senator XENOPHON: Sure. Could you take on notice that question in relation to the assertion by Frontier Economics of an increase in emissions.

Dr Parkinson: We will have a look, yes.

Senator XENOPHON: Thank you.

Senator BUSHBY: I will move on from the questions I was asking before lunch. I have another follow-up, though. There was some questioning about table 1-12 in Budget Paper No. 1, which compares the Australian projected debt position against those of other G7 nations. I am correct in saying that Australia is not a G7 nation, is it?

Dr Parkinson: No.

Senator BUSHBY: I know it is G8 now, but it refers to G7 on the table.

Dr Gruen: Those are the G7 countries in that list.

Senator BUSHBY: What used to be the G7 countries.

Dr Parkinson: No, sorry. That is the G7. The G7 still exists. The G8 just adds Russia.

Senator BUSHBY: Okay. Australia is not one of those, though. They have not changed the threshold point. A lot of the comparison that seems to occur—and my side of politics is guilty of it in respect of some indicators, as the government is in a lot of other indicators—does appear to be with countries like the UK and the US in terms of where we are at the

moment. But not all OECD countries are in an equivalent position to those countries that are in the G7, in terms of debt. That is correct, isn't it?

Dr Gruen: That is correct.

Senator BUSHBY: Countries like Chile, Sweden, Saudi Arabia, Finland and Norway all have very different debt situations to those G7 countries.

Dr Gruen: Yes. That would be right. They would have a range of different debt situations. That is true.

Senator CORMANN: They have no debt. In fact, they have savings.

Dr Gruen: In the case of Chile.

Senator BUSHBY: Chile, as I understand it, has net assets of 11.4 per cent of GDP. Sweden has 13.8 per cent. Saudi Arabia has 51 per cent. Finland has 52.6 per cent. Norway has a massive 157.3 per cent.

Senator Wong: I am sure Dr Gruen is very happy to answer that question, but I think I made the point to Senator Cormann in previous estimates—

Senator CORMANN: We had this discussion in Finance and you said we should discuss it in Treasury.

Senator Wong: I do not think I was telling you not to ask the question. I am responding to something Senator Bushby said. I am making an observation that, on the one hand, you want a comparison with a different set of countries. On the other, some of those countries—I think Finland, Norway and Sweden were three that you identified—have had a carbon price in place for some time. So it seems a little odd, doesn't it, Senator Bushby, that on the one hand a carbon price is going to be dreadful for the economy but on the other hand you are urging the government to look to these countries that have had a carbon price for some years as an exemplar of good economic management.

Senator BUSHBY: The issue that I am raising here is the net debt of those countries. The issue of a carbon price in those countries is obviously a complicated one when we are comparing with other nations. I am not looking to get into that. I am talking about the comparison of table 1-12—

Senator CORMANN: She is trying to divert the question.

Senator Wong: You cannot have it both ways, though, Senator. On the one hand you say we should be looking at the purposes of one thing—

Senator CORMANN: You can absolutely have it both ways, because what you are doing is not in any way—

Senator BUSHBY: Why don't we talk about defence spending while we are at it, or something to do with education? The issue I am raising is in a macroeconomics area—

Senator Wong: I am responding to that. You said, 'Why don't we talk about defence spending or education?' I would say this to you: because no-one in this parliament, from either party of government, is suggesting that defence spending or education spending will bring the economy down. Yet that is the approach that you are taking. So it is an entirely different context. You cannot sit there and say, 'Government, you should look to Sweden, Norway and Finland for the purposes of macroeconomic management,' without reflecting the fact that they

also have a carbon price—the very type of policy that you say will end the economic sunshine as we know it.

Senator BUSHBY: I do not think that we have ever said that the economic sunshine is going to end, but what it will do is have an important impact on the cost of living of Australians. It will have an impact on jobs.

Senator Wong: Senator, with respect, you should have spoken to your leader. I reckon he has said more than that.

Senator CORMANN: Senator Bushby is quite right: he has never said the sunshine is going to end.

Senator Wong: He has used much stronger language.

CHAIR: We are getting into toing-and-froing rather than answering questions.

Senator BUSHBY: My question, having highlighted that there are other OECD nations that have very different net debt position, some of which are also comparable in the sense that they are commodity exporting nations, is: why doesn't Treasury also look at a broader sample? With a lot of those G7 countries the size of the economy is more comparable to Australia than that of the US. Why doesn't Treasury broaden the examination when it provides comparative statistics to highlight that Australia is not that different to other OECD nations in terms of its debt position? Why does Treasury always compare against the slowest runners in the field rather than the fastest runners in the field, which presumably we are one of?

Dr Parkinson: I will make two comments. The first thing is that there is a supposition in your question which is a very common one in Australia and that is that we are a little economy. We are actually not. We are not a small economy.

Senator BUSHBY: But we are not the same scale as the United States.

Dr Parkinson: No, we are not, but we do not have their population either.

Senator BUSHBY: Exactly.

Dr Parkinson: There are the major advanced economies—your G7. Then there is a group of advanced economies. If you look at the advanced economies for comparison, the advanced economy average debt—G7 general government net debt in 2011—is 79.5 per cent of GDP. For advanced economies, including all of the others that you are talking about and more, it is 70.2 per cent of GDP. For Australia it is 7.2 per cent of GDP. The reason I want to highlight that is that Australia is actually about the 14th largest economy in the world. It depends on which metric you use. But it is right for us to compare ourselves to the major developed economies. The objective should be to do better, and indeed a lot better, than them. We have not put in comparisons with Finland or Greece, for that matter. Greece is—

Senator BUSHBY: Far worse than the ones you have included.

Dr Parkinson: Absolutely. We are just trying to use a common grouping that everybody knows and that traditionally has been something to which we would have aspired to compare ourselves to.

Senator BUSHBY: We are an economy that is doing reasonably well comparative to other nations.

Senator CAMERON: Reasonably well!

Senator BUSHBY: We have had some pretty good foundations from decisions that have been made by the Hawke government, the Keating government and the Howard government that set us up very well. But we are not unique in the sense that there are other nations around the world that are also doing well. I would have thought that there would be some usefulness in comparing us, as a fast runner, with the other fast runners to see how we are comparing against other advanced economies that are also doing well. You get distorted pictures if you compare us only with those who are performing badly when there are other economies that are performing well. It would be useful, I would have thought, to see how we are comparing against the frontrunners.

Dr Parkinson: That, again, happens on a regular basis in the IMF and OECD reports.

Senator BUSHBY: But not in the budget papers.

Dr Gruen: Sometimes in budget statement 4 we take a topic and look at it in some more detail. In the 2009-10 budget we had a statement 4 which was called *Assessing the sustainability of the budget*. In there we did a range of comparisons. One of the ones we did was to look at Australia along with all the countries which have different sovereign credit ratings. We looked at things like net debt. Indeed, it was the case, looking at net government debt and other things—

Senator CAMERON: Barnaby will be back again in a minute if you keep that up.

Senator BUSHBY: That was a useful contribution.

Dr Gruen: So, on average, for AAA-rated sovereigns in 2009 net general government debt was of the order of 21 per cent or 22 per cent of GDP. I am reading off the chart. We are at four or five, peaking at 7.2. I think that is the number in the budget. So we do do comparisons with countries other than the G7. It is just that the G7 is a grouping that is very well-known and is comparable to us in some ways. It does include one commodity exporter; it includes Canada.

Senator BUSHBY: I know that Canada is a commodity exporter. But, similarly, it is not what you would necessarily say is one of the OECD frontrunners in terms of its current net position.

Dr Gruen: But we are. We are one of the frontrunners.

Senator BUSHBY: I do not disagree with that, particularly compared to those and most other OECD countries. But there are other OECD countries that are ahead of us. I am just curious as to why there are no comparisons with those who are in a better position than we are. I thought that might have been instructive. I will move on from there. I accept your answers and I will move on to something else. Still on debt, could you explain the process for calculating net interest payments. We have actually gone over that to some extent.

Senator CAMERON: Did Barnaby leave you that one?

Senator BUSHBY: We did talk about the difference between gross and net. I will not go into that again. But what I do want to know is: why do net interest payments continue to increase whilst the debt is falling in the budget papers?

Dr Gruen: Can you show me the page? This is really a question for Fiscal Group, but I may be able to help you.

Senator BUSHBY: It is Budget Paper No.1, table 3, page 10-8.

Dr Parkinson: This is net debt. We could take that on notice and come back to you. It will be relatively straightforward. One of the issues could be that gross debt on issue remains high and market interest rates have risen.

Senator BUSHBY: It could be assumptions about market interest rates.

Dr Parkinson: No. Remember that what we are looking at here is net debt. Net debt is gross debt on issue less the financial assets that we have built up.

Senator BUSHBY: Those factors that we have discussed.

Dr Parkinson: If the financial assets are essentially cash at the Reserve Bank, we will be earning a very minimal amount of interest on it, whereas we would still be paying market interest rates on the gross debt. It could have something to do with that.

Senator BUSHBY: I would appreciate it if you would take that on notice.

Dr Parkinson: We will take that on notice and get back to you. It is a straightforward question.

Senator BUSHBY: I am sure it is, but it was a curious thing to read that as net debt goes down the interest payments continue to rise. If there are assumptions about it—

Dr Gruen: It may also be that there is obviously debt maturity. So, to the extent that some of the things that are maturing have lower interest payments, what is left has—

Senator BUSHBY: I was going to say that if there are some assumptions about what might be happening with interest rates as debt comes off and goes on I would be interested in that as part of the answer as well.

Dr Parkinson: If our Fiscal Group colleagues were here they would be able to answer this for you off the top of their head. I am afraid I cannot do that.

Senator BUSHBY: I would appreciate, then, if you could take that on notice. What interest rate is used to calculate the net interest payment? It is a reasonably sophisticated approach, isn't it, looking at the issue of what is coming off and then—

Dr Parkinson: No, it is the interest rates that the debt is issued at. So when we issue debt today we issue it at a particular interest rate.

Senator BUSHBY: I know that, but in the forward estimates you have some debt coming off and you have to make assumptions, presumably, about—

Dr Gruen: I think we use the current yield curve. I could stand corrected. As I understand it, we use the yield curve at the time we are putting this together and a weighted average of the yield curve. We obviously issue at different maturities, so it will not just be the 10-year rate. It is a weighted average of the yield.

Senator BUSHBY: That is right, because some of it will come off and might go on for 18 months, depending on what—

Dr Gruen: Indeed, so I think that is what we do. But I stand to be corrected.

Dr Parkinson: We will take that on notice and get back to you.

Senator BUSHBY: Thank you. I have a couple of other questions which you might be able to answer or might not. It appears that net interest payments continue to rise until the last figure in that table of 2014-15 to 7,498.

Dr Gruen: But not as a percentage of GDP, as you can see.

Senator BUSHBY: No, but in terms of actual figures. It is mainly stable as a percentage of GDP.

Dr Gruen: Indeed.

Senator BUSHBY: It is continuing to increase in terms of actual number.

Dr Gruen: Yes.

Senator BUSHBY: Are there any projections for what it is likely to do in the years following that?

Dr Gruen: Yes. There are in the sense that the chart that we were talking about with Senator Joyce shows you projections of net debt, and in order to get projections of net debt you have to have background information.

Senator BUSHBY: So will the \$7½ billion be the peak or does it get higher?

Dr Parkinson: I do not know the answer to that.

Senator BUSHBY: Could you take that on notice.

Dr Parkinson: Yes. Senator, these are questions which AOFM, the Australian Office of Financial Management, and our Fiscal Group colleagues could answer off the top of their head.

Senator BUSHBY: They are on later tonight.

Dr Gruen: Did you say AOFM are on tonight?

Senator BUSHBY: They are on late tonight, yes.

Dr Parkinson: Then you will be able to ask them.

Senator BUSHBY: Can you take it on notice as well. Even if it is answered tonight, I would appreciate Treasury's perspective on that as well.

Dr Parkinson: AOFM is part of Treasury.

Senator BUSHBY: I mean the Fiscal Group.

Senator CAMERON: Don't let your empire crumble too quickly, Dr Parkinson.

Dr Parkinson: There are some parts I might be tempted to give away.

Senator Wong: That is going to do morale good in the department. 'Are we the bit he wants to get rid of?'

Dr Parkinson: I did not say within the department.

Senator Wong: Within the portfolio.

CHAIR: Senator Bushby, do you have any more questions?

Senator BUSHBY: Yes. I will just ask one more set of questions before leaving a little bit of time for my colleagues to ask some more. Budget Paper No. 1, on page 6-46, shows a time series for net capital investment. I note that this item is generally positive between \$3 billion

and \$5 billion in each year except for the 2012-13 year, when it turns sharply negative by \$1.367 billion. Could you explain how net capital investment is calculated, please.

Dr Parkinson: Again, this is a level of detail that is best addressed to our colleagues in Fiscal Group.

Senator BUSHBY: I hesitate to raise the issue that we had a little bit of controversy over yesterday, but we were told, when it was explained to us that you were appearing today, that we could ask fiscal questions today and that officers would be present to assist.

Senator Wong: Senator, with respect, that is true. We have taken many questions for Dr Parkinson on that. But these are questions of great detail about the budget papers. We really would need officers who deal with these figures to be at the table. The secretary would generally not have all of these answers. He is smart, but he would not have all of these off the top of his head.

Senator BUSHBY: I am quite sure he is smart. He has been there for three months and I imagine there are a lot of things to look at in Treasury. Although I am sure he would remember everything he has looked at, he may not have looked at everything quite yet.

Dr Parkinson: I assure you I have not looked at what underlies that question.

CHAIR: Where it is a matter of facts and figures you can put these questions on notice.

Dr Gruen: There is a sentence on the next page that may help you. If you are interested in the change in the net capital investment between 2011-12 and 2012-13, there is a sentence which says:

The significant reduction—

I am now reading from page 6-47—

in net capital investment in 2012-13 is due to a number of items in the Contingency Reserve.

Senator BUSHBY: Yes, and I am interested in knowing what they are.

Dr Gruen: Okay. Sorry. I was trying to be helpful.

Senator Wong: We had that discussion in Finance.

Senator BUSHBY: With respect to these particular depreciation figures?

Senator Wong: No, in terms of what is in the CR. I hope we do not have to reprise Senator Cormann's and my lengthy discussion about it.

Senator BUSHBY: I cannot speak for my colleagues. I am not intending to go through the contingency reserve data, but I am interested in this particular figure because it does not appear to reflect a significant decline in purchases of non-financial assets, as indicated in table 21 on page 6-50. So, to me, it seems like it must be the result of an increase in depreciation expenses.

Dr Parkinson: We will take it on notice and see if we can give you an answer.

Senator BUSHBY: I will finish up by reading the question I was going to ask and you can take it on notice. My calculations suggest that depreciation expenditures must increase from \$6,156 million in 2011-12 to \$10,534 million in 2012-13 and then drop back to \$5,863 million in 2013-14 and \$6,134 million in 2014-15 on the basis of these figures. Obviously, if you could prove otherwise I would be delighted that you could. So what I want to know is: why are depreciation expenses—if this is indeed what they are—so much higher in 2012-13?

I also want to know the degree of latitude that exists for moving depreciation expenses from one year to another when you are putting together the budget. Thank you.

Senator CAMERON: Dr Parkinson, we have been talking about manufacturing. We have been talking about the coal industry. You did indicate—I am not sure whether it was you or Dr Gruen—that one of the big issues facing the manufacturing sector was the high dollar and the crowding out of manufacturing by the minerals sector. Today Mr Abbott said that the carbon tax ultimately spells the death of the coal industry. He said it spells the death of the manufacturing industry. Can you just reprise what are the biggest threats for our manufacturing industry and is this correct that a carbon tax spells the death of the manufacturing industry?

Dr Parkinson: Without reflecting on what Mr Abbott may or may not have said, because I obviously do not know, the challenge to manufacturing is twofold. One aspect is the long-term structural change that has been occurring in our economy, which has seen manufacturing's share of employment fall quite dramatically. Indeed, there is a chart in the ABE speech which shows how the structure of our economy has changed over time and how we are not unusual, relative to the other advanced economies, in the declining share of manufacturing. That challenge is one that is being faced by the United States, the UK and all of the other advanced economies, including those in Asia. A natural part of the progression of economies is that, as they get richer and they evolve, a greater share of activity occurs in the services sector and there is a compression in the relative size of manufacturing. That clearly was exacerbated by the emergence in the last 20 or 30 years of large-scale manufacturing in countries with large supplies of labour—for example, China, India et al.

But now manufacturing is facing a second challenge, which is that caused by the terms of trade shock. That manifests itself in two ways. Firstly, the profitability of the mining sector and other sectors is influenced by the terms of trade, so they are better able to pay higher wage rates or to bid away any capital from manufacturing. Secondly, the pure exchange rate effect undermines the international competitiveness—everything else unchanged—of exporters and import competing firms. That is particularly the case for manufacturing. As we have talked about in other places, in the context of a carbon tax there have been a lot of extravagant claims—they are perhaps the kindest words one could use—about the impact of a carbon price on particular sectors in the economy, such as steel, coal and various others. Those claims, in my view, do not stand up to scrutiny. There are pressures on the steel industry that have nothing to do with the imposition of a carbon price. There are pressures on the manufacturing sector that have nothing to do with the imposition of a carbon price.

Senator CAMERON: So, given the pressures that are already on manufacturing and manufacturing workers, a manufacturing worker in the western suburbs of Sydney or Melbourne does not have to go home tonight and worry that a carbon tax is going to destroy their job, do they?

Dr Parkinson: No, absolutely not.

Senator CAMERON: Thanks.

Senator CORMANN: I have a question about the macroeconomic outlook. Do you monitor trends in industrial relations and their implications for productivity and the

macroeconomic outlook? How does that feed into your assessment of how we are going, moving forward?

Dr Gruen: We monitor everything that we think is relevant to macroeconomic outcomes. Industrial relations would be one of the things that we monitor, along with a lot of other things.

Senator CORMANN: So what have you observed in your monitoring in the last 12 months and what is your outlook, moving forward? It is in the context of the front page headline today that says unions can strike first and talk later. There is obviously unrest in the context of Qantas. There is unrest on our waterfronts. There seems to be, across the mining industry, an increasing incidence of more assertive industrial relations. That is a gentle way of putting it.

Senator CAMERON: You want to bring back Work Choices, do you?

Senator CORMANN: I am asking a question.

Senator CAMERON: You want Work Choices back. Bushby wants Work Choices back.

Senator CORMANN: Here we go!

CHAIR: Senator Cameron, Senator Cormann is trying to finish his question.

Senator CORMANN: I am asking to what degree you think that what is happening across the economy now and what you expect to happen in the industrial relations area is going to impact on the macroeconomic outlook for Australia.

Dr Gruen: I guess what we are particularly interested in in terms of that question is wage developments. Wage growth slowed very considerably in the global financial crisis as unemployment rose from four per cent up to 5.8 per cent. Now wages growth has sped up. The latest reading on the labour cost index is four per cent during the year, or it is high threes?

Mr Duggan: It is 3.8 per cent.

Dr Gruen: That seems to us to be pretty consistent with where we see the economy, which is at close to full employment. We monitor what is going on in the industrial relations arena. I guess what matters ultimately is what the outcomes are, rather than the process by which you get to those outcomes. We keep a watchful eye on this, but I would say that developments to date are quite consistent with where we would expect to see wage growth, given where unemployment is.

Senator CORMANN: Sure. You say that on the basis that your interest is what the outcomes are, but of course there are now a whole range of areas where we do not yet know what the outcomes are going to be. There are two things that matter. The first is what the outcomes are going to be and making sure that growth in wages is consistent with what a sensible trend line is going to be, moving forward. The other bit is whether there is going to be an outcome that can sensibly be achieved. But at this point in time you are not concerned about the early signs that it appears to becoming a bit more difficult to bring the parties together to actually reach an outcome than it has been in the recent past?

Dr Gruen: At this stage, I think outcomes are consistent with where we would expect them to be. The other thing which I think is a kind of sign of the flexibility of the system is that you get significantly different wage outcomes depending on the sector of the economy that you are looking at. So you have seen quite strong wage growth in mining and quite

moderate wage growth in the retail trade. That is a sign also of the labour market operating across sectors in a way that is consistent with the more efficient labour allocation across the economy. There have clearly been changes in the industrial relations environment. Thus far we think that the behaviour of labour market aggregates, wages, is pretty consistent with where we would expect it to be, given the unemployment rate. The future may hold surprises for us. We do not know that. But so far we do not think anything particularly untoward is happening.

Senator CORMANN: Any changes in the legislative framework obviously could take a while to work their way through, so it would be something that you would be monitoring, moving forward—that is, whether there are going to be outcomes affecting our economic situation?

Dr Gruen: Yes, but we would do that as a matter of course.

Senator CAMERON: You will not have to monitor New South Wales very much with what Barry O'Farrell is doing. Take any rights away from workers—we know that is where you guys want to go. You are the same as New South Wales: take all the workers' rights away.

CHAIR: Senator Cameron!

Senator CORMANN: Thank you, Madam Chair. I have a few more questions, so I am being very restrained. Dr Parkinson, I flagged that I was going to ask a few questions in relation to the review of the GST distribution. I gather that Treasury is running the secretariat for that review.

Dr Parkinson: That is correct. As you know, the panel is former premiers Greiner and Brumby and Mr Bruce Carter. The secretariat is in Treasury and it is headed by somebody who will be well-known to many members of the committee, Mr Phil Gaetjens, one of our very experienced senior officials. It has a joint Commonwealth-state team. Other than Mr Gaetjens, there are about three or four Commonwealth Treasury staff. There are a couple of people from the states, nominated by the states, and a couple from the Grants Commission.

Senator CORMANN: And the objective still is that the review would lead to:
... a simpler, fairer, more predictable and more efficient distribution of GST to States and Territories. Instead of States facing penalties for economic growth and rewards for economic underperformance, the GST distribution process should encourage economic reform and better delivery of services, and provide States with certainty.

That is still the objective, Dr Parkinson? That is from the Treasurer's press release.

Dr Parkinson: If it is out of the Treasurer's press release and the terms of reference, yes, that is the objective.

Senator CORMANN: That is still your objective?

Dr Parkinson: Yes.

Senator CORMANN: Given what we talked about yesterday, the concerns that Queensland has expressed and the concerns that Western Australia has expressed about the current system not encouraging economic growth—

Senator CAMERON: Senator Bushby, now is the time to stand up for Tasmania!

Senator CORMANN: and providing rewards for economic underperformance—

Senator CAMERON: Stand up for Tasmania! This guy is going to do you over.

Senator CORMANN: These are your government's term of reference.

Senator CAMERON: This guy is going to screw you over.

CHAIR: Senator Cameron!

Senator CAMERON: Senator Bushby, stand up for Tasmania!

CHAIR: We are in the final session and Senator Cormann is working through questions.

Senator CORMANN: You are reflecting on the Treasurer's review of the GST.

Senator CAMERON: Stand up for Tasmania! Don't let this guy take every cent off you.

Senator BUSHBY: I do not think he has that option.

Senator CORMANN: Dr Parkinson, that review is still due to report by February 2012?

Dr Parkinson: There is the first report, by February 2012, then the final report by August-September 2012.

Senator CORMANN: In terms of timing, it says in the release that the GST shares will be distributed in 2011-12 and 2012-13 based on the current arrangements.

Dr Parkinson: That is correct.

Senator CORMANN: So am I to assume that 2013-14 onwards would be based on the revised arrangements?

Dr Parkinson: From 2013-14 onwards will be the first time any revised arrangements could be introduced. It is not saying that 2013-14 will be based on revised arrangements, but it would be the earliest time.

Senator CORMANN: Given the fact that the changes in royalty arrangements in Western Australia, the removal of the royalty concession for iron ore fines, are going to take, according to the Commonwealth Grants Commission, until 2014-15 for the first phase and 2015-16 for the second phase to start working their way through the system, it is fair to say that by the time horizontal fiscal equalisation comes into play as a result of that royalty decision in Western Australia we would actually be likely to have a new GST-sharing arrangement in place which is focused on preventing penalties for states that are going for economic growth and providing rewards for economic growth rather than rewarding economic underperformance. So we will have a changed GST distribution system in place by the time the consequences of the budget decision in Western Australia, from an equalisation point of view, have actually worked their way through the system.

Senator Wong: There are a lot of hypotheticals in that question, Senator.

Senator CORMANN: There is nothing hypothetical.

Senator Wong: You are saying, 'If this happens and the result is this, therefore this will happen by this date.'

Senator CORMANN: Minister, I just asked him whether it was going to happen. I just asked the Treasury Secretary if what the Treasurer promised at the end of March is going to happen in the time line outlined in the press release. The Treasury Secretary confirmed that it was.

Senator Wong: Are you not assuming an outcome for the review in that question?

Senator CORMANN: I am assuming that the review is going to have an outcome. Sorry, yes, I am assuming that.

Senator Wong: You misunderstood what I was saying. I am not saying there will be no outcome. I am saying you are assuming a particular outcome in the review.

Senator CORMANN: I am assuming the outcome that the Treasurer has promised in his press release, which is:

Instead of States facing penalties for economic growth and rewards for economic underperformance, the GST distribution process should encourage economic reform and better delivery of services, and provide States with certainty.

Yes, I am assuming that what the Treasurer is saying the outcome of the review will be will indeed be the outcome of the review. If you are telling me that is not going to be the outcome—

Senator Wong: No. Do not verbal me.

Senator CORMANN: That is what you have just said.

Senator Wong: I am not going to be verballed. My point is that there are policy propositions which are referred to in the Treasurer's press release—which I do not have in front of me. But, as you know, as to how those policy positions might be given effect, I am sure there are a number of ways, which is the very purpose of having the review in any event. I am simply making a point that your question to the secretary assumes a particular set of outcomes as a result of the review.

Senator CORMANN: No, it does not. It does not assume a particular set of outcomes at all. It just assumes—

Dr Parkinson: Perhaps I can help. As you mentioned, the Treasurer's press release says:

The incentive for states to pursue reforms which get the best performance for their economies can be ... dulled by the current arrangements ...

On the other hand, major errors that lead to sustained slow growth can be compensated for. It says that states should have an incentive to invest in economic reform and not be unfairly punished for success.

Senator CORMANN: Which is very sensible. That is great.

Dr Parkinson: Then the Treasurer goes on to note that as well as structural problems that need to be addressed, the economy is undergoing some major shifts, growth in the mining sector is increasing the discrepancy amounts of revenues raised by states and territories, making it difficult to anticipate GST distribution from one year to the next. That has all been picked up in the review. What I said—and this goes to item 12 in the terms of reference—is that the GST shares for 2011-12 and 2012-13 will be based on the current arrangements. It will only be agreed recommendations that come out of the review that could be used in future. They would not be able to be used any time earlier than 2013-14. It is not saying they will be introduced in 2013-14. It could be much later. It is not even clear that, in the end, the states will be able to agree on a set of ways forward.

Senator CORMANN: Secretary, I completely understand that. Obviously, ultimately it is going to be the federal Treasurer who gives direction to the Commonwealth Grants Commission, because that is his responsibility under the act. The point here is that the 2010

review caused certain issues because of the change in the categorisation of minerals and resources. That has caused issues in Queensland and Western Australia which go against what the Treasurer says he is now trying to address. The decision by WA two weeks ago to remove a royalty concession caused some comments by the Treasurer where he seemed to imply that Western Australia would get penalised as a result. The only observation I am making is that by the time the Commonwealth Grants Commission processes catch up with what happened in Western Australia two weeks ago, if the timetable is still consistent with what the Treasurer announced and if the objectives are still consistent, the Commonwealth Grants Commission will be operating under a different set of rules and methodologies.

Dr Parkinson: We are almost on the same page but just slightly out of sync. What I am talking about is any agreed recommendations. So the first thing is: can they be agreed? One of the reasons we are doing this is that the states have expressed diametrically opposed views about the approach to be taken, so the Commonwealth thought it was sensible to step back and have an independent assessment done; hence the Greiner, Brumby, Carter panel. The second thing is, if there are agreed recommendations—that is, the states are able to be reconciled on this—then they could not be introduced any earlier than 2013-14. They may well be agreed and not introduced till later.

Senator CORMANN: Sure, I understand. But are you suggesting that the states have to unanimously agree for any recommendations to be implemented? That is not past practice.

Dr Parkinson: No, that is right.

Senator CORMANN: The changes in royalty ranges for iron ore fines will take effect in WA from 1 July 2012 for the first phase and 1 July 2013 for the second phase. Obviously the way the Commonwealth Grants Commission processes work there is a lag.

Dr Parkinson: It works with a lag of two years.

Senator CORMANN: So advice yesterday was that the first phase will not get into the update until 2014-15 and then 2015-16. The time line that you have spelled out means that by the time we are likely to be working under the revised arrangements, whatever they are going to be, as long as they are consistent with the objectives the Treasurer has set out we will have a very different type of GST sharing arrangement.

Dr Parkinson: If we have new arrangements by 2013-14, the first year in which they could be introduced, then they could be very different from what we have now.

Senator CORMANN: Does it have to be a unanimous agreement—is that what you are suggesting?

Dr Parkinson: No but you have to understand that the states have diametrically opposed positions here.

Senator CORMANN: I understand that.

Dr Parkinson: For them, this is a zero-sum game. So we will need to see how all this plays out and see whether there is a way forward.

Senator CORMANN: Whatever happens, though, none of the money will come to the Commonwealth as a result of changes in the equalisation process?

Senator CAMERON: That question has been answered a thousand times.

Dr Parkinson: But that is always the case. We are just distributing the GST revenue.

Senator CAMERON: If Senator Bushby stood up for Tasmania he could get national press two days running.

CHAIR: I cannot hear the answer. Senator Cameron, order! Sorry, Dr Parkinson. Did you finish your question?

Senator CORMANN: Yes.

Dr Parkinson: I am happy to finish.

CHAIR: And we will finish. Thank you.

[14:37]

CHAIR: I now call the Treasury Markets Group. Welcome Mr Murphy, do you have a general opening statement?

Mr Murphy: No, thank you.

CHAIR: We will begin, then, with the Superannuation Complaints Tribunal.

Senator HEFFERNAN: I have a letter here from the Superannuation Recovery Action Group. There is a company called Ruttley transport and they have a history of probably 10 years of not paying child support across to the agency under great sufferance. They have a history of having their payroll on companies that go into liquidation and do not pay their superannuation, and I have a long line of people who have not been paid superannuation for 10 years who have been employed, with their super still outstanding. The letter says:

Dear Senator Heffernan,

Thank you for agreeing to receive this documentation as requested by [a certain person] on 14 February [2011]. After overviewing the attached documentation you may appreciate this is a very serious problem that all employees at Ruttleys are facing. There have been many attempts by individuals over many years to rectify this problem. They inevitably fail and they are forced to move on to other employment without receiving the unpaid super payments due to them by Ruttleys. We have started a register for all persons who are current and past employees of Ruttleys and their associated shelf companies—

which is how they dodge the business—

that are owed superannuation payments, and I have enclosed a few as samples for you to view. Having been in contact with many of the past and present employees, we envisage that we will eventually collect hundreds of these statements and they will tell the same story of nonpayment. While being engaged in the pursuit of unpaid superannuation we have also become aware of a second and perhaps more serious problem, this problem being the failure of Ruttleys to pass on child support payments they have been deducting from some employees' wages to their ex-wives and dependent children.

And so it goes on. What is the history of your division or whatever with a company that could get away with—I have the company names here—over a period of years they simply put the company into receivership and do not pay the money. There is an account here where you have them in the courts for \$7 million from the Taxation Office.

Mr Murphy: Yes. That would be primarily a concern of ASIC, the Securities and Investments Commission, and, if it is with superannuation, the ATO.

Senator HEFFERNAN: But aren't you the superannuation complaints?

Mr Murphy: These officers are from the Superannuation Complaints Tribunal, which primarily deals with conflict between parties over the payment of superannuation.

Senator HEFFERNAN: Isn't that precisely what this is?

Senator Wong: Senator, what I propose—because obviously there are concerns about the facts you have raised—is that, if you provide that information to Mr Murphy, we will take it on notice and we will pass it on to the relevant bodies, which I understand would be the ATO and ASIC.

Senator HEFFERNAN: Can I table this letter now, because I have permission? I did not have permission in the ASIC hearing yesterday to table the letter.

Senator Wong: No, no. If you give it to Treasury, we will ensure it is passed on to the relevant authorities.

Senator HEFFERNAN: Thank you very much, Minister, for your assistance in that matter. I could put on the record the companies that have dodged it but I presume I will pass that on in documentation.

Senator Wong: Yes.

Senator HEFFERNAN: These people are seriously intimidated. There is one guy here who is owed \$40,000 in unpaid super over a period of 10 years. The company has a history of employing people and, when they complain, shunting them. They do occasionally pick up the child support and send some in—I have been talking to the Child Support Agency—and then they put the company into liquidation and start again. I do not think that in Australia today companies ought to be able to get around like that. These are the guys who drive the flashiest cars, go to the races—

CHAIR: Senator Heffernan, this was raised in ASIC yesterday. It will be taken up.

Senator HEFFERNAN: Thank you very much, because I now have permission to table the stuff, which I did not have yesterday.

Senator CORMANN: How is your time to resolve complaints tracking?

Ms Furlan: It is tracking in a positive direction now but we have had problems with the timeliness of our complaints.

Senator CORMANN: The time lines have blown out quite a bit over the last year to more than 300 days there at some point.

Ms Furlan: Yes, they have blown out by about 30 to 40 days in the average time taken to resolve the complaints over the last two years. The reason for that is that we finding that as the superannuation industry matures complaints are becoming more complex, there is more money at stake and we are finding that we are needing new and different ways to resolve complaints. But we are committed to our statutory objectives.

Senator CORMANN: But you are having fewer complaints and they are taking longer to resolve.

Ms Furlan: We have more complaints within our jurisdiction. We receive about 2,500 complaints—and you are right: that has been decreasing gradually over the last couple of years as the global financial crisis impact peters out—but the percentage of those complaints that are within our jurisdiction is increasing, so we have had a slight increase in the number of complaints we have had to investigate.

Senator CORMANN: Can you explain that to me?

Ms Furlan: Sure. We receive about 2,500 written complaints a year. Under the legislation that establishes us, a percentage of those complaints are not within our jurisdiction.

Senator CORMANN: Such as?

Ms Furlan: By far the biggest is where they have not complained to the fund first. With between 30 and 40 per cent of the complaints we get, they have not complained to the fund first. So we write back and say, 'We don't have jurisdiction; you need to complain to the fund first.' And there are statutory time limits and other things as well.

Senator CORMANN: So essentially people are now coming to you at a time when they should be coming? They are more likely to come to you now at a time when they should be, even though the overall number of complaints has gone down?

Ms Furlan: That is right.

Senator CORMANN: When I looked at the statistics last—because there was a question on notice about this—there had been a significant blow-out in the time taken to resolve complaints. I think the average was about 302 days. What is your benchmark? What is your target?

Ms Furlan: Our target is for an average of somewhere between about 150 days and 250 days, depending on at what point the complaint is resolved. If we can resolve the complaint by informal conciliation—by which we mean a telephone conversation to a trustee to say, 'You really need to think about this; it would be appropriate for you to make some offer' or something, they are very short. So the median number of days for complaints where either we withdraw them or the complainant withdraws them is about the 78-day mark. The ones where that does not occur all go to conciliation and then there is a process for holding a formal conciliation conference. If that is unsuccessful, those complaints are then prepared for a formal hearing. That involves a call for submissions and then an exchange of responses. That will then mean, because we give 28 days for submissions and then we give another 28 days for calling for responses, because of our procedural fairness requirements those times are much longer than for the ones that we can resolve when they first come in the door.

Senator CORMANN: You are saying things are improving. Where is your average at now?

Ms Furlan: I think the last average we reported was about 302. It has only slightly come down. It is about 298 days—something like that.

Senator CORMANN: So you are still a fair way away from your target. Is there a resourcing issue involved?

Ms Furlan: When the impact of the global financial crisis was felt, our workload went up about 14 per cent. Over the last six years it has gone up about 36 per cent. As a result of that, in 2009 we got an independent review by KPMG of our operations. They made 20 recommendations about how we could streamline our operations and make better use of our resources—because we are as committed as anyone to timely resolution of complaints. We implemented a new organisational structure on 1 December last year. It is fair to say we are still bedding that down. We are interested in the amount of resources but also the talent that we have to best utilise those resources.

Senator CORMANN: Okay. It will be interesting to talk to you in October to see how you are tracking.

Ms Furlan: Yes. If we are not going in the right direction I will be very disappointed.

Senator CORMANN: As you say, it is important—and I am sure that you do appreciate that—to resolve these sorts of complaints in a timely fashion.

Ms Furlan: And justice delayed is sometimes justice denied.

Senator CORMANN: Thank you.

National Competition Council

[14:47]

CHAIR: I call the National Competition Council.

Senator EGGLESTON: This is about the FMG dual-access railways decision in the Pilbara. Thank you for appearing today. I am interested the access of third parties to the Pilbara railways decision, and where it is at and what has happened—the progress in that case which I believe FMG was bringing. I do know the outcome, I think, but I would like to discuss it with you.

Mr Feil: Well, it continues. As you would know, the Treasurer declared for access a number of BHP and Rio Tinto's railways. That matter was appealed to the Competition Tribunal, who upheld the decision in some cases and in one particular case did not, and then shortened the duration of the declaration of the road railway. Both sides of the argument—Fortescue took a number of those decisions to the Full Federal Court on appeal, as did Rio Tinto in respect of the declaration of both Robe and Hamersley. The Full Federal Court decided that everyone up till this point had had a wrong view of one of the criteria and held that criterion (b) is determined on the basis of private profitability rather than economic wastefulness or whether these facilities are natural monopolies. As a result of that, they overturned the declarations of Hamersley and Robe. The day before yesterday Fortescue lodged an application for special leave to appeal that decision to the High Court. The council is in the process of lodging the same application for special leave to appeal. Our interest is in respect of the interpretation of criterion (b).

Senator EGGLESTON: Which is?

Mr Feil: Criterion (b) is whether the facility that provides the service is uneconomical to duplicate. We are seeking special leave to appeal ourselves. We will also seek to intervene in Fortescue's application to the High Court for special leave. The parties are in the process of being served with the proceeding. There will be, obviously, a consideration by the High Court as to whether it will grant special leave. If it does then the matter will proceed to appeal. If it does not then the council's view—we think that the criterion (b) interpretation adopted and given to us by the full court has some implications that we would have some considerable concern about. Obviously once we have exhausted our appeal possibilities we may have to consider requesting to government to consider it as a policy question. But at this stage, given that the appeals to the High Court are beginning, we are prepared to wait and exhaust that process before we go further.

Senator EGGLESTON: I see. Is it state or federal legislation we are talking about? Originally it was Western Australian legislation, I think, wasn't it, to provide dual access?

Mr Feil: Our interests in these matters are all under the Competition and Consumer Act—the Trade Practices Act as it was—so it is Commonwealth legislation. The state has regulatory arrangements in respect of some railways but not the Rio Tinto and BHP railways.

Senator EGGLESTON: When you say some railways but not these—those ones are private railways of the mining companies. Are there other private railways which the state has an interest in?

Mr Feil: The state regulates the TPI, the Pilbara infrastructure at Fortescue's railway. Also there are some proposed railways that will be brought within the state arrangement. We also in the last year or so have certified as effective the state access arrangements under their legislation. So where a certified arrangement applies at a state level, that is the regulatory approach. Where it does not—and for BHP and Rio the legislation at the state level does not cover them; therefore they are dealt with under Part IIIA.

Senator EGGLESTON: That was quite old legislation really, wasn't it? But the Fortescue railway system is under the state's regulatory authority is what you are saying?

Mr Feil: Yes. There is also a set of state agreement acts. That is how these various railways are brought within the operation of the Western Australian Economic Regulation Authority. That is how TPI's railway came in. It is how any future railways would be added to that list. There are also obviously state agreements in respect of Rio and BHP railways. They had some provisions that purported to deal with third-party access but have never successfully allowed anyone to do anything. That is why, I think, Fortescue has approached this matter under Part IIIA.

Senator EGGLESTON: I know the original state agreements do provide for third-party access but the large mining companies that you have referred to, BHP and Rio, I think argue that the amount of activity on those railways today was never envisaged in the 1960s or thereabouts when those state agreements were made. It is a very interesting problem in a way, because it really is quite inefficient to keep on building new railways every time there is a new mine established in the Pilbara and your ports and so on, or access to ports by railways. There must be a very strong public interest in having some sort of dual-access regime so that you do not have railways running down every gorge in the Pilbara from some mine to the coast. But it seems to be a very difficult and thorny area.

Mr Feil: It is certainly a hard-fought area. I think the council's concern in considering the declaration criteria, and in particular criterion (b), is the cost of duplication to society as a whole and the waste of resources where you are building a second railway when the first one could have, or with some relatively modest could have, accommodated all comers. Unfortunately under the interpretation given to us by the Full Federal Court the test is not that. They have acknowledged that the test is not concerned, in their view, with waste. We think that—with the greatest respect—that is not the view that is consistent with our understanding of the policy. The court obviously has a different one. That is the sole reason why we are interested in having the matter taken to the High Court to have it considered further. We think it is a matter that the High Court can properly address if it grants special leave, and then it will fully consider it. I guess we are also concerned that until the most recent decision of the Full Federal Court we had thought that the law on criterion (b) was relatively clear. There are always arguments about whether there is room on the railway—

Senator EGGLESTON: That is an argument that is used.

Mr Feil: and the cost of allowing access, which is dealt with by a different provision. There is also a question about whether you need it to promote competition in another market. But criterion (b) we always thought was about the consequences of duplicating what are essentially natural monopoly facilities, and the cost to society rather than the financial cost to the players. At the current time there is so much money being made out of mining ore and selling it that financially you can build multiple railways. But then you end up with a whole lot of railways, and I think wasting resources of that type, even in a time of abundance, is what Part IIIA was directed to stop rather than allow.

Senator EGGLESTON: When we talk dual access or multiple access to infrastructure, does that extend to port facilities or is it just to railways?

Mr Feil: Potentially it extends to any facility that meets the declaration criteria, and ports are—some ports at least, on the face of it, without having ever considered an application. We have not had an application in recent times for a port, but as you see things developing you could see ports being a potential source of applications if the parties cannot sort it out among themselves. I think the primary way of having third-party access dealt with is private negotiation. When the ports are not vertically integrated, generally most port businesses are quite happy to get more revenue by having more customers, so the market sorts that out. The question of access only arises if someone for some reason cannot come to a commercial arrangement. They can then seek declaration. Even at that point the primary aim is to encourage private negotiation. It is only after a further round of private negotiation that you get a regulator involved other than ourselves as the gatekeeper. So most ports I think take the view that the commercial arrangements can be met. There is always—these are complex issues. Generally the business people can sort that better than a regulator but in the end, in our view, you must have a fall-back, if only to encourage them to come to commercial arrangements. Regrettably, I think, the implication for a number of ports that might have been able to be declared under the prior view of criterion (b)—on the approach adopted by the Full Federal Court it may be much for difficult for them to succeed in an application. Again, our concern is less about the particular outcome here than about having a criterion that does not effectively block access applications being made and declarations being made where it would otherwise be wasteful of society to duplicate it. I do not know of a particular port—as I say, we have not considered one—but there are a number of ports where there clearly are congestion issues and incumbents who have some rights and other people who want to be able to use it as well; and expansions in some ways are determined by the people who are there, not the people who want to be there.

Senator EGGLESTON: Where it particularly creates a problem for us is with smaller companies, smaller miners. I know that in the port of Port Hedland FMG has permitted a small miner—one at least that I know of—to load iron ore through its port facilities. But I am not sure that that applies anywhere else. The fact of the matter is that the major miners tend to build port facilities—the BHPs and the Rios—and I suppose in that sense the ability to have access to a port to export your product does become perhaps a competition issue at some point. It is a very interesting matter.

Mr Feil: It is certainly not something that would give rise to a declaration application unless it did give rise to a competition issue. There are cases—depending on how a port and

the ownership of various facilities is organised—where on the face of it you would think that the encouragement of private dealing through either the risk of part 3A being applied or part 3A actually having to be applied is a route to getting smaller miners some degree of access. It is also important to remember, though, that that access is not free and it is not at a subsidised rate. The requirements are that they pay a commercial rate of return to the owner so that the owner is not being deprived of their property in the port. Any sharing has to be done having regard to the owner's needs and to making sure they get a commercial rate of return. That is the regulator's function rather than ours, but the ACCC is a capable regulator in that sense.

Senator EGGLESTON: Those criteria apply to railway access as well, don't they?

Mr Feil: The criteria apply universally to railways, ports, sewerage systems and a range of other facilities. As I said, most access questions are picked up and put down on a commercial basis. That is how it is designed to be. They are only a fallback. Declaration, again, only activates the regulatory scheme; it does not put the ACCC in the middle of everything instantaneously.

Senator EGGLESTON: Thank you for that overview. It will be interesting to see the outcome of some of these court cases.

Corporations and Markets Advisory Committee

[15:02]

Senator BUSHBY: I understand that the Corporations and Markets Advisory Committee had a look at the Productivity Commission's report into executive remuneration.

Mr Kluver: That is correct.

Senator BUSHBY: You undertook a review?

Mr Kluver: That is correct.

Senator BUSHBY: In general, what were the findings of that review?

Mr Kluver: The report by the Corporations and Markets Advisory Committee was provided to the Parliamentary Secretary to the Treasurer in April and was published a number of weeks ago. The issues that were raised were twofold. The questions that we were asked in essence were: should there be some legislative intervention in the ways by which companies arrange their remuneration portfolios and arrangements with particular officers and, secondly, should there be some change to the reporting requirements for the purposes of the annual general meeting, where shareholders vote on the remuneration report?

In regard to the first question, the essence of the CAMAC report was that matters concerning particular arrangements within companies are for the decision of those companies, being mindful of the implications that those decisions have on the profitability and future running of the companies, and that those matters would not be better be dealt with through legislative intervention, which would not necessarily ensure that the interests of shareholders were being properly protected. In regard to remuneration reporting, the committee considered a number of options: firstly, a detailed review of each of the sections of the existing provisions; secondly, a sweeping aside of the existing provisions and the substitution of a number of general principles; or, thirdly, some level of incremental change to those provisions to take into account existing concerns.

After a full consultation process—which involved both written submissions and a roundtable conducted in Sydney with all interest groups, including institutional and retail shareholders, invited and attending—the view was that it was not yet time to move towards just a principals based legislation. The view was that there was need for some changes to the existing provisions where the requirements were misleading to shareholders in terms of the information they would receive. We were particularly referred, for instance, to the accounting requirements. The requirements that currently apply to the remuneration report are relevant to the question of the cost to the company of remuneration arrangements; however, they can create confusion in the minds of shareholders on the more important question, from their point of view—and the question on which they vote at the annual general meeting—of what the remuneration is of each individual officer received.

Our recommendation was that those accounting requirements be dispensed with because they are confusing to, rather than of assistance to, shareholders. However, we also recommended that there be a clarification that, in a remuneration report, all shareholders are entitled to three types of information that are currently not required and, again, on which there can be confusion to shareholders. That information was: the pay an executive was entitled to and received in that year; the pay an executive was entitled to and was paid in a previous financial year, based upon, say, conditional provisions or performance conditions; and the pay arrangements entered into in that financial which will not mature until a future financial year. Shareholders should be entitled to that full range of information rather than being confined to information about, say, present and future entitlements but not past entitlements which are now maturing.

Senator BUSHBY: Thank you. That was a very comprehensive summary of the report.

Senator Wong: I dare you to ask another question!

Senator BUSHBY: I may well. I had a number of questions I was going to ask you about that report which you have answered in your comprehensive answer. In summary, essentially you are saying that you do not think it is in the shareholders' interest at this point to legislatively interfere in the actual remuneration but you think there are some advantages to be had by shareholders through lifting the transparency and accountability to them in terms of how that remuneration is paid.

Mr Kluver: That is correct. The report was written in the context of the bill before parliament that was proposing a two-strikes rule. The committee was not asked to report on that and did not do so. But it was mindful that shareholders are entitled to be informed and to have a full and clear understanding of the remuneration arrangements, to inform them for the purposes of making a decision on which way to vote on the remuneration report and the implications that might have for companies. The committee felt that it was important that matters that were left uncertain and were therefore not in the interests of shareholders—and I gave that example about the three different types of remuneration arrangements which may not necessarily appear otherwise—as well as matters which could confuse shareholders be understood.

The committee finally said that, in the event that the two-strikes rule was introduced, it anticipated that would have a significant impact on companies and the way in which they report. Therefore, at some future time it might be appropriate to go a further step towards some simplification of the detail that is currently in the reports. The committee was mindful

of the present needs of shareholders—hence the recommendations for immediate change. It was also mindful of the right of shareholders to have a full understanding of the future impacts as the changes to the remuneration arrangements take effect.

Senator BUSHBY: Thank you for that; that is very useful. You were asked to look at this by the government—is that correct? The minister requested that you look into this particular issue?

Mr Kluver: Yes. The committee can either initiate its own references or be asked by government. The trend in more recent years is to be asked by government.

Senator BUSHBY: What other references are you looking at currently?

Mr Kluver: We have two current references, both of them having come from the government. The first is in relation to the definition of 'derivative'. There is a question about whether the definition may be too wide, particularly in the way it could possibly be interpreted to pick up contracts which were not originally intended to come within that definition, and therefore whether there was a need for any change to the definition to ensure that it effectively covered the types of financial products that it was intended to without having too extensive a coverage. There is consultation continuing on that matter.

The second reference that we have deals with managed investment schemes. You may recall that in September 2009 there was a parliamentary joint committee report on problems that arose with the collapse of various agri-schemes in 2009. Following on from that report in 2009 and some recommendations that were contained in that report, the committee has been given a more extensive reference to review the way in which the legislation operates in light of experiences, not only in the agribusiness but also managed investments generally, to see what solutions there may be to the problems that have arisen in recent years, particularly with the collapse of some agribusiness schemes. Our reference goes wider than that. The committee is looking at all types of managed investment schemes. It is effectively looking at a number of key questions that arise in the transfer of a viable scheme where there is no ready responsible entity for that; secondly, ways to rehabilitate a potentially viable scheme; and, thirdly, ways to ensure that, in the liquidation of a non-viable scheme, the interests of creditors and members is properly taken into account. The committee is now close to publishing a discussion paper on this matter. We hope to do so within the next couple of weeks. We will be calling for submissions over a three-month period given the scope of this particular review and its importance in terms of the impact on the economy of this very large area of investment, and also the including of superannuation funds in the managed investment schemes and issues arising as to their operation vis-a-vis companies.

Senator BUSHBY: Do you think you are making some progress in that regard? I know that the discussion paper is not released yet. But have you made some progress in the work you have done so far?

Mr Kluver: In the discussion paper we hope to come forward with a series of suggestions as to ways in which there may be a need for some level of readjustment of our legislative thinking in light of the developments that have taken place in the way in which the managed investment scheme industry has operated since the legislation was introduced in 1998. We will also be calling for and seeking submissions on a large number of questions that we raise in there. We are anticipating and hoping that we get a significant number of submissions to

work through with a view to recognising that the model in the legislation at the moment—the managed investment scheme model in the legislation—is very much focused on the relationship between an individual managed investment scheme and an individual responsible entity, not recognising that, in fact, over the last 10 years the pattern has been somewhat different. That is, the majority of responsible entities, from our research, have multiple schemes that they operate and that creates considerable problems in ensuring that the affairs of each scheme are separately distinguishable for the purposes of transferring the affairs of that managed investment scheme and ensuring in either the rehabilitation of a particular scheme or the winding-up of a scheme that there is a way in which you can isolate the interests of both the property of those schemes and all of the parties who have an interest in that particular property, either to the scheme’s rehabilitation or its orderly winding-up. It is those matters that we think are not covered in the existing legislation. The discussion paper will put forward a series of proposals and a series of questions to invite discussion, then the further review and final report of the committee in light of its close consideration of those submissions.

Senator BUSHBY: You say in a few weeks—is that the end of June?

Mr Kluver: I cannot be exactly precise. I can say that the draft is in its advanced stage. We would be keen to have it out as soon as possible. If that can be done by the end of this month then that would be a good outcome. I cannot be more precise, but I can assure you that we are now very close to a discussion paper. It has taken a period of time to do because of the need to get on top of all of the problems that have arisen in this particular industry. You may be aware that there has been a large amount of litigation that has taken place in the last couple of years after the collapse of these particular schemes. Clearly, trying to solve a lot of problems—particularly those based on trust law rather than corporate law, which do not necessarily fit in to the commercial nature of managed investment schemes—through further complex litigation with a large number of dissatisfied parties is not a path that we would like to pursue in the future for the orderly reconstruction or dissolution of management investment schemes. That is the purpose and intent of the discussion paper.

Senator BUSHBY: I look forward to seeing the consultation paper when it comes out. I know that a number of my colleagues in this place are very interested in MISs, so I am sure they will look closely as well. One final question: those three reviews that you mentioned were all referred to you by the government, but you mentioned that you are able, on your own initiative, to start reviews. When was the last time you did that?

Mr Kluver: The last recent one we did was schemes of arrangement, which was reported about two years ago. This is the arrangement that has been in place for a large number of years. Under the act, the committee is entitled to initiate its own reviews. The practice always is that the committee consults with Treasury and the government if it is mindful of initiating its own reviews so that there is a full transparency. References coming from the government always take priority. Over the last number of years, we have received a sufficient number of references from the government so as not to have any down period other than for completion of the managed investments review that has been initiated from us. But the committee can always and at any time put forward to government proposals for a particular review if it wishes to do so. At the end of the day, under the legislation it is a matter for the final decision of the committee.

Senator BUSHBY: Thank you very much.

Senator CAMERON: Have you ever initiated an inquiry into executive salaries on your own volition?

Mr Kluver: We were given a reference from the government as to executive remuneration that came out of the Productivity Commission report. That report in December 2009—

Senator CAMERON: That is not what I am asking you. I am asking you whether you have ever—simple—initiated an inquiry into executive remuneration or salaries of your own volition. I know about the Productivity Commission report.

Mr Kluver: The answer is no.

Senator CAMERON: Why not?

Mr Kluver: If you want to look at the broader context, the way in which references are initiated either from government or from the advisory committee depends upon the commercial context of matters that are occurring at a particular time. Focuses change from time to time. If we look at the question of executive remuneration, I think we can identify that the major problems that arose and which really initiated the Productivity Commission report were to do with the implications and the impact of the global financial crisis. Prior to that, there had been legislation that was set up in 2000. There was the introduction of the non-binding vote in 2002. There was, therefore, a level of shareholder involvement. I suppose what concisely caused the major concern, I think, from shareholders about executive remuneration was particularly the consequence of the global financial crisis and the decline of the Australian Stock Market, from its peak at 6,800 in October 2007, of over 2,000 points. There was a concern from shareholders that, when it came to the remuneration reports that they were being asked to consider, they did not necessarily see a similar level of decline of remuneration received by executives consistent with what they saw as the decline of the value of their particular shares.

Senator CAMERON: Are you seriously telling the committee—seriously—that the only problem in recent times and the only concern in recent times about executive remuneration is as a result of the global financial crisis?

Mr Kluver: No, I am just giving you an example of what can be of concern to shareholders. There was considerable concern by shareholders that there appeared to be a mismatch between the problems that they were suffering with the value of their shares and what was happening with companies. It may have been from that that the particular issue arose. We were asked to look at the question coming out of the Productivity Commission—

Senator CAMERON: I know that. You have indicated that already. You do not need to go over that again. I am just wondering, given the long-held concern not only of shareholders but also in the community about the rip-off that was going on on executive salaries, especially in the financial sector, why it was never considered by your committee that you should have a look at it.

Mr Kluver: It is hard to answer a hypothetical—

Senator CAMERON: It is not hypothetical. What is hypothetical about the fact that there was long-held public concern and shareholder concern about rip-offs by executives in terms

of their bonus systems in terms of their remuneration generally? Are you telling me that I am wrong?

Mr Kluver: If you look at the history, there was a series of steps through which the executive remuneration arrangements developed, both legislative and in terms of initiatives.

Senator CAMERON: I know about that. Mr Kluver, you do not have to dive into your papers to tell me about that. I know that. What I am saying is that the history of problems and concern about executive remuneration predates by a long way the global financial crisis. I just cannot believe that you would come here and say that the cause of an investigation into executive salaries was that executive salaries did not go down as a result of the global financial crisis.

Mr Kluver: I was just giving that as an example as to what may have been an initiating factor for some of the concern. If you look at the legislative element, there has been a series of developments. In 1998 section 300A was introduced in lieu of the existing disclosure requirements. Section 300A of the Corporations Law required—

Senator CAMERON: Mr Kluver, if I want the legislative nomenclature of what has happened, I will go and get that. It is dead easy. I do not have to ask you that. I really do not want you to go there. I do not have a lot of time. In terms of where we are at the moment, you have indicated that you have looked at two issues—the arrangement and the reporting. You have done that because the government sent it to you. Is that correct?

Mr Kluver: We received the reference from government.

Senator CAMERON: It seems to me that there is still a need to look at another area of executive salary and what causes the problem—that is, the issue of comparative wage justice amongst executives. They seem to be able to access comparative wage justice when there are regulations, rules and laws in place to stop an ordinary worker in an industry from having access to comparative wage justice. Why should an executive have access to comparative wage justice when the rest of the workforce cannot? Why, in terms of your inquiries, would you not look at the role of remuneration consultants in driving the comparative wage justice that is driving wages up across executive remuneration in this country?

Senator Wong: Before Mr Kluver responds, there were a few aspects to that question. Probably a couple of them were policy questions, which I am happy to take notice, if you want, for the Treasurer. Those matters that Mr Kluver thinks he can answer, obviously he is able to.

Senator CAMERON: Thank you, Minister. But, as I understand it—

Senator Wong: I am just making the point that there are some things he may not be able to respond to.

Senator CAMERON: I am not asking for a view on a policy issue. What I am asking is this: here is a problem; has that committee ever considered the role of remuneration specialists in executive salaries? I am interested in that.

Mr Murphy: I think that the questions you are asking—I am trying to be helpful—are actually—

Senator CAMERON: You always are, Mr Murphy.

Mr Murphy: Thank you. They are questions that I would have thought the Productivity Commission would look at—that is, social justice in terms of executive remuneration. What the government's policy has been over a number of years has been to try to get more transparency into remuneration reports. There was also an issue about whether the arrangements for incentives that companies were establishing for their executives led to excessive risk-taking, which contributed to financial crises, either in the company or the economy-wide. I think some of those issues are live issues. There is still work going on in the G20 on executive remuneration. There are still issues before the government in particular on whether there should be a clawback provision in terms of executive remuneration pay. I think Mr Kluver's work is one contribution to that broader sweep in terms of executive remuneration. But, as to that issue of social justice or equivalency in treatment between executives and employees, I think that is more a policy issue, which would be either Treasury or the Productivity Commission or someone like that.

Senator CAMERON: There are two aspects to that. One is the equity issue and the treatment issue and the other is the implications it has for the economy in terms of comparative wage justice at the executive level. It can drive wages that are not appropriate to the productivity outcome of the firm or the profitability or the share price. It can do all of that. I am just wondering whether anywhere in Treasury this question of comparative wage justice at the executive level has been looked at.

Mr Murphy: I think those are the types of things that, as I say, are not really what CAMAC is about or has the capacity—

Senator CAMERON: Let us go wider. Is it something that the Treasury—

Mr Murphy: Yes, they are issues that would go into macroeconomic policy. It goes into labour policy. It goes into various aspects of what Treasury looks at.

Senator CAMERON: Are there any comprehensible papers that you have done—for a layperson—that we could look at?

Mr Murphy: I expect there would be. I will take that on notice and talk with my colleagues.

Senator CAMERON: Can you take it on notice and let me have a look them?

Mr Murphy: I expect there would be.

Senator CAMERON: Thank you.

The Treasury

[15:28]

CHAIR: We will get back to the general Markets Group.

Senator CORMANN: In the context of the government's announcement on where it wants to go with the Future of Financial Advice changes, can you explain why commissions on risk insurance inside superannuation are proposed to be banned?

Mr Murphy: Basically it is felt that what the government is trying to do with future financial advice, and I suppose also in terms of the superannuation review, is to get a better return for investors. One way of doing that is to try to get better facts on the table, get more transparency into the negotiations or the engagement between an investor and their adviser. In terms of superannuation and in terms of insurance coming with superannuation, the principal

issue is that when people are engaged in their superannuation they should be in effect largely focused on that. If you look at the thinking behind the superannuation report—the Cooper report—and the proposal for My Super, the committee felt that, especially in terms of default funds, people were not paying enough attention and did not have enough understanding of their superannuation. That flows into why when we have to decide whether, when people are getting their superannuation, you should detach insurance from their engagement on the superannuation and separate that out so that the nature of the transactions becomes quite transparent. One is about superannuation advice and investment. And a separate transaction would then to be taken in relation to insurance matters. So it is mainly trying to meet a perceived need that people were not fully understanding their arrangements on super and to try to get more transparency into the process.

Senator CORMANN: I would agree that we should always try to get better facts on the table and more transparency in the system. But why is banning commissions on risk insurance inside superannuation contributing to better transparency and getting more facts in the system?

Mr Murphy: When you have commission payments it is felt that that introduces a conflict situation for the adviser. There is encouragement there for them to get that additional business of insurance without actually bringing those matters to the attention of the person who is seeking to engage with the provider of the service.

Senator CORMANN: But if the issue is a conflict situation, or that it is felt that there is a conflict situation, why are you treating commissions on risk insurance inside super differently from commissions on risk insurance outside superannuation. If the issue is that the commission based remuneration structure in relation to risk insurance is a conflicted remuneration structure—which I do not agree with, incidentally; that is where we part—what is the rationale for treating commissions on risk insurance inside super differently from commissions on risk insurance outside super?

Mr Murphy: You are going back to, as I said before, the issue that you are looking at prioritising and you are trying to improve the situation in terms of policy. The review of superannuation found that there was a lack of understanding and willingness by people to engage on superannuation. So you are trying to, in effect, remove some of the complexity or uncertainty around it. One of those is to move insurance outside so that in relation to superannuation a person can engage another provider or get insurance at a separate time; it is just not wrapped up in the one engagement.

Senator CORMANN: That is not quite right. You are not proposing to ban insurance on the inside of superannuation; you are just proposing to ban a particular payment structure inside superannuation.

Mr Murphy: Yes, the commissions.

Senator CORMANN: That is right. The proposal from government is to ban commissions on risk insurance inside super. The proposal of the government is not, unless there has been a change—

Mr Murphy: Sorry—I meant to say that.

Senator CORMANN: Okay. You talk in terms of prioritising. Are you saying that this is a first step and that the next step will be to ban commissions on risk insurance?

Mr Murphy: No, I am not saying that. You have to decide what policy objectives you are seeking to achieve.

Senator CORMANN: Sure.

Mr Murphy: The principal reason is that superannuants are not engaged in the finer details of their superannuation policies—

Senator CORMANN: That is a very generic statement.

Mr Murphy: That was the finding of the report, which was quite comprehensive.

Senator CORMANN: The superannuation sector is not one homogenous group. Let us break it down a bit. If you were talking about people who end up with risk insurance automatically without taking any specific advice about how to structure their insurance—that just get it because they get into a default fund—I would agree with the proposition that they should not be forced to pay commissions. However, the government is proposing to take that choice away from everyone. Some people obviously are more engaged than others. Why shouldn't you have the option of choosing a commission based remuneration structure to pay for the advice that you access in the context of structuring your insurance arrangements inside super. Why should you not have that choice? What is the policy objective of removing that choice from people?

Mr Murphy: The policy objective is to try to simplify and to get people more engaged with their superannuation, and to ensure that people understand what they are paying for. The ban on commissions in other areas is that they are not transparent and over a period of time people—if you get down to it, what are we trying to do with superannuation? We are trying to get the best possible returns for people when they retire so that their lump sum is not diminished by the payment of fees and charges for something they really did not understand. So what you are trying to do is to increase the return for superannuants and hopefully increase people's understanding and awareness of what they are paying for. The commission bases are hidden fees, and that has been the issue that the government is seeking to address.

Senator CORMANN: We are all opposed to hidden fees. We are all in favour of increased transparency. We are all in favour of policies that will maximise transparency, efficiency, competitiveness and things that improve returns. However, this is what I struggle to understand. Obviously risk insurance, protecting yourself or your family against the incidence of death and the financial consequences of this, or loss of your job, or temporary or permanent disability and so on—these are all important financial considerations. I think we know that there is a challenge to convince people to take out the level of cover that they might need as it is. If you increase the up-front expense and you force people to take it outside their superannuation arrangements, effectively, you actually potentially put people into a more difficult financial circumstance and not a better one if people do not end up with the levels of cover that they need because you have made it unaffordable for them. The question is this. The government clearly had a hesitation back in April 2010 when the discussion paper was put out. The minister was Minister Bowen. The proposal was to ban commissions on investment products but Minister Bowen very clearly differentiated the approach to commissions on risk insurance. That must have been a deliberate decision by the government at the time. Since then Minister Shorten has made a decision to split up commissions on risk insurance and treat commissions on risk insurance outside super differently from

commissions on risk insurance inside super. First that creates a distortion in the market. But secondly it does cause issues, does it not, in terms of the affordability for people accessing that sort of risk insurance moving forward?

Mr Murphy: I do not know if it does. What I think you need to do, as with any policy issue, is ask where your primary objective lies. That is trying to get the best return for superannuants from their superannuation. Yes, it is prudent, it is sensible to take out forms of insurance. But what the government is seeking to do is to ensure that people turn their mind to that and can make a clear decision on that, not to have it through commission based arrangements whereby there is no incentive for the provider of that service to put the information on the table for the individual to be able to make an assessment as to the costs and benefits of that engagement.

Senator CORMANN: The thing is, it is obviously tax-effective as well as cash-flow beneficial to structure your risk insurance inside your superannuation. There are tax benefits and there are cash flow benefits. You would agree with that?

Mr Murphy: I am not sure about the tax benefits. I would have to—

Senator CORMANN: Clearly if it is funded out of your superannuation contributions, which are taxed at a more beneficial rate—

Mr Murphy: Yes, I see what you are thinking.

Senator CORMANN: In fact the minister in his discussion paper and in his public comments pointed to that—as I see you know—as one of the reasons as to why he might want to move it out of super. Let me ask a different question. I have to admit I got a bit confused. The discussion that was released on 28 April talked about how the government decided to ban up-front and trailing commissions and like payments for both individual and group risk within superannuation. That sounded like a blanket ban on both individual and group risk within superannuation. But since then there have been some comments in some of the expert media—insurance media—that commissions, volume rebates and soft-dollar payments will still be allowed on general insurance products sold into superannuation, just not on life insurance. What is the rationale for that?

Dr Sandlant: The ban on commissions and volume payments applies to life insurance or risk insurance within superannuation and, as you stated, does not apply outside superannuation. One further reason for that which was not mentioned just now is that there is an investable amount within superannuation that can be used to pay for the insurance premium and for the advice, whereas outside superannuation there are other issues around how people would pay up front for the cost of risk insurance.

Senator CORMANN: So you are obviously not banning any commissions on risk insurance outside super, as I understand it.

Dr Sandlant: No. The answer to your question is that we are seeking to be consistent in how we are applying the ban on commissions outside super. So we are not going to be banning commissions on general insurance either inside or outside super, and we are not proposing to ban commissions on life insurance outside super—

Senator CORMANN: Hang on. Where are you being consistent? You are saying you are trying to be consistent but that you are not banning commissions on life insurance outside super but you are proposing to ban commissions on life insurance inside super.

Dr Sandlant: That is correct.

Senator CORMANN: You said that you were banning all commissions on all insurance inside superannuation but now you are saying you are not banning commissions on general insurance either outside or inside super. So there will still be commissions on general risk insurance inside super—that will still be allowed?

Dr Sandlant: To the extent that general insurance is provided within super, but there are restrictions on whether you can get general insurance within super; it has to meet the sole purpose test.

Senator CORMANN: Sure. But what is the rationale for—subject to meeting that test—treating general insurance inside super differently from life insurance or permanent disability insurance?

Dr Sandlant: Any consumer could get general insurance or they could get life insurance. The rationale is that most general insurance is sold through a general advice model or a no advice model whereas life insurance is more likely to be advised and can involve a financial adviser providing personal advice.

Senator CORMANN: So what you are saying is that because the purchase of a life insurance product is more complex, potentially, and involves the provision of financial advice which has to be paid for, you do not want people to be able to pay for that through a commission based structure inside their super. So either they have to pay for it up front or they have to take the life insurance outside super.

Dr Sandlant: You say they have to pay for it up front but there are still—

Senator CORMANN: There is going to be a fee.

Dr Sandlant: options for payment plans that can be spread out over a number of years.

Senator CORMANN: Inside super?

Dr Sandlant: It is up to the insurance provider, isn't it, and to the adviser as to how they structure their fee arrangements?

Senator CORMANN: So you are saying there can be payment plans inside super depending on what the client and the adviser determine?

Dr Sandlant: If an adviser sits down and talks to a client and in the course of recommending a financial plan that involves life insurance they agree on a fee, it is up to the adviser and the client whether they agree that that fee should be paid entirely up front or whether that fee could be spread out over a number of years for that piece of advice.

Senator CORMANN: Can you explain this to me? A fee that is agreed between the adviser and the client—the commission structure of course would be agreed between a client and his adviser, but let us call it a fee. A fee that is spread over a number of years that is agreed between the client and his adviser can be structured inside superannuation the way you are describing it, and that would not fall under the government's announcement 'that the government has decided to ban up-front and trailing commissions and like payments'—so what we have just described is not a like payment?

Dr Sandlant: No. The difference between a commission and an ongoing payment that a client and an adviser have agreed to is that arguably—and this is where the rubber hits the road in the policy debate—the difference with a commission is that it is a payment from the

product provider to the adviser, arguably an incentive to the adviser to sell the product. But that is quite different to the client agreeing to pay a fee through, for example, a payment plan that might take place over a number of years. The underlying rationale for the policy—going back to the original comments that we made—is that the model by which advice is provided with commissions raises serious questions about trust and confidence, about the view that consumers have of advisers. I think when consumers do have a relationship with an adviser they discover that advisers by and large are very professional—

Senator CORMANN: Indeed.

Dr Sandlant: and they find that the advice is very good, and so on and so forth. I do not think that is in question. But only a small proportion really of the Australian population in that position will get advice, and one of the concerns is this trust and confidence—whether an adviser is acting in the interests of a client or whether the adviser is being incentivised or selling a product. So the policy decision to ban commissions, which is quite a firm move on the part of the government but not unlike policy that has been implemented by other similar jurisdictions around the world, is addressing that issue.

Senator CORMANN: You raise an interesting point here. Is there any jurisdiction in the world that has legislation in place which forces clients and their financial advisers to re-sign contracts on a regular basis?

Dr Sandlant: Not that I am aware of.

Senator CORMANN: No. Is there any country around the world that has legislation in place that bans commissions on risk insurance inside or outside super?

Dr Sandlant: Not that I am aware of.

Senator CORMANN: Which really leads me to think that we are on the way to becoming world champions in red tape and reducing choice for consumers in these sorts of things. Why would we want to lead the world in generating policy which is going to increase red tape and increase costs?

Dr Sandlant: Again, that is policy debate about whether we are leading the world in increasing red tape or whether we are leading the world in implementing consumer protection policy.

Mr Murphy: I think you have got to look at the super systems you have in Australia. There is in effect an obligation on the government to ensure when it mandates that people make superannuation contributions that it sets in place arrangements that ensure that people get the best return for their superannuation in their retirement. I know, Senator, you are looking at it from the point of view of the providers of these services—

Senator CORMANN: I am not actually.

Mr Murphy: but at the same time—

Senator CORMANN: No, I am not. I am looking at it from the consumer's point of view.

Mr Murphy: That is a fair argument. But at the same time we have had parliamentary committee reports and we have had reports commissioned by the government which have pointed out these issues about transparency, these issues about people paying commissions for things they are not even aware of. So you have to decide how you are going to address those issues.

Senator CORMANN: Sure.

Mr Murphy: You mentioned in passing the opt-in arrangements. All of these measures are measures that maybe other countries do not need, but what we are looking at is that in Australia we need to get people to be more engaged in their superannuation, to understand it more, because that is in their best interests.

Senator CORMANN: As I said, do we need more transparency—of course we do. And I am going to correct the record here. I do not accept that I look at this policy issue from the providers' point of view. I look at this policy issue from a public interest point of view and getting the right balance between consumer protection and making sure that adequate and affordable services are still out there and available at a price that the average Australian can afford. It is a matter of striking the right balance, because all of these things ultimately add costs, don't they?

Mr Murphy: That add costs but it is a matter of balance—

Senator CORMANN: It is a matter of balance.

Mr Murphy: Yes, that is right, and that is why it may add some costs but that is short term; in the long run it may be better to have those additional costs in the system to enable people to be better apprised of their superannuation.

Senator CORMANN: I have got to say, though, I am totally confused. You are going to ban commissions on some risk insurance inside super. You are going to allow commissions on some other risk insurance inside super. You are going to allow commissions on risk insurance outside super holus bolus. It is a very complicated policy to explain, isn't it?

Dr Sandlant: If you use the term risk insurance to describe both life insurance and general insurance—you have to make that distinction. The ban applies to life insurance.

Senator CORMANN: Everything—insurance is risk insurance.

Dr Sandlant: You can use the term that way if you like.

Senator CORMANN: But are you saying that risk insurance is only life insurance?

Dr Sandlant: The term is generally used but sometimes it is used just to refer to life insurance.

Senator CORMANN: 'Sometimes it is used.'

Dr Sandlant: But that is the policy announcement. It is a ban on commissions on life insurance within superannuation.

Senator CORMANN: The policy announcement did not say 'a ban on commissions on life insurance'. The policy announcement was 'the government has decided to ban up-front and trailing commissions and like payments for both individual and group risk within superannuation'. There is no qualifier there whatsoever. And in fact we have no qualifier from the minister. We have only had a qualifier from the minister's office so far.

Mr Murphy: That is a statement, and there was a paper issued in April.

Senator CORMANN: I saw that.

Mr Murphy: There is an ongoing discussion with the industry, and we have to be careful—there are certain terms of art which the industry uses and you have to make sure

when you are designing the policy that you are not cutting across industry practices which are not of concern to the government. So, granted, it is a complex little issue.

Senator CORMANN: So it is still fluid, is it?

Mr Murphy: Well, the government has put down its policy parameters and we are working with industry as to how you implement them in a sensible fashion.

Senator CORMANN: Looking at that announcement, we had a conversation on volume rebates last time we met, in February, and the discussion went like this. There was a consensus that volume rebates which distort investment advice should be banned. On volume rebates which do not distort investment advice, you said there was a question as to how much of that there was but there agreement that volume rebates which do not investment advice—and I would add which might deliver benefits to business and consumers and enhance competition—should be quarantined from any ban. The government in its announcement lists a whole series of volume rebates that will be banned but it seems to be quite vague on the sorts of volume rebates that might be quarantined from any ban. Has Treasury got an established view, or is it a work in progress, as to what volume rebates might be quarantined from any ban on the basis that they are seen not to be distorting investment advice?

Mr Murphy: We have a position on that, and there are some volume rebates which are available.

Dr Sandlant: No. There was a position that was argued by industry to quarantine volume payments or volume rebates from platforms to dealer groups. Minister Shorten considered the proposal. We consulted on it prior to the April 28 announcement. But his decision was to go ahead with a broader ban—

Senator CORMANN: A broader ban?

Dr Sandlant: on volume payments from platforms to dealer groups.

Senator CORMANN: I am led to believe that the minister made some firm commitments around quarantining certain volume rebates, and my impression is that Mr Murphy was under that impression as well. My advice is that the minister gave some very clear commitments around quarantining certain volume rebates from the ban on the basis that they were demonstrably not distorting investment advice and provided benefits to business and consumers and enhanced competition.

Dr Sandlant: There is still some consultation continuing about volume rebates from asset managers or fund managers to platforms. Industry also made the case that in some instances these volume rebates represent a form of scale pricing that would ultimately be of benefit to consumers if it was passed on down the value chain to the end consumer. The government is still considering those volume payments. There was not a decision announced about them. I do know that there was some reporting in the press but I do not have any information about any arrangements or agreements that were entered into in respect of those. The key question with those payments is whether they will be passed down to consumers or whether they would be used by platforms to capture margin and become a particularly powerful member of that value chain. That is an issue that we are continuing to consider. It has been discussed in the most recent consultation group meeting.

Senator CORMANN: With the appropriate competitive tensions in a free, fair, transparent and well-informed market, I would have thought that these sorts of benefits do get

passed on. I am intrigued as to how far you get yourself into the minutiae of what the decisions in the free market between suppliers and clients are going to be. So you will make assessments all the way down to that sort of level, will you?

Dr Sandlant: It is a principle of the Future of Financial Advice reforms to focus more on the client and the client relationship with a financial adviser or with the dealer group than perhaps to look up to the very top of the value chain at payment that are being made between businesses. But certainly as part of the analysis and consultation the government has been looking at volume payments in total, and that includes payments that are made from fund managers to platforms.

Senator CORMANN: But if you remove features from the system that otherwise would enhance competition and help reduce costs, which can deliver benefits to consumers, you are not really focusing on consumers by banning those sorts of volume rebates, are you? Have you had a look at how that can potentially impact on the market structure? The big ones are always going to survive. It is the smaller ones that ultimately in the whole scheme of things will end up going by the wayside. Have you looked at how the market is likely to restructure itself?

Dr Sandlant: Yes, absolutely. I guess you could say that a policy goal in the banning of volume payments, particularly from platforms to dealer groups, is to try to shift the focus of dealer groups and advisers from the source of remuneration they are receiving from the product manufacturing side of the value chain to the client, to become more client-facing. This is consistent with the ban on commissions as well. An adviser should really be focused on their client and their client's needs, receiving their remuneration from the client, and then they can send the appropriate market signals to platform providers and fund managers. It is in effect saying to the members of the value chain above them, 'As a representative of the client, I am looking for lower platform fees; I am looking for lower fund management fees'. I completely agree with your arguments, Senator Cormann, that we want to have efficient price signalling, but the policy design here is to let the consumer be, if you like, the rod of discipline to that value chain because the consumer would now have to agree to pay the true cost of advice rather than having that cost hidden away in commissions or volume payments from platforms to dealer groups.

Mr Murphy: I have to clarify that issue of volume payments. There is some uncertainty on my behalf as to the policy. I must say that these are still matters of discussion with industry. So I think I will have to clarify that for you.

Senator CORMANN: I appreciate that. It is obviously one of the areas that I looked out for when I reviewed the announcement after it came out. It is fair to say that there was some consternation across people who had been part of the consultation process that it was not addressed in more detail.

Mr Murphy: Yes, I know that.

Senator CORMANN: So you understand that.

Mr Murphy: I do not want to say that these are complicated matters; but you are actually dealing with business structures that are there at the present time and government is seeking to improve the relationship between the member and the superannuation fund or the investor

and the retail fund, so it is quite difficult to ensure that any changes in policy work sensibly. I will get back to you on that.

Senator CORMANN: I appreciate that. In the context of the government's proposal now to require people to resign contracts with their advisers every two years, why has intrafund advice been carved out of that particular aspect of the Future of Financial Advice changes?

Dr Sandlant: It has not in a sense. Intrafund advice is very limited in scope. I think it will be legislatively limited in scope to ensure that superannuation trustees, whether they are industry funds or retail superannuation funds, do not provide more than a limited scope of advice to members by charging the collective membership. An industry fund or retail superannuation fund, if it is providing more than very limited scope advice, should be charging the individual. If it is ongoing advice, opt-in would certainly apply. It is important to note that, if a piece of advice is not ongoing, there is no need for opt-in—that is, if it is transactional or modular or a one-off piece of advice. Again, part of the policy design here is to try to grow access to advice and the availability of advice by expanding the scope of advice. Advice can be very expensive, holistic advice that might be upwards of \$2,000—that is more likely to be the kind of advice received by high net worth individuals. Members of a superannuation fund might not have access to that advice, but through their superannuation fund they can get some very simple questions answered. The idea behind intrafund advice is that that can be charged collectively. But, beyond that limited scope, opt-in and the FOFA rules would apply.

Senator CORMANN: You say that is limited in scope and you say that will be legislatively defined. Is there a policy position from the government at this point on what limited scope of intrafund advice actually means?

Dr Sandlant: That is still ongoing. It is subject to continuing consultation.

Senator CORMANN: So there is no policy position yet on what in intrafund advice means?

Dr Sandlant: No, not a final policy position.

Senator CORMANN: When you talk about collective payment by charging the collective membership, what you are talking about is cross-subsidisation of advice.

Dr Sandlant: Many financial services institutions do that, of course, when they provide information or general advice or limited personal advice but do not charge for it. Many banks do this. It would be impractical to require that, for every small piece of advice, the client and the institution must sit down and agree a contract and pay for it.

Senator CORMANN: But if I access intrafund advice and somebody else does not, why should somebody else then have to pay for it? Can that somebody else opt out of wanting to pay for the intrafund advice for others?

Dr Sandlant: It is the same if a bank is providing limited advice through customer service staff. Can you opt out of paying for the advice that other customers receive? It is spread across the—

Senator CORMANN: It goes to consistency, though. You are saying that it should be able to be done here but it should not be able to be done there.

Dr Sandlant: I am actually saying that it is done in both places but that the government is very much aware that the scope has to be limited within superannuation funds. There are trustee responsibilities to manage the investments of members in their best interests and to manage the costs of the services that they provide. Any limited advice that is provided would also fall under those same responsibilities. Above a very limited scope, individuals receiving advice through their trustees should be opting in. They should be paying for it in the same way as everybody else.

Senator CORMANN: The government is seeking to justify these changes—opt in, requiring clients to resign contracts with their advisers every two years and the banning of commissions on risk insurance inside super—with supposedly wanting to prevent a future collapse like the ones of Storm Financial and Westpoint. If we had had opt-in at the time and if we had had a ban on commissions on risk insurance inside super, would Storm Financial and Westpoint not have collapsed?

Mr Murphy: The two issues that we have been talking about here—volume payments and opt-in and commissions on life insurance inside super—are the last two or three issues of a raft of changes that largely industry and everyone agrees on.

Senator CORMANN: Well, they do not, really.

Mr Murphy: It seems that they do.

Senator CORMANN: It seems that they do not.

Mr Murphy: These are particular issues. These changes reflect various studies commissioned by this parliament and the government as to the problems for investors and members of superannuation funds largely coming out of the failure of those investments like Storm, Westpoint and others.

Senator CORMANN: I do not think that the Ripoll inquiry actually recommended opt-in or a ban on commissions on risk insurance inside super. The funny thing is that Storm Financial actually had opt-in. These clients were engaged and were paying massive fees, not commissions.

Mr Murphy: Clients at Storm were engaged in a certain way.

Senator CORMANN: They will get dud advice that was not suitable for their circumstances. Once the music stopped and there were too few chairs, people got hurt—not because they were not required to resign contracts every two years or because they were paying commissions on risk insurance inside super. The context of the question here and the premise for the question is that we all agree that there are times when there are problems. The question is whether what you are doing about it actually addresses the problem that you need to address in the first place. That is what we are exploring here.

Mr Murphy: All I am saying is that proposals by the government to ban commissions on certain matters, to try to remove conflicts of interest from the situation and to try to upgrade the level of duties that trustees in super funds have and all of these matters—

Senator CORMANN: I think you would know—

Mr Murphy: and to bring in a fiduciary duty are all matters that are probably needed.

Senator CORMANN: And the coalition supports these things. We support the introduction of the best interest duty. We support more transparent arrangements. We support

removing conflicted remuneration structures. We are talking here, really, about a few specific aspects and very specifically this requirement to force people to resign contracts every two years and, of course, the banning of risk insurance inside super. I was interested to hear Dr Sandlant say that no other country around the world has these arrangements in place. Why would we want to be the world champions of red tape, reducing choice and increasing costs?

Senator CAMERON: To look after people's money, that is why. We do not want them ripped off, that is why. The answer is simple.

Mr Murphy: I think we have traversed that the government feels that there is a need to bring in more transparency and address the conflicts of interest and improve people's capacity to take responsibility for their own superannuation or their own investments. There are balances here. On the opt-in one, it could be every year or it could be every two years—

Senator CORMANN: Or it could be opt out.

Mr Murphy: or it could be every five years. What we can do is talk to industry and consumer groups to try to find out what they think and then give advice back to the government. The government is accountable—someone has to make a call as to what is fair and reasonable and in the best interests of the community. At the moment, the government is looking at it and talking to the industry groups. I know that industry groups are concerned about the cost impact of opt-in. But, other than the cost impact, it seems to me not a bad thing that every two years issues are raised with people and they have to address their mind to it.

Senator CORMANN: I think it is very good practice for there to be regular contracts. The question is whether there is a role for government in forcing private parties in a contractual relationship. The question is actually not whether it is a good thing.

Mr Murphy: They are not actually private parties. I think in this whole area the government has intervened, is taking part of your salary and is putting it into super. That is a different matter.

Senator CORMANN: So the government is a shareholder?

Mr Murphy: No—that is a different matter from you deciding that you want to invest some surplus money in a managed fund. I think the government sees that there is an obligation on it to ensure to the best extent possible that people get the best return on their superannuation that they can. That is what all of this is about, I think.

Senator CORMANN: I have some questions on the penalty regime. There was obviously a discussion paper circulated around the penalties that would apply for breaches of aspects of those FOFA changes. Where is that process at?

Mr Murphy: It is quite preliminary. The penalties are still being discussed. Penalties are set not only within Treasury on those matters; there are also certain arrangements with the Attorney-General's in terms of what is a proper penalty for certain actions.

Senator CORMANN: What penalties are you looking at?

Mr Murphy: There would be a range of penalties.

Senator CORMANN: What sort of range?

Mr Murphy: For those types of things you would probably have a civil penalty regime where there could be fines for not adhering to what is set as market practice.

Senator CORMANN: What sorts of fines?

CHAIR: Senator Cormann, it is now 4.15. We will go to the afternoon tea break.

Proceedings suspended from 14:15 to 14:29

CHAIR: The committee will resume. Senator Cormann will continue.

Senator CORMANN: We were talking about penalties just before we finished. I was wondering whether you could share with us the sorts of penalties that you are looking at.

Mr Murphy: My understanding is that there was a discussion within a consultation group about proposed penalties. They are largely penalties that are consistent with other similar arrangements under the Corporations Act.

Senator CORMANN: So it is about \$200,000 for an individual and about \$1 million for a body corporate—does that sound right?

Mr Murphy: They are the penalties that appear in the Corporations Act. But in all of this area the government has not concluded its consultations and made decisions on these matters.

Senator CORMANN: But what you are looking at—and there is a discussion paper out on it—is that breaches on things like opt-in, failure to re-sign contracts between clients and advisers, could attract penalties of up to \$200,000 for individuals and up to \$1 million for a body corporate.

Mr Murphy: They may if that is what—there are a couples of variables there—at the end of the day the government puts in legislation and if that is what the government ascribes that particular penalty to.

Senator CORMANN: That is what you the Treasury has put on the table?

Mr Murphy: They are just across-the-board set penalties. For any type of matter which needs to be enforced certain penalties are ascribed to it. It is not really a matter of individually adjudicating on a particular penalty; it just falls into a class of matters which have a certain penalty ascribed to them.

Senator CORMANN: Moving on to a separate issue, have you done any policy work within your part of Treasury in relation to deferred lifetime annuities?

Mr Murphy: There has been some preliminary work done in other groups but also in Markets Group looking at the value of annuities to investors. What we see is that people wish to have more fixed interest options. Annuities may be one of those instruments that may be attractive to people.

Senator CORMANN: So in the preliminary work that you have done, are you identifying what some of the regulatory constraints may be at present that would prevent annuities from being one of those options as part of a retirement planning framework?

Mr Murphy: Yes, it has been looked at in various areas like the Henry tax review. John worked on that and they looked at annuities.

Mr Lonsdale: The issue of annuities is contained in a number of recommendations in the Henry report, specifically deferred annuities. A number of threshold issues around how, if you were to enhance the annuity market, that should be done—should it be done through the public sector or through the private sector; should it be mandatory or voluntary; and what are

some of the risks around that—were some of the key issues that were discussed in that report. So I can refer you there.

Senator CORMANN: I have read that report. I am aware of the Henry review but I am trying to get a sense of what is happening in this space post the Henry review within Treasury and what is happening within this space from the government's point of view. Henry laid out exactly the issues that you have just outlined very concisely and very eloquently, but where is the government at in terms of some of these issues? That is what I am trying to get a sense of.

Mr Lonsdale: I think the key lens that was looked through was the adequacy of retirement incomes and whether annuities could be a key part of that in the draw-down phase. That really goes to some of the issues that are considered in Revenue Group, for example. In the markets division it is something we think about when we think about fixed-interest markets and whether annuities could support a more vibrant fixed-interest market. But they are policy issues and that is for government at this stage.

Senator CORMANN: I understand that. I guess from my point of view this is a preliminary trying to get a sense of where the government is at and where Treasury is at.

Mr Murphy: We have had meetings with institutions that provide annuities and we have talked to them about why there is not as great an uptake on annuities as they think is appropriate. They have raised issues. It is very preliminary at the moment. But we have talked to institutions about this.

Senator CORMANN: On notice perhaps, can you—to the extent that you can—provide us with a list of the sorts of regulatory and taxation constraints that would be the roadblocks to annuities being more successful?

Mr Murphy: Okay.

Senator CORMANN: Has Treasury undertaken any analysis to estimate the number of Australian retirees whose private retirement savings become exhausted and who consequently become totally dependent on the age pension? Do you have some numbers around that?

Mr Murphy: Probably there would be but it is not with the Markets Group; it would be in—

Mr Lonsdale: It would be Revenue Group—Mr Phil Gallagher.

Senator CORMANN: So I have to wait till October now.

Mr Lonsdale: We are happy to take that on notice if you like.

Senator CORMANN: I really appreciate that.

Mr Lonsdale: It would be useful to clarify the question. There are a large number of retirees—80 per cent of retirees are on the age pension, either full rate or part rate. Most retirees are on the age pension at some time in their retirement. So it would be very useful to clarify the information that you are asking for.

Senator CORMANN: I would be interested to get a better understanding as to what Treasury's expectations are in the context of things like the intergenerational report work and so on as to how that is going to track into the future and how people who might start off with substantial private retirement savings are not able to manage them so that they last for all of their life. You do have the market risk and the longevity risk, which I think sounds terrible—it is the risk of growing old, I guess. People in this industry have strange terminology. But never

mind. I am interested to get a bit of a sense as to what your modelling and your expectations are, how that will track and how annuities fit into the overall retirement policies brain work.

Mr Lonsdale: We can see what is available.

Senator CORMANN: Thank you.

Senator CAMERON: I am not sure whether it is Mr Murphy or Mr Sandlant on these issues. The government's response in development of the Future of Financial Advice really was driven by the scandals at Westpoint, Timbercorp, Storm Financial and recently Trio Capital. We talk in the abstract a fair bit at estimates when we are talking about budgets and legislation. But really people's lives get destroyed in this, don't they?

Mr Murphy: That is why one is seeking to tighten up the regime and try to get better information out to people so they can be more cautious or have better information on the table before they make some decisions.

Senator CAMERON: The proposition has been put by Senator Cormann that only a small number of companies are involved—

Senator CORMANN: No, Senator, I did not say that.

Senator CAMERON: You did not say that? Okay, I will take that back. Do not panic. That is what I thought you said. The proposition seems to be generally when you hear the arguments on this that it is only a small number of companies that are involved; the rest of the industry is okay. I think you, Mr Sandlant, did indicate that it was a small group. But surely the government has a responsibility to protect an individual investor if they are being treated illegally or wrongly?

Dr Sandlant: Absolutely. I do not think I did indicate that it was a small group in terms of its importance—its social importance or moral importance.

Senator CAMERON: Right. Do most people get access to life insurance cover through their super? Are there any figures on that?

Dr Sandlant: The figures that we have for life insurance, based on recent APRA data, are that 42 per cent of people get life insurance through super and 58 per cent non-super.

Senator CAMERON: So given that super is only a few decades old that is quite a significant number of people who have access to both super and insurance that was not there before?

Dr Sandlant: That is correct.

Senator CAMERON: Can I come back to the advisers. Is there any analysis of the average size of the client base for advisers?

Dr Sandlant: There was some data that was available on that from ASIC—the PJC inquiry. I might have to take that on notice or come back to it. From memory, I think the average number of clients per financial adviser was about 370. But that is from memory.

Senator CAMERON: And that is an average. I do not want to hold you to that, but that is roughly where it is at and you will come back on that. So 370 clients. How could an adviser provide quality advice every year to clients if they have 370 clients?

CHAIR: Senator Cameron, I do not know that that is a responsibility of any of the officers at the table.

Dr Sandlant: The figure we have is 380 actually. That was in a submission by ASIC to the PJC inquiry.

Senator CAMERON: Chair, these officers are looking at the legislation—

CHAIR: If they care to give some answer around that I am happy to—

Senator CAMERON: I am just posing the question: if an individual adviser has 370 clients, how can they provide quality advice and value to that client base? It is just impossible, isn't it, on an ongoing basis every year?

Dr Sandlant: I think it is difficult for me as a Treasury official to answer that question, because of the wide range of financial planning businesses, business models and client relationships that there might be. But I understand the point you are making.

Senator CAMERON: I know you do not want to go there but I think it is self-evident that there is an issue. If there is an underinsurance problem, why do we have that problem if insurance commissions have existed on products for some time—if that was going to fix the problem?

Dr Sandlant: The underinsurance problem is a very intractable and difficult policy problem which there is a policy debate about—about whether the solution to that is commission payments and for advisers to be motivated by commissions to sell insurance, on the basis that insurance is not a product that the typical consumer wakes up in the morning and decides they need or want to go out and purchase; it is described as a grudge purchase. There is an alternative policy view that if clients understand the value of insurance and advisers are more up-front in charging the true cost of advice and explaining the value of insurance—and this comes back to the trust and confidence issue that if conflicts of interest are removed from the equation consumers will be more likely to go to advisers for advice about their needs, including insurance, and would be more likely to take up insurance, to trust in the adviser recommending the insurance and not to have that conflict of interest in the back of their mind that the adviser is selling them a product rather than recommending insurance which would be of benefit to them.

Senator CAMERON: But there is no evidence that insurance commissions are assisting to resolve the underinsurance problem is there?

Dr Sandlant: That is what I said: it is intractable in the sense that it is very difficult to identify the causal relationship. If you believe that commissions are a solution to the underinsurance then you could look at the underinsurance problem and say that commissions have not been doing a great job.

Senator CAMERON: Let us come back to these 380 people who have an adviser. Do you have any statistics on how often these clients would see their adviser? They would not see them annually, would they? They just could not do it, could they?

Dr Sandlant: Again, the ASIC submission included some data: an average of 380 clients per financial adviser, 60 per cent not having frequent contact and 40 per cent having frequent face-to-face contact. But again this data would be based on a sample and it is an average, so we should view it as being indicative. There would obviously be a wide range of financial planners, the number of clients they have and the kind of contact they have.

Senator CAMERON: But the indication would be that 60 per cent do not get any ongoing financial advice? If they do not see their adviser, isn't that the logic? If they do not see their adviser they are not getting financial advice.

Dr Sandlant: The implication might be that they are continuing to pay for financial advice but they are not receiving ongoing financial advice. But it may be possible that although they do not have frequent face-face-contact with the financial adviser they are still receiving ongoing maintenance and monitoring of their portfolio.

Senator CAMERON: Is there any evidence of that, or is that a guess?

Dr Sandlant: There is evidence in the sense that there are advisers who tell us in consultation that they have clients that they see more infrequently. In a sense they monitor their portfolios and they might not see them as frequently. One example that is provided of those types of clients is older retired Australians who might be on holiday, grey nomads travelling through the Northern Territory and so on. But as a proportion of clients I would think that that would not be the majority—that most of the clients that advisers see, if they wanted to see them more frequently, could.

Senator CAMERON: Could they? If you are a financial adviser with 380 clients, these clients would have to get in the queue, wouldn't they? It just physically could not be done to get quality advice on an annual basis.

Dr Sandlant: I do not know whether it is an annual basis or a biannual basis, if you are referring to the opt-in proposal. But again there is a policy debate about whether an adviser should be charging a client for ongoing advice if they are not seeing them at least once a year.

Senator CAMERON: Most people are paying an annual fee.

Dr Sandlant: Many advisers have said to us in consultation that they themselves would not be able to support charging their clients a fee for ongoing advice if they were not seeing, and many of the clients they are charging an ongoing fee for they might see two or three times a year.

Senator CAMERON: But it just seems to me that the logic of this is there is an annual fee, the average number of clients is 380—the quality of advice just cannot be there and people are paying for advice they are not getting. Anyway, let us move on. What has the ASIC shadow shopping survey shown about the impact of commissions on advice?

Dr Sandlant: There have been a number of ASIC shadow shopping surveys about inappropriate advice and life insurance products which have shown that there were instances of inappropriate advice resulting in either too much or too little cover. ASIC advised us in our consultation that they found evidence that conflicts of interest were driving this behaviour—for example, advice that might lead to a client switching from a super fund that had some life insurance to a fund that did not and then buying a large amount of standalone life insurance. ASIC argued in their submissions to us that overselling and poor advice were influenced by remuneration structures and volume bonuses.

Senator CAMERON: So that is the advice you got from the regulator?

Dr Sandlant: That is correct.

Senator CAMERON: What has been consumer group feedback on the opt-in requirements?

Dr Sandlant: The consumer groups, and I guess I am thinking primarily of Choice, which is a member of the consultation group that Treasury has been talking to over a number of months, are very supportive of the opt-in arrangements.

Senator CAMERON: So people who are looking consumers are saying they support the opt-in arrangements. The people who are getting the fees and not doing anything for it do not want the opt-in arrangements. That seems to me to be what is happening.

Dr Sandlant: Certainly there are some financial advisers who do not support the opt-in arrangements—in fact probably the majority. There are some that will tell us that the impact on their business would not be as significant because they tend to see their clients multiple times a year and they could opt their clients in that they are seeing frequently at little cost as part of their existing face-to-face client relationship. But it is the advisers who have perhaps a large number of clients that they do not see frequently that would find opt-in a challenge.

Senator CAMERON: But even just the average—if that is true and you have 380 clients and people are saying they see some of their clients on multiple occasions, that makes the argument I have been putting that some clients have no chance of getting any advice even stronger. If you are seeing some clients multiple times, the chances of 380 clients actually receiving something for the payment they make annually is zero.

Dr Sandlant: It is, again, a principle of—

Senator CAMERON: No, it is a statistical issue; it is not a principle.

Dr Sandlant: I am agreeing with you that the principle of the Future of Financial Advice reforms is that clients should not be paying for advice they are not receiving. That is the principle underlying the opt-in proposal—that this would require clients who might not even be aware that they are paying for advice as part of, for example, an ongoing commission, to agree to continue to pay.

Senator CAMERON: Has the industry provided Treasury with any estimates about the cost of opt-in?

Dr Sandlant: We have received some estimates that vary widely, from some advisers who have advised us that in the course of seeing a client in the normal course of their business the cost would be minimal, to other estimates which appear to be based on almost treating opt-in or the contact process and the administrative process as a standalone—something that you would not do in the course of having a meeting with your client but that you might do specifically as a standalone thing which would be more expensive. So the cost estimates range quite widely. And I think the cost would vary according to whether it is a client that you are seeing frequently or a client that you have not seen, perhaps, in two years.

Senator CAMERON: Are these estimates available?

Dr Sandlant: No, they are confidential submissions to Treasury made by industry. There are also consumer groups that have argued strongly that the cost of opt-in would be very minimal. Recently there was an industry Super Network press release based on some analysis done by Rice Warner which again argued that the cost would be minimal. So what we see is a wide range of—

Senator CAMERON: Rice Warner, are they—

Dr Sandlant: Rice Warner actuaries.

Senator CAMERON: Are they experts in the area?

Dr Sandlant: They are actuaries, and I guess experts in that area, who have conducted some research for Industry Super Network. I am just making the point that there are a wide range of estimates.

Senator CAMERON: But Rice Warner do not just do work for Industry Super Network, do they? They are, as I remember from my time in the industry, highly regarded in terms of their capacity to understand and provide advice on the industry.

Dr Sandlant: That is correct.

Senator CAMERON: So Rice Warner are not just somebody down the road that has been asked; they are highly regarded.

Dr Sandlant: That is right. And that is publicly available.

Senator CAMERON: Has Treasury done any independent scrutiny of these costs that have been put forward by the industry?

Dr Sandlant: No. We have received information from a number of different sources but we have not attempted to independently estimate the costs. I think it would be difficult, given the wide range of business models and client relationships, client size.

Senator CAMERON: But wouldn't Rice Warner be someone—I am not touting for Rice Warner; I do not know them from a bar of soap. But somebody like Rice Warner—wouldn't it be a good exercise for Treasury to undertake to have a third party independent scrutiny of what the industry is telling you in relation to the costs?

Dr Sandlant: Possibly but it is not a decision that I would make.

Senator CAMERON: Could I ask you to take that on notice as to—

CHAIR: The decision has not been made to do that, so I do not think it is—

Senator CAMERON: You don't know what I was going to say.

CHAIR: Okay, go ahead.

Senator CAMERON: Would it be appropriate for Treasury to provide itself with more information by having an independent assessment of the industry advice?

Dr Sandlant: Possibly.

Senator CAMERON: I might come back at the next estimates and ask you whether that has been and, if not, why not.

Dr Sandlant: Sure.

Senator CAMERON: What volume rebates have been banned, and why?

Dr Sandlant: Volume rebates from platforms to dealer groups and/or advisers. Volume rebates from fund managers to dealer groups and/or advisers. Volume rebates from fund managers to platforms at this point in time are still under review. Until the legislation is finalised, until draft legislation is put out for public exposure, which we expect to do in the coming months—that is when the final policy position will be—

Senator CAMERON: Were commissions involved in the collapse of Trio?

Dr Sandlant: My understanding of Trio is that there were the equivalent of volume payments that were made by Trio to some dealer groups—loans in some instances—but I am

not aware of commissions. That is not to say that there were not commissions involved; I am just not aware of that.

Senator CAMERON: What has been done to increase the provision of lower cost advice so that more Australians can access advice? It is obvious to me that these so-called advisers cannot advise. Firstly they do not have the capacity with the number of clients that they have. They cannot do it on a yearly basis. So what is being done?

Dr Sandlant: Again, just to talk about principles, there are two key principles: one is to improve the quality of advice and the other very important principle is to expand the availability of advice and access to advice. Underlying that is a policy concern, if you like, that Australians need financial advice—financial services are getting more complex and Australians have more responsibility for managing their retirement and so on. So it is a very important component that often gets overshadowed by the debate about commissions and opt-in and so on. The government is doing a number of things across this area, one of which is not directly part of Future of Financial Advice but it is important to note—that is, expanding financial literacy and in particular the MoneySmart website that was launched recently by ASIC. Obviously, that is free, generic advice available online to all Australians. This is important, because a number of other jurisdictions around the world are doing similar things. Advice need not only be provided by advisers; it can also be provided through other channels. This is actually quite an important channel.

Above that level, which is the entry level or the baseline of financial advice—and obviously there is a grey area between that and financial literacy; they are both very similar—the Treasury and ASIC are looking at developing guidance around what is known as scaled advice or scaled personal advice. Currently, under the rules surrounding the provision of personal advice, it is possible for an adviser or anyone who is providing personal advice to scale the scope of the inquiries that they make to focus them on limited issues or the particular needs of the client. But for various reasons it has been very difficult for financial advisers to do that. They have argued that it is very difficult for them to meet the requirements of section 945A, which is the reasonable basis test in the Corporations Act. That requires them to have a reasonable basis for the advice. The outcome of that has been that most of the advice that is provided has been what is known as holistic in nature. It tends to be very expensive and it covers the full gamut or the full suite of needs that a client might have. Advisers have been wary of the reasonable basis test in not wanting to limit or narrow the scope of the advice that they provide if they do not take into account certain important aspects of the client situation. ASIC is working on guidance and the guidance includes scenarios which are designed to illustrate in as practical terms as possible the various ways in which an adviser can provide limited, scoped or simple advice. There are different terms that are used to describe it. This kind of advice could be provided not only by financial advisers but also by anybody who is licensed to provide personal financial advice. It is the case that superannuation funds have been providing intrafund advice, which is a subset of this limited advice under class order relief that ASIC provided about a year ago or a year and half ago. Superannuation funds would also be able to provide limited, scaled advice without relying on the class order relief. In fact, the majority of superannuation funds that have been providing intrafund advice have not been relying on the class order, which provides relief from that reasonable basis test. So there are a number of steps that are being taken, ranging from the new website that ASIC has

launched just recently to ASIC guidance on how advice can be provided in a scaled or limited way.

Senator CAMERON: What has been put to me by a number of people is that they do not financially have the capacity to pay \$2,000 or \$3,000, as some of the advice can be, because they are working people on \$50,000 or \$60,000 a year. Their main asset is their superannuation fund that has been accumulating. Why can't someone—or can someone—access their super fund to get advice about how to manage their retirement and their superannuation fund?

Dr Sandlant: They can through intrafund advice. That is the policy rationale for intrafund advice.

Senator CAMERON: But you said it was narrow.

Dr Sandlant: It is narrow in the sense that, as you say, it is likely to be simpler questions about the member's interest in the superannuation fund. But, if a member wants to get more individual advice about either other investment options or other products, some of the superannuation funds—I think Australian Super was recently reported in the media as exploring—

Senator CAMERON: That is the one that I used to be on—a good fund.

Dr Sandlant: working with 60 dealer groups from the adviser side of the business spectrum in outsourcing to them financial advice services to their members under quite strict requirements. I think they require an annual opt-in and no commissions. But there are steps that are being taken and can be taken by superannuation funds to provide for this modular advice. The guidance that ASIC is developing will help to give greater confidence on the part of advisers as to how they can meet their consumer protection obligations and yet be able to scope advice to particular issues and keep the costs low.

Senator CAMERON: We might revisit this in August, because I am interested in how we can give workers access to wide-ranging advice and why they should be stopped from getting a wide range of advice simply because all of their assets are in super.

Dr Sandlant: When you say 'stopped', what is preventing them?

Senator CAMERON: You are saying that it is narrow and it is scoped.

Senator CORMANN: Otherwise they are going to be able to opt out—that is the requirement.

Senator CAMERON: No, it is not opt-out; it is when they retire—how they deal with issues when they retire. They are not all going to be like you—they are not going to spend their lifetime in parliament and have plenty of money when they retire. Workers actually do it tough, Senator Cormann.

Senator BUSHBY: Just one thing first. I note that the Assistant Treasurer, in early April, put out a paper noting a proposed standard definition of flood cover across the insurance industry. Where is that currently at now?

Mr Murphy: I believe that there is a paper and also consultation with industry on that. Then there will be draft legislation prepared.

Senator BUSHBY: So is the consultation finished or is it continuing?

Ms Vroombout: The consultation period closed on 13 May. We have received submissions and are currently considering those submissions.

Senator BUSHBY: Are there any further time lines that have been publicly made available on when things are likely to happen in respect of this?

Ms Vroombout: Not that I am aware of, Senator.

Senator BUSHBY: I want to ask some questions about RMBS and the recent Fitch review and rerating of the RMBS market. Is this an appropriate place to ask those questions?

Mr Murphy: Yes.

Senator BUSHBY: Firstly, can you bring me up to date on the dollar value of RMBS that has been purchased through the AOFM at this point?

Mr Lonsdale: The latest figures I have are that it is \$13.1 billion RMBS that has been purchased by the AOFM since the program commenced.

Senator BUSHBY: Thank you.

Mr Lonsdale: I should add that linked to that 13.1 was another \$18 billion that the private sector contributed.

Senator BUSHBY: Effectively leveraged into it?

Mr Lonsdale: Correct. So that is a total of 31.1 all up.

Senator BUSHBY: So there is still a fair bit of flexibility there for the AOFM in terms of what it still has available?

Mr Lonsdale: Yes. The government in its Competitive and Sustainable Banking package outlined support for another \$4 billion on top of the existing programs. That takes the total amount to \$20 billion. So it would be the difference between the two.

Senator BUSHBY: I will ask the AOFM some more questions tonight about how that is going. It appears to have slowed down a bit, but I will explore that later. In view of Fitch's review, to what degree is the credit quality of this RMBS assured?

Mr Lonsdale: That would be something that you could ask the AOFM. Under the program, the AOFM purchased triple-A-rated securities and that remains the case—the highest quality mortgage-backed securities available in the market.

Senator BUSHBY: Are you aware of whether any of the 54 tranches of RMBS that Fitch rerated include any of the RMBS that has been bought through the AOFM?

Mr Lonsdale: Yes, I think there are some.

Mr Douglas: My understanding is that there may be one or two that were being reviewed. The AOFM this evening can give you the precise details on exactly which ones and how much was involved.

Senator BUSHBY: Okay I will talk to them about that. But, in general, what are the impacts of recent Fitch rerating on the overall RMBS market?

Mr Lonsdale: Again, the AOFM are much closer to the market developments. But, in general, what we have seen over recent months is certainly a pick-up in the RMBS market. We have seen a number of issuances done—about nine billion, I think, in total. The amount of AOFM support has shrunk, suggesting that we have had private sector buyers come in.

Senator BUSHBY: Which is the \$13.1 billion you mentioned earlier. It has sort of slowed down how much support would need to go in. I acknowledge that. But what I am particularly interested in is the impact of Fitch putting those 54 tranches on negative watch due to concerns about the effectiveness of loan mortgage insurance and what impact that has on the overall RMBS market. That is a fairly recent development, as I understand it. It was very encouraging to see the degree to which the RMBS market was recovering with the assistance of the AOFM or the government, far more so than in just about any other comparable jurisdiction. But, as to this negative rating, I am just wondering if you have done any analysis of what impact that is likely to have and whether it is likely to slow the degree to which the RMBS market is recovering or even have worse effects.

Mr Lonsdale: I think that is difficult. I would put that to AOFM. What I would note is that there are a number of impacts on the market. That would just be one of them.

Senator BUSHBY: This is probably another question you will refer me to the AOFM on. Have you conducted a close analysis of why Fitch has put those tranches on negative watch?

Mr Lonsdale: We have examined it.

Mr Douglas: A lot of the review is part of a reassessment of the ratings methodologies that is happening globally through these rating agencies. In relation to the tranches that are under review, my understanding is that they are generally the subordinated or riskier tranches that are being reassessed. But the AOFM can give you a far more thorough answer than we are able to today.

Senator BUSHBY: But, in terms of the reasons that they have done it, what I have read is that it is to do with concerns about the effectiveness of LMI. Is that what your understanding is as well?

Mr Douglas: I think you would need to put that question to AOFM. But there have been questions about LMI more in the offshore contexts than in the Australian markets.

Senator BUSHBY: So it is possible that it might be—and I think we are often a victim of this—international considerations of particular activities that are not necessarily occurring in Australia or risks that are not necessarily—

Mr Douglas: Yes, but, as I said, the AOFM has been through those reports. I have had some discussions with them. In terms of detailed answers, the AOFM can probably give you a far more thorough analysis.

Senator BUSHBY: There is one question that I am curious about. If the government had chosen to provide a government guarantee of suitable standard RMBS, would that have solved any problems of questionable private sector credit enhancements in terms of the way the rating agencies view RMBS in Australia?

Mr Murphy: What is the proposition? That there be a government guarantee?

Senator BUSHBY: There has been public debate and suggestions about RMBS. During the course of the banking inquiry—

Mr Murphy: Yes, we saw that.

Senator BUSHBY: we had submissions along those lines as well. One option, not necessarily in substitution of the \$16 million and now \$20 million support but in addition, was to provide a government guarantee of RMBS at a suitable standard—triple A and all of those

sorts of things. Would the provision of such a guarantee avoid the problems of questionable private sector credit enhancements, which appear to have led to Fitch's downgrading?

Mr Murphy: I think it has been mentioned here that ratings methodology has been reviewed. I think it is greater assessment of risk in the system, and that has led to the shaving of the rating of the major Australian banks and also the housing market. You have to look at the distortion issue in terms of government guaranteeing RMBS. I know this is leading to the regime in Canada. Our position at the moment and I think the government's position would be that there is no need for government intervention in guaranteeing RMBS. The government is in there at the moment. It is supporting. The government's policy position is that it wants to withdraw from the market. The private market and the domestic market seem to be picking up. Why we have not still got an amount of securitisation going is that a large part of securitisation was foreign investors.

Senator BUSHBY: The special investment vehicles and—

Mr Murphy: Yes. Now that has gone away and the issue is whether that is going to come back. Realistically, the government's intervention has provided some support to the industry and you have actually seen some reasonably good deals without AOFM support. So I do not think that it is an issue that we are really addressing at the moment—whether there is a need for credit enhancement of RMBS. It should be able to stand on its own two feet without government support.

Mr Lonsdale: It certainly would not be an incremental change. It would be a significant departure from where we are now.

Mr Murphy: And there does not seem to be a need.

Senator BUSHBY: Although it is only a tiny concern, when a rating agency downgrades RMBS, some of which have taxpayers' funds invested into them, that raises questions of risk to the taxpayers' funds. I am just exploring generally—

Mr Murphy: The other thing is that it is not unusual for institutions or investments to be put on negative watch. That is not the end of the world. That is just a highlight to people that there may be issues that could emerge.

Senator BUSHBY: That is right. I will explore with the AOFM tonight what those issues could be and what their understanding of it is. Moving on to a different subject: I am wondering where the government is at or Treasury is at with the Tax System Advisory Board. Is that something that you are working on or is that Revenue?

Mr Murphy: Yes.

Senator BUSHBY: I will put that on notice—that is fine. At the last estimates I asked about—and it was taken on notice—the details of the differences between the dates on the initial website for the Competitive and Sustainable Banking System reforms and those that were likely at that date. The answer that was provided in AET 116 does not actually tell me what the dates were on that initial website. I was wondering whether you could provide me with the details of—to use the phrase you used in the answer to the question on notice—indicative-only consultation time frames that were publicly published on that website at the time of the release of that package.

Mr Lonsdale: We will get you the exact dates.

Senator BUSHBY: While we are on that, I would like to ask where we are at with some aspects of the package. What is the current status of the exit fee ban in terms of the consultation? I know that it is due to take effect on 1 July.

Mr Lonsdale: We have some regulations ready and the date of effect will be 1 July.

Senator BUSHBY: Are the regulations—

Mr Lonsdale: They are regulations that set out in more detail the exit fee ban—in particular, which exit fees.

Senator BUSHBY: Are they in parliament yet?

Mr Lonsdale: That is my understanding.

Mr Douglas: I will find the exact date when they were made.

Mr Murphy: It was 23 March.

Mr Douglas: And they have been tabled.

Senator BUSHBY: I apologise for not looking into it. I was just putting this together. Has the period they have to lie on the table before they can be disallowed passed?

Mr Douglas: My understanding is that it has not.

Mr Murphy: It would be 14 sitting days. We could do a count.

Senator BUSHBY: As yet they are not fully effective or potentially they may not be fully effective?

Mr Murphy: They will not really come into operation until 1 July.

Mr Lonsdale: That is right. They come into effect on 1 July.

Senator BUSHBY: Okay. Mr Bernie Fraser was conducting an inquiry into account number portability. That was due on 30 June. Is that likely to be delivered by 30 June?

Mr Lonsdale: Yes.

Senator BUSHBY: Will it be on 30 June or could it be before?

Mr Lonsdale: That would be a matter for Mr Fraser, but my understanding is that it is on track.

Senator BUSHBY: On the lenders mortgage insurance that we mentioned a minute ago in terms of Fitch's concerns, there was an undertaking in the package to develop a framework to allow this to be transferred. Where is Treasury at with the development of that framework?

Mr Lonsdale: That is also on track. We have spoken to a number of insurers, we have done some consultation and we will be providing advice in terms of a report to the government in June, as was foreshadowed in the government's package.

Senator BUSHBY: The actual package talked about developing a framework to allow transfer. Have you looked at any other alternatives as a way of dealing with LMI in addition to the transfer possibility?

Mr Lonsdale: There are a range of options. One is transfer and another is pro rata. There are a range of different approaches.

Senator BUSHBY: You have cast the net wider than the initial focus?

Mr Lonsdale: Yes.

Senator BUSHBY: Where are we at with developing the framework for the central repository to hold all mortgages?

Mr Lonsdale: It is on a similar time frame. Again, advice will go to the government in June on some options there.

Senator BUSHBY: I am asking this as somebody who used to do a bit of conveyancing law: without asking you to disclose them, are there options?

Mr Lonsdale: There are certainly options. I think it is fair to say that we have moved a bit in our thinking from the original plan, which was to think about a clearinghouse approach, towards seeing if we can utilise e-conveyancing much more. There is a process currently underway as part of the COAG agenda and we are talking to states and banks as part of that.

Senator BUSHBY: I have a few questions about the fast-track legislation on credit cards. I use the words ‘fast-track legislation on credit cards’ because that is the term that was used in the package. As I understand it, that was probably a reflection of the fact that this was originally an election policy and the element in the package that made it different was that you were going to fast-track—the government wished to fast-track it to get it through. I have had some representations to me regarding the time lines on consultation. In a way, it looks like the fast-tracking of legislation means doing away with meaningful consultation and ramming it through without actually having a good look at the potential issues raised. I am sure that is not what the intention was, but that is how it appears. I would just like to go through that. What consultation was undertaken in respect of that proposed legislation?

Mr Mikula: The consultation on the credit card reforms began very early, because it was announced as an election commitment in the middle of last year. The consultation began more or less as soon as the government of the day came into being. I am just looking for the precise times. There have been two main vehicles for discussing the reforms. The first was a broader consultation group with a range of stakeholders, lenders, consumer groups, the Law Society and Abacus. That met on a number of occasions, primarily face to face—I think it is five times since September 2010 last year—and discussed credit cards on each occasion. Very quickly, the nature of these reforms I think dictated that we needed a specialist group in which there could be far greater representation by lenders. So all major lenders were invited, together with Visa and MasterCard as payment systems, and American Express. I think that group met primarily by teleconference but not exclusively and had seven such teleconferences or meetings between November 2010 and March 2011. The development of the policy went through a series of refinements at each meeting. The issues around implementing each of the election commitments were discussed and refined and lenders certainly had great ability to raise all of the practical issues they wanted to and they certainly did. The final product, I think, reflects the extent of that consultation.

Senator BUSHBY: When was the exposure draft released?

Mr Mikula: I do not have that in front of me, but it was I think either at the end of February or early March.

Senator BUSHBY: Had there been any consultation papers that had been publicly released before then or just consultation with the groups that you referred to?

Mr Mikula: There was typically a consultation paper for each meeting prepared by Treasury. There were no restrictions as to who they were distributed to. But they were not, for example, released on the website or anything like that.

Senator BUSHBY: So the first opportunity that the industry as a whole had, other than those represented through the groups that you were talking to, to consider the proposals was the exposure draft?

Mr Mikula: They certainly had access to the material. We understood that the industry bodies were sending it through to all of their members, such as the ABA and Abacus.

Senator BUSHBY: To what extent did the exposure draft fully reflect the matters that had been agreed at those meetings?

Mr Mikula: The exposure draft was primarily driven on those. There were some issues that were developed at a late stage, though.

Senator BUSHBY: How long was provided after the exposure draft was released for people to provide written submissions?

Mr Mikula: It was a short period—less than a week.

Senator BUSHBY: Would two days be right—two working days?

Mr Mikula: I would have to check.

Senator BUSHBY: That is what has been suggested to me. I conclude from what I have heard here today that there were new measures contained in the exposure draft that had not been discussed—or new aspects of the legislation that had not been discussed at the meetings beforehand. There had been no public formal consultation across the industry other than to the extent that people in meetings had had that opportunity. And then the industry was provided with two days to provide comment and to consider the consequences of the exposure draft, what that might mean for the businesses that they operate, how they would be able to incorporate and make the changes that would be required and what potential unintended consequences there might be, and then to put that together in a submission and get it into Treasury. Is that correct? I am putting my own emphasis on it, but essentially that is as far as the facts go.

Mr Lonsdale: I think we would want to be a bit more definitive on the length of time.

Senator BUSHBY: Okay—less than a week anyway, and potentially as little as two working days.

Mr Lonsdale: I think that is right.

Senator BUSHBY: Is that period of consultation—given the potential burden that would be placed on those who are subject to this legislation—reflective of the normal period of time that would be allowed to stakeholders in developing this sort of legislation?

Mr Lonsdale: I think we try to give the maximum amount of time we possibly can, because there is no doubt it produces a better result. But sometimes there are constraints that do not make it possible to have a long consultation period, and in this case we had commitments to introduce legislation.

Senator BUSHBY: Those commitments were government commitments, not Treasury's commitments?

Mr Lonsdale: The government announced as part of its package that it wanted to implement some measures.

Senator BUSHBY: I made some comments in my opening statement on this particular issue that the government uses the term 'fast-track the legislation' and effectively that is what it has done, and what that means is squeezing the consultation and, effectively, the ability for those who are impacted to have full input into what that might mean for them. That is probably not an answer that Treasury can give us.

Mr Murphy: That is a time thing. But that consultation, in a lot of these legislative matters, is one step along the way. Now there has been a public hearing held by the House Standing Committee on Economics about that legislation.

Senator BUSHBY: They had less than three full working days to prepare their submissions for that as well. From the date that submissions were called for they had less than three working days in which to lodge their submissions.

Mr Murphy: With the House committee?

Senator BUSHBY: Yes.

Mr Murphy: The committee has not reported, and then the legislation awaits the committee's report.

Mr Lonsdale: If there are outstanding issues it is open to anybody to put those to us and for the government to consider them.

Senator BUSHBY: I think we have explored the consultation side of it. Has a regulatory impact statement been compiled in respect of the proposed legislation?

Mr Mikula: Yes. It was attached to the explanatory memorandum.

Senator BUSHBY: So it has been publicly released?

Mr Mikula: Yes.

Senator BUSHBY: What consideration was given to the potential for the government's newly legislated responsible lending obligations to address the mischief that this proposed credit card legislation is designed to address? At least in part I would have thought that the responsible lending obligations that now fall upon credit card providers would have addressed some of the mischief that is being addressed by this legislation. Was there any consideration given to that?

Mr Mikula: There was consideration given to that. I think, though, they are quite discrete issues and looking to address quite different topics and problems. The responsible lending is about whether the consumer can afford the repayments, at least in the context in which I think the question might be raised, whereas the credit card reforms, particularly those in relation to prohibiting unsolicited credit limit increases, are about seeking a more active engagement and more active choice by the consumer in deciding whether to increase their credit limit.

Senator BUSHBY: While we are on the credit limits, my reading of the draft legislation suggests that it is now very difficult for a credit provider to offer an increased limit. I would be interested in your views on how a credit provider, if this legislation were passed, would actually go about providing the consumer with the choice of an increased credit limit. What would they still be permitted to do?

Mr Mikula: The way in which the legislation is structured is that it would—section 133BE contains a prohibition on making unsolicited credit limit increase invitations. That is specifically designed to address the instant 'sign here and return this form' or 'click on this button and you can get an immediate increase' sorts of offers where consumers can make a very simple choice when it is put in front of them. The characteristic that defines those is that there is some level of encouragement or enthusiasm by the lender for this proposition. It has always been contemplated, since the issue was raised in the various consultations we have had, that lenders would still be able to provide neutral factual information about how you could increase your credit limit—for example, a statement that you would be able to discuss this by contacting a particular person or ringing a particular number or doing something like that. That has always been Treasury's position and that is being addressed through the regulations. There is no constraint on communications between lenders and their customers on that topic. They can still discuss it. But they have to do it in neutral ways that avoid the precise—

Senator BUSHBY: Could they write a general letter to customers in general saying, 'If you would like to consider an increase in your limit then please talk to us'? Are you saying that sort of thing would be fine?

Mr Mikula: That is we what we would anticipate the regulations would allow when they finally—

Senator BUSHBY: But if it is a specific letter to a customer, because it may be observed that that customer is continually hitting the limit, saying 'We notice that you're continually hitting the limit and we thought that you might like to consider an increased limit', is that something they could do?

Mr Mikula: I suppose they would still be able to write to individual customers. The customer themselves would know whether they are going up to or over their limit, so whether they would be able to point that out or just provide the neutral information is still one of those issues of a level of detail that we are still considering.

Senator BUSHBY: So that is a bit grey at this point? So it is a bit fuzzy still at this point what they might be able to do in that?

Mr Mikula: Yes.

Senator BUSHBY: What about—and this is probably less fuzzy—the situation like we had earlier this year with the floods in Queensland? Banks in that case were, I think, asked by the federal and state governments to show a bit of largesse to some of the people who were affected. If in that case a bank wanted to offer the ability to have a higher limit for a period to help people through that, presumably they would not be allowed to send a letter saying that, under this legislation.

Mr Mikula: There is possibly a misconception about that sort of scenario. Largesse by the banks in providing such a credit limit may not be in the consumer's best interest if they cannot afford to repay it.

Senator BUSHBY: But the responsible lending obligations would surely address that.

Mr Mikula: That is correct. So the utility of writing to consumers in that situation is questionable. I think what they did previously in that scenario was mass media messages,

which are certainly still allowed. It is only individual written communications that fall within this prohibition.

Senator BUSHBY: I will leave that aspect of it there. On what basis has the government decided to only apply these measures to new customers? Did the government obtain legal advice on the issue?

Mr Mikula: We did.

Senator BUSHBY: On what date was the legal advice provided to Treasury?

Mr Mikula: I would have to take that on notice.

Senator BUSHBY: If you could, that would be appreciated. And what is the basis of that legal advice? Why is it only applied to new transactions?

Mr Mikula: Some of the measures apply to new customers; some apply to both new and existing customers. The basis of the distinction, essentially, is whether there is a risk that the Constitution might be infringed—that granting rights to a consumer under an existing contract might be an acquisition of the rights of the lender. So there are some restrictions as to how far you can intervene in an existing contract. But restricting the sorts of offers that can be made or requiring disclosure does not affect the rights under the contract and so can be extended to both new and existing customers to ensure that the policy has the fullest impact.

Senator BUSHBY: Has the legal advice on which that decision was made been released publicly?

Mr Mikula: No, and there is no intention to.

Mr Lonsdale: That would not be the normal practice.

Senator BUSHBY: I presumed that was probably the case; I was just confirming that it was the case in this particular instance. Obviously, you have got the legal advice and I would love to have a look at it so I could see how it actually pans out. I can understand the basis on which that was stated, but if you have existing customers who are doing new things then I would not have thought that there were existing property rights that they might be losing when they do new things. You did mention that it might apply to existing customers in some circumstances; is that right?

Mr Mikula: I would rather not engage in a legal debate on this issue, given the complexities.

Senator BUSHBY: I am not looking for a legal debate; I was just asking about how the regulations are intended to apply in that situation. You mentioned that the regulations would apply to new customers and also to some existing customers.

Mr Mikula: Yes.

Senator BUSHBY: So in what circumstances would this apply to existing customers?

Mr Mikula: As for the basis of the distinction, perhaps we should go through it individually. Restricting the level of communications applies to both new and existing customers. Setting up an allocation of payments hierarchy only applies to new customers and does not apply to both new and existing ones, although lenders would be free to adopt that voluntarily to ensure consistency across their systems should they want to—but it is not seen that the government can intervene to dictate how an existing contract should be reshaped in

that way. The provision of the default buffer only applies to new customers, for similar reasons: because that might otherwise affect existing rights between the parties.

Senator BUSHBY: Thank you. On the over-the-limit processes, my understanding is that there are a number of different processes involved and that there are different outcomes in different circumstances. My reading of the Labor Party's promise before the last election was that they would ensure that customers would not be charged an additional fee unless they explicitly agreed to the service. It seems to me that promise could have been delivered in full by far simpler options like a simple opt-in to a fee service. Why was the decision made to go for a more complicated over-the-limit process than the simple approach that could have been delivered and that would have delivered on the government's promise?

Mr Mikula: The way in which it is structured is that there is still that opt-in process for a fee for what is called the supplementary buffer so that consumers who might want access to credit above the default buffer of 10 per cent still have that option but do have to pay a fee. There was significant discussion in the consultations about how the default buffer should operate. I suppose the consensus achieved was that the outcome that is in the bill, where the default buffer is the position that applies unless the consumer opts out and there is no fee payable, was seen as the one most consistent with current practices and the most practical outcome.

Senator BUSHBY: I will move on in the interests of brevity. One thing that does worry me a lot about this is the introduction of strict liability criminal sanctions for breaches of what in some circumstances are essentially administrative requirements that have been placed on credit providers. I am interested in Treasury's thoughts on the extent of this. I am sure you have looked at this and I am sure you are satisfied but satisfy me, please, that there is no risk to workers at these institutions whereby if they make simple administrative errors on forms or in what they may have advised or not advised that could arise out of those strict liability sanctions or consequences.

Mr Mikula: In relation to the bill, the strict liability is not novel. It exists already in the act that is proposed to be amended by this bill. There is a different framework around penalties but in essence I think that reassurance can be given. While there are some situations where employees can be liable it is usually where they are actively complicit so that they are actually conspiring or they knowingly breach the law. But for employees who are simply following the instructions of the lender there is no risk.

Senator BUSHBY: But the nature of a strict liability criminal sanction is that there is no mens rea component of the criminal action. If the action occurs then liability is strict. There is no need for an intention on the part of the person who does it. That is where the concern for me arises. You cannot use the defence that you would use in many criminal cases that it was an inadvertent thing, there was no intention and you were not complicit. The fact that it is strict liability means that you are liable regardless of your intention and the degree of complicity. That is where my concerns arise.

Mr Mikula: The strict liability offences are only placed on the licensee in practice.

Senator BUSHBY: I am clearly concerned about individuals who might make an error of some sort and then have the strict liability apply. But if an individual makes an error—let us

assume that the worker is in that case protected—does the credit provider then wear strict liability for something that was an administrative error by one of their employees?

Mr Mikula: Yes. Well, the offence is couched in terms of an obligation on the licensee, not on the employee.

Senator BUSHBY: So the answer to that is yes. Even if the credit provider goes to great lengths to ensure that staff are fully trained and does everything possible that anybody could conceive of to ensure that they know exactly what they should be doing to comply with the legislation, and an inadvertent error nonetheless occurs, the credit provider will be liable?

Mr Mikula: That is correct but that is offset by the fact that the penalties are much lower.

Senator BUSHBY: And they are not just liable for a fine but criminally liable.

Mr Mikula: It is only a fine.

Senator BUSHBY: I know it is only a fine but it is a criminal fine.

Mr Mikula: It is only a certain number of penalty units and it is one-tenth of the normal offence, I think, from memory.

Senator BUSHBY: You have answered my questions there. You have not satisfied me, though. If you have any more information that you can provide to me on how you see that this would work and that you think might be useful for the committee on that issue, I would appreciate that.

Mr Mikula: In relation to the penalties?

Senator BUSHBY: Yes.

Mr Mikula: I think we can provide something.

Senator BUSHBY: Okay. In general it appears to me that there is going to be a cost for the credit providers of meeting the requirements that this will in place upon them. Has Treasury considered the differential way that that might play out between the larger credit providers, who probably have a greater ability to absorb increased administration costs, vis-a-vis smaller credit providers and the impact that may have on their overall running costs and their ability to compete?

Mr Mikula: We have considered that. There are a number of angles to these reforms and one of them is to look at greater consistency and transparency in pricing as a result of these changes. So while inevitably there are some cost implications there will also be competition drivers in greater visibility between products that we think will offset that.

Senator BUSHBY: But the main reason why this legislation was first promised by the government before the election and is being implemented is not really a competition factor; it is more about consumer protection, as I understand it. That is a fair comment, isn't it? Minister, you are probably best placed to answer that. The main purpose behind this legislation is consumer protection rather than driving competition?

Senator Wong: I have to be honest with you: I have not been following this discussion in great detail, I confess. So maybe Mr Murphy can help.

Mr Murphy: It is part of that competition package. Again, it just goes down to this position of empowering consumers, putting them in a better position. There have been concerns out there about unsolicited credit limit extensions—

Senator BUSHBY: That is right, but that is more of a consumer issue.

Mr Murphy: and angst about that, and that is what this is seeking to do.

Senator BUSHBY: But I am pretty sure the government—and I stand to be corrected because I have not researched it—when it first went to the Australian people during the election with these proposed changes, was doing so because this was a matter of consumer protection and of ensuring that consumers are better protected, rather than with a view to actually increasing competition within the financial sector.

Mr Murphy: But given the whole thesis underlying that competition package, just in general policy terms, the key thing was to empower consumers, to redress the unequal balance or poor bargaining position they have with major financial institutions, and even smaller ones I suppose. So that is what you are looking at. You are giving them more rights.

Senator BUSHBY: And as a consumer I agree. I can see that, and a lot of the measures are good. I have some concerns about some of them but a lot of them are good and actually will achieve that aim. But it is not all as such—even fast-tracking that legislation as part of the consumer protection. I do not want to dwell on this point because it is not really a key point.

Mr Murphy: No, but it is all that theme of empowering the consumer.

Senator BUSHBY: I will move on from the credit card stuff now. Taking the 'Bank on a better deal' awareness campaign, where are we currently at with that? How much money has been spent on that so far and how far through it are we?

Mr Lonsdale: We are progressing it. The one thing I would refer you to is the MoneySmart website as a start—

Senator BUSHBY: That is from ASIC?

Mr Lonsdale: That is from ASIC; that is correct—and Dr Sandlant talked about it earlier. We are also progressing some educational material from concept that might involve media, but it is very much at the concept stage at this stage. The government has provided money in the budget to progress this. I refer you to Budget Paper No. 2, page 320, which outlines funding for \$10.2 million in 2010-11 and \$4.8 million in 2011-12.

Senator BUSHBY: And that is the full extent of it?

Mr Lonsdale: That is the full extent of money that has been provided for the campaign.

Senator BUSHBY: You mentioned the MoneySmart website. How is that website different from financial literacy programs that have been on ASIC's website before? They have run similar things in the past.

Mr Lonsdale: It is all part of it. I think one of the things the website tries to do is explain some of the measures that have either been announced or are in train. There are a number of measures, as Mr Murphy mentioned, empowering consumers—to switch, for example. That is discussed.

Senator BUSHBY: I tried switching myself recently and it was not easy.

Mr Murphy: Did you?

Senator BUSHBY: I did switch banks, yes.

Senator Wong: Well done.

Senator BUSHBY: When I needed to refinance I thought that I should probably talk to a few different banks and do the right thing. I think it paid off, so it was worth doing.

Senator Wong: You see.

Senator BUSHBY: But there were some challenges.

Mr Murphy: Can we take that to say the package—

Senator Wong: So we should say Senator Bushby thinks it's—

Mr Murphy: We will put it on the record. You came in with all this information—

Senator BUSHBY: I will not name the bank but I did actually ask them about the switching package that was introduced and they had no idea what I was talking about at the local branch level.

Mr Murphy: That is why this needs some more measures.

Senator BUSHBY: I had to do it all myself.

Senator CORMANN: It is fair to say that you are better informed than the average consumer.

Mr Murphy: Mr Fraser's report on portability has some very good options to make that a lot easier. We are still looking at them but—

Senator BUSHBY: I look forward to that. If we can actually achieve a simplification of that process then I think everybody agrees that would be a good thing.

Mr Lonsdale: The other thing I would add is that the website has been revised to make it a bit more interactive with people as well. That would be another change.

Senator BUSHBY: Thank you. Now, the joint Treasury/RBA task force on ATMs: that report is still due to be delivered in June as planned?

Mr Lonsdale: Yes, that is on track. There has been an interim report. The RBA and Treasury have provided advice to the government, particularly on ATMs in Indigenous communities. That is with the government. There will be a further report this month on the broader ATM competition issues.

Senator BUSHBY: I look forward to seeing that. I refer to the use of the term 'bank'. Has APRA delivered its report to the government which was due in March 2011?

Mr Lonsdale: Yes, on time. That is with the government.

Senator BUSHBY: It is with the government now for their response?

Mr Lonsdale: Yes.

Senator BUSHBY: So they have had it for over two months.

Mr Lonsdale: Yes.

Senator BUSHBY: The government protected deposits symbol: is that in use?

Mr Lonsdale: That is under development. It was flagged in the package. We are going through the design of that symbol and also rules on how it would be used and who would be able to use it.

Senator BUSHBY: Is that the delay? I hope the delay is in setting up the rules rather than its having taken us six months so far to design a symbol.

Mr Lonsdale: There is no delay. The government flagged the development of this symbol. There has been design work. There has been—

Senator BUSHBY: Was there a date when this would be in use by?

Mr Lonsdale: No.

Senator BUSHBY: Obviously, I can understand the need to ensure that there are appropriate rules around the use of it, but it is a pretty clear set of financial institutions that are ADIs—that are approved deposit-taking institutions—and which receive a government guarantee. I would not have thought you would have to think too hard. You have to get the rules right but it is a fairly clear and it would not take that long to do it.

Mr Murphy: But the government has just put out the paper on the Financial Claims Scheme dealing with removal of the guarantee, so it would seem logical that the bank branding, or government guarantee branding, should come in with all of that.

Mr Lonsdale: There is a link.

Senator BUSHBY: As for the design itself—and this being budget estimates I guess we had better ask about some costs of things—has the design itself been tendered to a graphic design company?

Mr Lonsdale: I can come back to you on that.

Mr Douglas: I am pretty sure that has been done in-house, but we can double-check that. There has been some market testing with consumers to make sure that they do not infer that it applies to products that it does not apply to and vice versa.

Senator BUSHBY: I have one final question about the Financial Claims Scheme. You mentioned that there have been some developments in that area. Can you outline those developments and where they are likely to go before we can have a final position on that?

Mr Lonsdale: A discussion paper has been released. It looks at a number of aspects of the existing Financial Claims Scheme. A number of them are technical issues, but the key issue that is raised is the size of the cap that applies to the Financial Claims Scheme. At the moment there is a \$1 million cap that applies to deposits in ADIs. The proposal that has been put out for discussion, which has come from the Council of Financial Regulators, is to move that cap somewhere between \$100,000 and \$250,000. The Treasurer has put out a discussion paper seeking the community's views on the council's recommendations to it.

Senator BUSHBY: Did the review paper also suggest that the scheme should operate in a similar way, just with a different limit, or are there other changes that might be involved?

Mr Lonsdale: The broad architecture of the scheme would remain the same. That would be broadly the thrust of the recommendations. Having said that, there is a recommendation to have a change in the cap, as I said. There are also a number of other recommendations—for example, a change in the trigger in which the FCS would apply. For example, in the case where APRA appointed a statutory manager, at the moment the FCS would not apply until after that. There is a proposal to apply that at that time. There is also a recommendation to not provide the FCS to deposits of ADIs in foreign branches. Again, that is consistent with the rationale that this is for Australian retail depositors. There is also a recommendation to consult on the transitional arrangements, which are very important if there is to be a move in the cap. All of those issues are in the discussion paper and we are providing a month for that.

Senator CORMANN: Last time we talked about MySuper. Where is the development of the MySuper proposal at now?

Mr Lonsdale: Mr Rollings can speak on that. We are current currently going through a consultation process which has just concluded, but Mr Rollings can comment further.

Mr Rollings: As Mr Lonsdale has said, we have been consulting on the design and implementation details of the Stronger Super package of reforms. We have undertaken consultation meetings from February through to the last meeting of our peak consultative group, which was just this Monday gone—30 May. We are now in the process of collecting and collating the feedback from that process and preparing to advise the government on those issues.

Senator CORMANN: Are you aware of research that indicates that under MySuper, 750,000 Australians would end up paying higher fees in their superannuation funds than they are currently paying?

Mr Lonsdale: Yes, we are aware of that.

Senator CORMANN: What is your assessment of that research?

Mr Rollings: I think it is probably difficult to assess the impact of MySuper until the final design details have been settled by the government. Some of the issues considered in that research around what the pricing structure of MySuper will be cover issues that are squarely in the scope of the consultation process. It will be up to the government to determine the final way that is implemented.

Senator CORMANN: But you are going to essentially prescribe by legislation what the product design is going to be. Are you going to prescribe the fee by legislation?

Mr Rollings: Part of the design of MySuper will be what scope there is to set different pricing levels for the MySuper product. MySuper's starting point is that each fund would have one MySuper product. That was in the government's announcement and is consistent with the recommendation of the Cooper review. But, beyond that core principle, there are implementation details as to whether that product has to be provided at a single price or if there is scope for it to be provided at different prices.

Senator CORMANN: By the way you are talking, it does not sound as if there is going to be a uniform price for MySuper imposed across the board.

Mr Rollings: That remains an option.

Senator CORMANN: To have a uniform price remains an option?

Mr Rollings: It remains an option. I think there is a spectrum of options here for the government to consider, ranging from uniform price through to allowing multiple pricing.

Senator CORMANN: Government price-setting?

Mr Rollings: There are policy trade-offs on this issue. Given the policy objectives that MySuper is trying to achieve, which are largely around some greater simplicity, transparency and rationalisation of the products provided in the default superannuation market, obviously a product that is required to be offered at a single price could provide greater simplicity and potentially greater competition around a smaller number of products in the market. The trade-off of allowing prices—

Senator CORMANN: On government prescribing a single price, you mentioned government price-setting and competition in the same sentence.

Mr Rollings: Yes.

Mr Lonsdale: Can I add that I do not think there is a proposal for the government to set a price. This is an issue that government has not taken a decision on. A range of issues have been put to government as part of the consultation process. They will be put to government. As Mr Rollings said, the outcome is very much a policy choice between how much weight you put on having a very simple product in MySuper—transparency in the system and the benefits that can come from transparency—against having, I guess, more pricing points in the system. That is a policy trade-off that government will examine.

Senator CORMANN: Sure, but there are no-frills, low-fee products in the market now. The question I am exploring is whether there is added value by the government designing products through legislation and prescribing certain features, including pricing. In that context, of course, you say that they have not made the policy decisions, but Minister Shorten has asserted certain savings that would come from Australian workers being on a MySuper product. I think he mentioned \$40,000 in additional savings over 35 years of working life. That seems to ring a bell with you, does it?

Mr Rollings: Yes.

Senator CORMANN: So for him to be able to make an assertion like that, there must be some policy parameters around that.

Mr Lonsdale: There are. There are a number of elements to the superannuation reforms. The MySuper product is one of those, but there is Super Stream cost reductions as well. There is a whole range of benefits.

Senator CORMANN: So the \$40,000 figure does not actually come from MySuper? Super Stream we all agree with—that is a sensible thing to do.

Mr Lonsdale: Just let me check that.

Mr Rollings: The \$40,000 figure reflects a combination of both MySuper and Super Stream.

Senator CORMANN: So the \$40,000 saving does not come from MySuper exclusively. I would like to know how much of the \$40,000 is expected to come from Super Stream and how much of the \$40,000 that the government has claimed is expected to come from the MySuper initiative. I would be very interested in that research. But, of course, that modelling does not take into account any changes in fund performance that are caused by the fact that people all of a sudden end up in a low-fee, no-frills product that might have a different return profile from other products with different features attached to them. That is true, isn't it? In your modelling, you have not assumed any changes in returns that would come from a different profile that MySuper might have in terms of fund returns?

Mr Rollings: There are a couple of points that you have raised there. In terms of the breakup of the \$40,000—and you would understand that these estimates are based on a range of assumptions—there is \$33,000 broadly from MySuper and \$7,000 reflects the Super Stream savings.

Senator CORMANN: So it is 40,000—

Mr Rollings: No, it is \$33,000 from MySuper and \$7,000 from Super Stream. The estimates are based on an assumption around broad rates of return that have been achieved from a balanced portfolio.

Senator CORMANN: You assume that all other things remain equal, whereas, of course, industry experts will tell you that only a small drop-off in returns as a result of being in a less well performing fund will very quickly wipe out any improvements. I guess the overall proposition is the best way to maximise value for consumers is to have the appropriate competitive tensions in the system across all parts of the value chain, of which fees is one. Obviously, the quality of advice and the fund returns are other parts of that value chain. We will see how that discussion ends up. Given the time and the commitment I have given to the chair, I will just quickly move on to the National Disasters Insurance Review. Can you tell us where that is at?

Mr Murphy: There is a paper that has been prepared by the committee headed by Mr John Trowbridge. That consultation paper is expected to be released in the near future. It is imminent.

Senator CORMANN: Obviously, I am aware of the review and I am aware of the fact that Mr Trowbridge is chairing the review. There is a review under way, yet Mr Trowbridge is out there making quite extensive commentary about what he thinks should happen before the review has been concluded. I have been asked to comment repeatedly now about propositions that Mr Trowbridge has put out as directions that he wants to go in—for example, mandatory flood insurance for all home and contents policies.

Mr Murphy: His paper will put out options and that is one option. But it is a matter for him and his committee to do consultation, talk to the industry, talk to consumers and report back to government.

Senator CORMANN: Has the markets group in Treasury got a view on how desirable a proposition of mandatory flood insurance in all home and contents policies would be?

Mr Murphy: There is a secretariat in Treasury working for Mr Trowbridge and the committee. But I suppose the starting point would be that it is unlikely that the status quo would be acceptable for the future. So then, taking that from there, how do you do this trade-off between ensuring the availability of insurance and the cost of insurance? That issue is a hard one to crack.

Senator CORMANN: Sure, but risk insurance obviously is all about transfer of risk and pricing risk, and 90 per cent of people across Australia do not face that particular risk. Those who do—

Mr Murphy: It is a very small percentage of people who are in highly flood-prone areas.

Senator CORMANN: So the question then is—

Mr Murphy: That is right. It is a public policy question and that is why the government has commissioned Mr Trowbridge and his colleagues to look at options for the government and to talk to industry. Realistically, one would hope you could get some consensus from industry as to what should be recommended to the government.

Senator CORMANN: Never mind industry—this is not a problem so much for industry. Just think about the consumers. I am thinking about the consumers. If you are among the 90

per cent of consumers who are not living in a flood-prone area and you are required to take out flood insurance then obviously that is not insurance; that is like paying a tax.

Mr Murphy: That is one way of looking at it. The other way of looking at it is that the general principle of insurance is pooling of risk. I am not saying that is—

Senator CORMANN: But, if you do not face the risk, you are not being pooled into risk. You are being asked to subsidise somebody who is taking on a higher risk.

Mr Murphy: But the pooling of risk is one way of seeking to deal with—if you want to have a position where you complete coverage for flood in Australia for individuals, you have to look at options of trying to achieve that. So this is very early days. It is a paper that is yet to be released. Let us see how people respond to that.

Senator CORMANN: But the government has not made any decisions yet in relation to this?

Mr Murphy: No.

Mr Lonsdale: The decision is that Mr Trowbridge and his panel should go away and look at the issue, and soon they will issue a consultation paper. The normal course for us would be to then examine the policy considerations after recommendations are made, not during.

Senator BRANDIS: I have one question on Mr Trowbridge's review. Will that be considering the question of a common definition of flood?

Mr Murphy: Minister Shorten has issued a paper on the common definition of flood.

Senator BRANDIS: I am aware of that.

Mr Murphy: That will be incorporated into Trowbridge. I do not see the need for Mr Trowbridge to go over that ground, because the minister in effect has done a consultation and reached a position on the definition of flood.

Senator BRANDIS: I guess what I am getting at is whether Mr Trowbridge will be making his own independent judgment about that issue or whether that is something he is just not going to address.

Mr Murphy: That would be for Mr Trowbridge. But I would say he would take note of Minister Shorten's decision on that.

Senator CORMANN: I have some questions in relation to the microlending sector. Is Treasury doing any work assessing whether to cap or regulate interest rates, fees and charges in relation to the short-term microlending sector?

Mr Murphy: Are you looking at PayPal and this type of thing?

Senator CORMANN: Various. I think Mr Mikula knows what I am talking about.

Mr Mikula: As part of phase 2 of the national credit reforms that is one of the topics that is being looked at.

Senator CORMANN: In this context I would just like to get a few things on the record. Is it right that most banks will not lend any amount below \$4,000 and certainly not as quickly as some of these small lenders will do?

Mr Mikula: There is a small number that seem to possibly lend lower amounts. But there certainly are some difficulties in getting it. They would apply normal bank or ADI lending criteria, which usually is a longer process.

Senator CORMANN: Have you got a good understanding of the microlending market? Talk me through the sort of structure of the microlending market in Australia at the moment.

Mr Mikula: Do you mean commercial lenders or—

Senator CORMANN: Talk me through the whole market.

Mr Mikula: For that segment who have some difficulty accessing mainstream products in the commercial sector there is a distinction between what are called payday lenders and microlenders. The payday lenders particularly offer loans for one or two months with repayments that can be as short as 14 days, which is where the term 'payday' comes from. You got the loan one day and paid it back on your next receipt of salary. Those are typically the smaller amounts: \$100 to \$500 for two to three months. The sort of next tier of lenders is those who provide larger loans, probably between \$500 and \$1,800 for up to a year or possibly longer. Then there is a range of government or charitably backed alternative forms of products. There is a range of no-interest loan schemes that are run through community agencies such as the Good Shepherd in Victoria. They will provide loans for perhaps up to \$1,000 for whitegoods or for a specified concrete need. It is not just for living expenses; they have to be used to improve the position of the borrower. Those are no-interest loans. There is a range of low-interest loan schemes, often backed by the larger banks, where they are trying to help people, through particular programs, to transition from being outside or financially excluded to the mainstream. They might have a \$1,000 or \$2,000 loan with a relatively low interest rate to get them familiar with saving patterns and hopefully move them in time into the mainstream.

Senator CORMANN: What is your area of concern in relation to this area that causes you to have a policy/regulatory look at it?

Mr Mikula: The issue of concern is the commercial lenders and the level of costs that are being charged and the impact on borrowers. That has been squarely raised by the transfer of responsibility to the Commonwealth for this topic, because in New South Wales, Queensland, the ACT and Victoria there are currently caps on the cost of credit that can be charged. They all operate slightly differently; there is no consistency. They are all seeking to address the same problem, which is the level of costs being charged and the risk of consumers ending up in debt spirals where an increasing proportion of their income just goes to meet repayments on the loans through taking out successive loans.

Senator CORMANN: So what are you proposing to do? Are you looking at regulating those fees, regulating the interest rates?

Mr Mikula: That is certainly an option that is being considered, yes, but there is no government decision yet.

Senator CORMANN: In considering these things—and we have talked about it before—there are always trade-offs between consumer protection and making sure that services remain available and that there is a supply of a particular service. You are focusing on what the impact of any regulatory intervention might be on supply of services in this area?

Mr Mikula: It is certainly one of the things that it is at the forefront of our mind. We have certainly received a lot of information from that commercial sector as to the range of models that are out there, the costs they need in order to be viable—

Senator CORMANN: Is there a best practice model around the world that you are looking at and guiding your thinking against?

Mr Mikula: The problem is not unique to Australia. There is a range of models in different countries. But the extent to which they can be readily adapted is probably limited. America has some significant differences in the way it operates that make their sorts of caps probably not an ideal approach, for example.

Senator CORMANN: What is the time frame around all this?

Mr Mikula: I think we will be looking to probably put a recommendation to government in the next month or two.

Senator CORMANN: Thank you very much.

CHAIR: We will take a break now and then resume with the Productivity Commission.

Proceedings suspended from 18:24 to 19:32

Productivity Commission

CHAIR: The committee will resume now with the Productivity Commission. I thank officers of the commission for coming in. Mr Banks, do you have an opening statement?

Mr Banks: Yes. Thank you very much. I will take the opportunity again. I thought I would briefly outline, as I have in the past, the work that we have underway and the work that we have completed. We currently have about 10 commissioned projects underway. Since the commission last appeared before you, we have completed a number. One was on performance benchmarking of Australian business regulation, focussing on planning, zoning and development assessments, and a report on vocational education and training workforce came out in May. We have done two reports in relation to indigenous matters—the compendium of indicators from the larger review of government services report and, for the first time, a report on indigenous expenditure. In both of those, we acted as a secretariat in the preparation of those reports. We made a submission to the taskforce on sustainable population strategy for Australia and held a roundtable on that broad topic. The submission was actually a background paper for the roundtable. The roundtable proceedings will be published in due course to enable a wider audience to have access to the various papers.

In terms of projects currently underway, we have two major reports that are related. One is on disability care and support and one is on caring for older Australians, with draft reports released in January and February respectively. Final reports are due in June and July. We have produced a draft report on Australia's urban water sector, and then on another inquiry—the economic regulation of airport services—we have a draft scheduled for August. Equally, an inquiry into the economic structure and performance of the Australian retail industry has a draft report due also for August.

Of the suite of projects we have, education and training our workforce is one. It was the first and it has just been completed. We have two more in that series. One is on early childhood development and one is on school teachers. The former has a draft report coming out later this month and the one on schools, which has only just commenced, will have a draft report in November.

We are also continuing the work we are doing in the area of regulation and red tape. The fifth year of our series of reports on regulatory burdens on business is focussing on the theme

of identifying and evaluating regulatory reforms, which is intended, I think, to harvest some of the lessons from the earlier work and identify for government the ways of prioritising regulatory reform going forward. We also have a series of reports on the economic impacts and benefits of the COAG reform agenda. We are hoping to have the next series of work in that area formalised shortly.

In addition to all that, we have ongoing work. I will not go through that in detail. I have talked about it in the past. But we do the work for the government services review, the blue book and the ochre book on indigenous affairs and so on. But we also have a stream of reporting to the COAG Reform Council, which informs its work and its reports on the national agreements and the national partnership agreements and so on. I have talked about the indigenous reporting. We also have the competitive neutrality complaints office. So that is a very quick overview, I guess, of the work that we are engaged in presently. We are happy to take questions.

CHAIR: Thank you, Mr Banks. I want to ask a question about Australia's urban water sector report just to get your response. Part of the report was talking about how water is allocated and the costs of buying water. The way it was reported, particularly in the Adelaide media in relation to South Australia's use and the desalination plant, was that people should be able to fill up their pools and have lush gardens if they want to buy the water. One of the summaries says:

There are, however, fairly low cost ways of managing the risks associated with the reliability of allocations, such as carrying over water in dams and purchasing additional allocations. This latter option could be reasonably costly in a year like 2008-09 but, on average, it would be much lower.

Now, I think that was seen to some extent as going against what we in South Australia have been trained to believe, which is that we should not regard water as just an easy commodity to be purchased if we have the money for pools or whatever but that it should be conserved and we should leave as much water in the Murray as possible. I wonder what your reaction to that is.

Mr Banks: Broadly, my colleagues might want to comment on that report. I guess the report shared the objectives that most people have about water—the importance of water and of conserving it and having it for multiple uses. So the notion of equity of access and low-cost access for all people for basic needs and so on is very strongly in there. But I guess the direction of the report—and this is the report on urban water I guess you are talking about—

CHAIR: Yes.

Mr Banks: was really how to arrange the governance, pricing and institutions around water to make sure that it goes to appropriate uses and that investments are being made based on sound criteria and so on. While water is special, it nevertheless is a service and a product that currently does have a price on it. And doing that well and making sure that investment decisions are made properly and that in times of shortages existing water can be allocated properly and so on was really the same objective. I am not familiar with some of the reporting that you are referring to in South Australia. Clearly, South Australia has particular needs and interests, and I can understand why the South Australians would be taking special interest. I should say that we have been going around the country, including Adelaide, in public hearings. I guess one of the strengths of the commission's process is that people have an opportunity to raise issues and put views to us and additional information which we will take

into account in completing the report. I might ask whether anyone else has any thoughts on that.

Ms Gropp: I would only add, Senator, that when we are talking about pricing, I guess the price is to reflect the full costs of providing the water and that if it were sourced from an area, say, that had environmental impacts, then those prices should reflect environmental impacts.

CHAIR: I can find it, if you like. One part of the report did talk about people having amenity and being able to fill up their pools if they want to. There was some advantage to that. In terms of the restrictions, it said, 'Well, virtually if you can pay for the water, then you should be able to do these kind of things.'

Ms Gropp: My understanding is that would be in the context of a discussion about restrictions versus the pricing of scarce water.

CHAIR: Yes. Exactly.

Ms Gropp: My understanding of the report did say that there could be some gains from not imposing restrictions in times of scarcity but having more price signalling of that water.

CHAIR: And how does that affect equitability? I am clearly someone who can afford the water and can afford to water their garden or fill up their pool. But are you saying that there should be differential pricing, or is water an equal price for everyone regardless of income?

Ms Gropp: As the chairman said, there could be some arrangements for limited allocations for equity regimes or certain entitlements to certain amounts to address equity considerations.

CHAIR: The quote I read out was in the context of whether South Australia should have put in a larger desalination plant. The quote I read discussed alternatives, such as carrying over water in dams, which would require us to build more dams, I believe, and purchasing additional allocations. Can you explain more the thinking behind them?

Ms Gropp: I am not fully across that particular part of the report, Senator.

Mr Banks: I think the broader principle probably sitting behind that was really that options should not be closed off unnecessarily. When decisions are being made about the future investments and future sources of water, the different trade-offs of different options should be looked at and be publicly discussed. So it was not saying that there was any option that was inherently superior but making a more general point about investment decision-making in this area and looking at a range of options.

Senator CORMANN: Mr Banks, on 31 May, which was two days ago, a deadline expired from an order of the Senate which was passed in November, seven months ago. It was an order to require the Productivity Commission to produce some information to the Senate about designing a process to ensure an open, transparent and evidence based competitive process for the selection of superannuation funds identified under modern awards as defined funds. We have not had any response from the Productivity Commission whatsoever other than an initial piece of correspondence suggesting that you were seeking advice from the minister and the Assistant Treasurer. You are, of course, an independent statutory agency set up by the parliament. You have had an order from the Senate which has been on the books since November and we have had no response to it, which is obviously highly unsatisfactory. I want to know your intentions in relation to it. Are you going to give some feedback to the

Senate at some point as to what you are planning to do so that the Senate can decide on the next steps?

Mr Banks: Senator, I did respond, as you say, early on. I said that my understanding was that work of this kind would have to be commissioned by the Assistant Treasurer, that I referred the matter to him and that I would come back to the matter you raised when I had further advice on the matter.

Senator CORMANN: But you have not.

Mr Banks: There has been no precedent in the history of the organisation, either in its current form or in its modern form going back to 1973, of such a request coming from the Senate for a public inquiry. We have had quite a number of requests to furnish documents, and we have done that. I think Michael Kirby, who appeared before you last time, gave some examples of that. But as that discussion reflected at that time, this Senate order related effectively to a requirement for us to conduct a public inquiry in a matter that would involve us engaging significant resources and public participation, which was seen as obviously going significantly beyond the furnishing of documents.

Senator CORMANN: The powers of the Senate are not limited to the furnishing of documents.

Senator Wong: Senator, we can have a long discussion on this.

Senator CORMANN: And we will.

Senator Wong: But—

Senator CORMANN: I have only just started.

Senator Wong: And you want to make a political point.

Senator CORMANN: No, I do not. I am asking questions.

Senator Wong: You do. But the evidence from Mr Banks is that the effect of compliance with the order would be that the Senate would be in effect requiring or directing the Productivity Commission to undertake an inquiry. With respect, Senator, I know you said before you want to be a minister, but that really is—

Senator CORMANN: No. I do not.

Senator Wong: You did.

Senator CORMANN: That is not right. That is not what I said.

Senator Wong: Well, I think you anticipate that you are going to be one.

Senator CORMANN: That is not what I said. You are verballing me. If you want, we can stay until 11 o'clock, Minister.

Senator Wong: We will stay, then, if you are suggesting I cannot say anything.

Senator CORMANN: Well, you can say what you want.

Senator Wong: I am just making the point that it is an unreasonable request, Senator, to expect a statutory organisation to go away and undertake a whole inquiry because you want it to. That is something that can be referred to them by government, but it is not a matter that can simply be the decision of an opposition senator who wants something done.

Senator CORMANN: Mr Banks, did you personally review the *Hansard* of the last Senate estimates?

Mr Banks: Yes, I did.

Senator CORMANN: So if you read the *Hansard*, you would be aware that there is significant precedent, and that is in the context of both Labor and coalition administrations, of organisations like yours or, if not yours, the ACCC, ASIC, the National Audit Office and a whole series of organisations being ordered or asked by the Senate on various occasions to produce information in relation to matters where they have to actually go out of their way and put that information together, not just make available documents that they already have. Are you aware of that?

Mr Banks: Yes. I was. We looked carefully at all of those instances. I did not think any of them really created a precedent in this case.

Senator CORMANN: Why is that?

Mr Banks: The Productivity Commission's functions as an independent statutory agency are different to the ACCC's and a range of other bodies. Our purpose is to conduct public inquiries for the purposes of making recommendations about public policy to the government. So the nature of the role and the function of the commission differs in that respect. In the instances that you cited, they either involve the collation or collection of documents that were already available, which is a situation where we have responded in the past or, in the case of the ACCC, reflected differences in the ACCC's act that positioned it differently to my organisation. The act refers exclusively to the relationship that we have in reporting through the minister or being asked to do work by the minister.

Senator CORMANN: I do not have the list here again. Most of those inquiries, incidentally, were initially by cross-bench senators, by nongovernment senators, that were referred to ASIC, the ACCC or the National Audit Office in relation to smoking policy and a great variety of issues. It was not a matter of the ACCC or others putting together documents they already held. It was about them doing actually work that then had to be provided to the parliament. Just because that has not happened to the Productivity Commission so far—of course, in your current iteration, you have not existed that long—does not mean that you have a different status from any other independent statutory agency that has been created by an act of parliament. I am interested to hear from you your intentions. Is it your intention to just ignore it and not come back because you have not given us conclusive advice as to how you propose to deal with it? The last indication was that you would respond more fully to the matters that you raise in your letter to me once advice becomes available from the Assistant Treasurer. Clearly, there is a deadline here, which ran out two days ago. What is your intention in terms of how you are going to handle this?

Mr Banks: Well, I have had advice from the Assistant Treasurer that an inquiry of the kind in question here will be sent to the Productivity Commission next year. So the task will be dealt with by us with a reference from the Assistant Treasurer in the normal way.

Senator CORMANN: So when did you get that advice?

Mr Banks: That is only just in recent days.

Senator CORMANN: So eventually you are going to tell the Senate what your intentions are so that the Senate can make a judgement on your approach to this?

Mr Banks: Well, I can tell you now, Senator, that my response will be when we receive those terms of reference, we will conduct the inquiry.

Senator CORMANN: There is a formal order of the Senate. Now, you might not think that is an important thing, but there is a formal order of the Senate requiring you to do something by a certain time. It has been in place for seven months now. All other parts of government have to take these things quite seriously. Essentially, you think that now telling me in this committee is going to do the job?

Senator Wong: Senator, I obviously am at a bit of a disadvantage. I am not Mr Shorten and I do not have all of the relevant documents with me. I understand that there was correspondence to the President outlining PC's response to the order. I understand the government has made its view clear about whether or not the Senate possesses this sort of power. Is this a matter, Senator, where the broader issue of guidance for officials giving evidence and the provision of information to the Senate and its committees—

Senator CORMANN: Sorry?

Senator Wong: Is this not something that the privileges committee is dealing with?

Senator CORMANN: This is something that is quite—

Senator Wong: No. Is not the broader issue of the provision of information to the Senate and its committees something that the privileges committee is dealing with?

Senator CORMANN: The privileges committee, the procedure committee and various bodies of the Senate are dealing with the fact that under your government, Minister, there is now an increasing trend of statutory agencies and government departments not complying with legitimate orders passed by the Senate for the production of information.

Senator Wong: Well, we do not accept this is legitimate, Senator.

Senator CORMANN: Absolutely it is legitimate.

Senator Wong: No. We do not accept that—

Senator CORMANN: Well, indeed.

Senator Wong: for the reasons I have outlined.

Senator CORMANN: For which reasons? So what are the reasons?

Senator Wong: Because, as Mr Banks has said—and I can go on the advice he has provided to the committee today—if you look back to 1973, this is not the sort of order that the Senate has made. Just in terms of public interest, Senator, do you really think it is an appropriate thing that a parliamentary chamber can simply direct a statutory body to go away and do an inquiry?

Senator CORMANN: They have done it many times before, Minister.

Senator Wong: Senator, I am sorry, I do not—

Senator CORMANN: Including Labor. Senator Conroy has done it. Senator Conroy initiated motions in the Senate as a nongovernment senator to get the ACCC to do work on telecommunications matters.

Senator Wong: We are not going to agree on this, Senator.

Senator CORMANN: Well, it is a fact.

Senator Wong: Senator, I am just not going to argue with you about it. We are not going to agree. You have a view. We have a view.

Senator CORMANN: This is a recent trend under your government.

Senator Wong: Well, I do not accept that. But I am saying in relation to this issue, I am not sure where you want to proceed with it. I do not think we are going to be able to resolve this impasse tonight.

Senator CORMANN: I am going to proceed with this a bit further. Are you aware of the occasional note that was written by the Clerk of the Senate in February in relation to these issues? Have you seen those?

CHAIR: This is really not a question for the Productivity Commission.

Senator CORMANN: No. I am asking the Productivity Commission because it is actually directly relevant to the order that was passed by the Productivity Commission and the initial advice that was given.

CHAIR: I think the minister has given that response.

Senator Wong: We will take that on notice, Senator.

Senator CORMANN: I might table it for the benefit of Mr Banks.

Senator Wong: I will take that on notice and I will ask Minister Shorten the response he thinks is appropriate.

Senator CORMANN: Minister, the answer—

Senator Wong: The question is—

Senator CORMANN: It is a question for you.

Senator Wong: It is unfair. The question I am taking on notice is whether the government is aware of the occasional note.

Senator CORMANN: I did not ask about the government. I asked about Mr Banks.

Senator Wong: Well, I do not think it is fair to put Mr Banks in this position.

Senator CORMANN: Why not?

CHAIR: Well, the minister has taken it on notice, and the minister is entitled to do that.

Senator Wong: I will take it on notice, thank you.

Senator CORMANN: Thank you, Madam Chair. Just to clarify, this is an occasional note that is directly relevant to the issue of whether statutory agencies have to comply with orders of the Senate or not. It is an independent statutory agency. So as much as the minister might want to take it on notice for the government, it is not actually a matter for the government. It is a matter for an independent statutory agency.

CHAIR: But it is in the estimates a matter for the minister at the table to be able to take questions on notice if she chooses.

Senator CORMANN: The question is for you. Of course, the order of the Senate passed in November last year asking the Productivity Commission to design a process to ensure that the selection of the defined superannuation funds under modern awards was open, transparent, objective, competitive and evidence based was actually an implementation of Labor Party pre-election policy. Why is it that you still have not moved on it?

Senator Wong: I will take that on notice. It is not my portfolio. I have to pass it on to the minister who is responsible.

Senator CORMANN: I will be very interested to see whether you eventually get a response to this. I will move on to another issue. Mr Banks, could you update us on the difficulties that you faced in the study that you have just completed on an international carbon policies comparison? You gave a speech about this a little while ago, so I am keen for you to talk us through the complexities of the task that you have just gone through.

Mr Banks: Well, this is a report that has just been submitted to government. Obviously, I cannot comment on that report. But I think you are referring to the methodology paper that we put out to get reaction from experts and others on the approach that we were intending to follow in that study. In that report, that methodology paper, which is on our website and is publicly available, we went through the nature of the task. I guess the challenge is to come up with a common price metric to allow the multitude of various carbon abatement policies around the world to be compared both with each other and internationally. We spelt out some of the challenges in doing that but also some ways forward in terms of metrics that would take into account the costs or the cost burden that different countries were bearing in this area of carbon abatement policy. That methodology is one that has flowed through into our final report. Obviously, the final report will have results that have come out of that work.

It was obviously very challenging—in some countries like America we got to 300 different programs directed at reducing carbon emissions; Australia has about 230 and the UK has about 100—just getting on top of the range of programs that are available. We were also looking at China, Korea and Japan in the time available. It was obviously quite challenging. We benefitted from using contractors in different countries and internationally to help us harvest that information. So just acquiring the data in itself was quite an adventure. We got very good cooperation from a range of governments, and the Department of Foreign Affairs and Trade facilitated that. But the other point that was raised in the paper to which you refer was just the conceptual difficulties of coming up with measures that would be comparable internationally.

Senator CORMANN: I am obviously aware of your methodology paper. But I am also referring to the speech that you gave at the Business Council of Australia AIGN carbon pricing forum here in Canberra on 23 March, which I think is the day you released that methodology. I am summarising, but you said:

Measuring effective carbon prices would be a relatively straightforward task if all countries applied economy-wide CO₂ emission taxes or quota schemes, because the carbon ‘price’—simply equivalent to the tax rate or the market price of emission permits—would be observable, and comparable...Crucially—and this point seems not to be widely understood—it will not be efficient from a global perspective (let alone a domestic one) for a carbon-intensive economy, such as ours, to abate as much as countries that are less reliant on cheap, high-emission, energy sources...Modelling aside, it’s commonsense that achieving any given level of abatement is likely to be costlier in a country with a comparative advantage in fossil fuels.

Do you still stand by these comments?

Mr Banks: Yes, I do. I guess the perspective is this is a global problem. An efficient global solution means achieving abatement around the world where it is least costly to do so. Part of the methodology, in fact, of our paper was to look at the programs and the marginal

abatement costs that were involved in some of these countries and programs. So the way in which an international trading regime works, I guess, is that countries where the costs are high discharge their obligations under a cap by buying abatement from other countries where the cost of abating is lower. So it was in that context that I made that point.

Senator CORMANN: The other thing, of course, that you said is:

Without some idea of the amount and nature of abatement required by each country to achieve efficient global abatement, the Commission's estimates can give little indication of the efficiency of the abatement measures analysed and great care will have to be taken interpreting them.

Is that still the proviso and the qualifier that you put over the work that you have done?

Mr Banks: Yes. I made that statement in a speech totally reflecting what was already in the methodology paper that we released. I might just see whether my colleague wants to comment further.

Ms Gropp: No.

Senator CORMANN: You talk about looking at where essentially the maximum opportunity for abatement is. For example, if Australia were to increase its emissions because of the production of LNG in Australia, if we exported it to China in displaced coal, we could achieve significant reductions in global emissions. But the problem is that the price on carbon in Australia, in the absence of an appropriately comprehensive agreement on pricing emissions, is going to make that more difficult. Are they the sorts of issues that you have looked at in your report?

Mr Banks: In our report, in one sense, it is a simple requirement, and that is for us to come up with a common metric to compare the range of programs that different countries have. So the report directs itself to that, which was a challenging enough task, as I have described. We have not in that report gone further than that, Senator.

Senator CORMANN: Have you been able to come up with a common metric?

Mr Banks: Well, we have. What the report is really about is explaining what that metric says and what it does not say. Equally, the methodology paper was dealing with that. But I am not really in a position to talk more about that paper until it is released, Senator.

Senator CORMANN: Sure. I understand. Obviously, there has been a lot of talk about shadow carbon prices as well as carbon prices in recent months. Have you looked at shadow carbon prices across countries?

Mr Banks: This whole area is quite confounding in the sense that terms are being used by different people in different ways.

Senator CORMANN: Exactly.

Mr Banks: One of the tasks of the study, I think, was to sort of clarify what the terminology actually means. I guess the bedrock of the work we have done is really based in the costs of abatement rather than the price of emissions. But, in a sense, you can think of that because no matter what program you implement, whether you are discouraging consumption or whether you are encouraging certain forms of production, at the end of the day there is a cost that someone will have to pay. So you can convert all of that essentially into the notion of a cost of abatement, which you can think of as the price that each country is prepared to pay and the resources it is prepared to commit for the abatement effort. That is the kind of

information that we have provided. But we will have a lot of contextual information around that to indicate why certain interpretations cannot be made from certain price information and so on.

Senator CORMANN: Sure. But I guess one method, obviously, is to put a direct price on emissions, whether it is through a carbon tax or an emissions trading scheme. Another method is to go, for example, like the government has, with the support of the coalition, for renewable energy targets. In China, they are looking at planting trees or going for nuclear. In the United States, they are looking at various regulatory responses. There is direct action, dare I say, in the US.

Senator Wong: That is a long bow.

Senator CORMANN: That is not a long bow at all.

Senator Wong: That is a very long bow, Senator. That is why no economist is backing your stance.

Senator CORMANN: They have jettisoned their emissions trading scheme in the US, as you well know, and they are going for the direct regulatory response.

Senator Wong: Senator, I am going to respond to that. There is a very big difference between direct action, which is taxpayers funding hopeful pollution reductions—and I say hopeful because you do not have any policy mechanism to ensure that somebody next door does not just pollute more—and a regulatory scheme.

Senator CORMANN: So the US is not putting any direct action—

Senator Wong: I am just saying you conflated two things. You called it direct regulatory action. I am saying there is regulation, there is a price, which is a market mechanism of some various designs—

Senator CORMANN: What is the renewable energy target, Minister? Is that a regulatory scheme?

Senator Wong: Senator, we can go through all these things. I am just saying that I think direct action as you have described it is in fact taxpayer funded abatement with no regulation.

Senator CORMANN: Minister, I am asking the questions. Direct action is a whole range of things and you know it is. The question I am asking is—

Senator Wong: Yes. Taxpayers paying a lot of money.

Senator CORMANN: When you talk about the resources a country or an economy is prepared to deploy, or whatever words you used, towards abatement, do you clearly differentiate in the way you have assessed it, whether it is through a direct price on emissions or whether it is through either direct regulatory approaches or through direct intervention by governments in the economies that you have assessed? Do you clearly make that differentiation?

Mr Banks: What is clear is that there is a diverse range of instruments available. The challenge for us in that study was to find, as I said, a common metric for comparing them. All of them can be converted into a subsidy equivalent, so whether it is a regulatory measure, whether it is a price based measure or whether it is an actual subsidy, they can be converted into a subsidy equivalent, a subsidy that would achieve that amount and nature of abatement as an alternative to the particular instrument. That also enables calculations about the cost

effectiveness of different instruments. Part of that report will shine some light, based on empirical information around the world, about the cost effectiveness of the various instruments that we have just been talking about.

Senator CORMANN: I am looking at your methodology working paper. Obviously you were asked to look at the UK, the US, Germany, New Zealand, China, India, Japan and South Korea. You made the point that to cover relevant policies in all of the countries in the list presented some difficulties because accessing data for some of those countries was particularly challenging. How did you go with that?

Mr Banks: I cannot really go any further than—

Senator CORMANN: I am not asking about substance. I am asking about process.

Mr Banks: I guess what I can say is that we got good cooperation. In many respects, we got better data than we thought we could. For example, in relation to Japan, notwithstanding the tsunami and all the problems they had, we had excellent input from Japanese think-tanks and government and so on. So, yes, it was challenging, but when you see the report when it is publicly released, you will see the extent to which we were able to deal with those.

Senator CORMANN: Do you know when that is going to be?

Mr Banks: This is a matter for the government at this stage.

Senator CORMANN: Sure.

Senator EGGLESTON: What sort of data, if you can say, did you get back from India?

Mr Banks: Well, you have chosen the very country, Senator, that in the end was not able to participate in this review. So we have information in the report that catalogues all the programs, as much as we could find them, in India, but we were not able to get the data that would have allowed us to do the kind of calculations that I talked about earlier in the case of that particular country.

Senator CORMANN: Was there any other country that you had problems with other than India?

Mr Banks: No. That was the only country. With all other countries, we had cooperation not only through the government but also from research institutes and so on.

Senator EGGLESTON: Including China?

Mr Banks: That is true.

Senator EGGLESTON: China has a fairly well-coordinated approach. India I am not surprised about, I have to say. I think setting up emissions abatement in India would be a very difficult thing to do. I look forward to your report with some interest.

Senator CORMANN: The minister announced that there would be a Productivity Commission inquiry into the economic structure and performance of the Australian retail industry. How are you going with that?

Mr Banks: That inquiry is underway. An issues paper has been released. There have been a range of industry visits conducted. So it is still relatively early stages. I think the draft report for that is scheduled for about November.

Mr O'Brien: The draft report is August.

Mr Banks: August, sorry.

Mr O'Brien: Followed by some public hearings around September. We are working towards a final report in November.

Senator CORMANN: When you get these sorts of requests, have you got a discretionary budget? How do you organise your budget around this because these requests for inquiries seem to come up on a reasonably ad hoc fashion depending on what political issue is burning hard at a particular point in time?

Mr Banks: That is a very good question. As I implied earlier, any inquiry that we conduct has certain requirements in terms of public participation—a draft report, if it is an inquiry, and public hearings. If it is a commissioned study, we would still have roundtables and so on. So there is quite a resource commitment both within the commission and in terms of public participation in these reviews. So the notion of scheduling these reviews, of having a pipeline of them and ensuring that we have the resources and the right allocation of resources to meet the needs of different inquiries is something that the government and we give a lot of attention to. It is true that some inquiries will be signalled months in advance, sometimes years in advance. Others will emerge. In emerging, they may displace another inquiry that might otherwise have come. The government makes a judgement about the relative priority of the different topics that are in the pipeline. So that is broadly how the work is managed, Senator.

Senator CORMANN: That is probably it from my point of view.

Senator EGGLESTON: You obviously do a lot of reports. Are all of your reports made public?

Mr Banks: All of our reports are made public, Senator. Indeed, all of the inputs to our reports are ultimately made public, particularly public submissions. But, as in the case of this carbon report, we will be making available the data that we have used so that people can scrutinise the inputs to our report as well as the substance of the report itself.

Senator EGGLESTON: I see, in looking at a speech made in Melbourne, you said, ‘A carbon price equivalent: a step too far?’ Do you wish to enlarge upon that comment for the benefit of this committee?

Mr Banks: I am not sure that I recall saying those words, Senator, particularly in Melbourne.

Senator Wong: My recollection, Senator—and you might like to refer back to me—is that you are reading the headline.

Senator EGGLESTON: No. I am reading a summary. It says ‘Comparing carbon prices internationally: the challenges’. It is the chairman’s speech. One can download it. The second last heading is ‘What will it all mean?’ Then it says ‘A carbon price equivalent: a step too far?’ It says it is by you.

Mr Banks: It sounds like a subheading to get the reader’s attention, Senator.

Senator EGGLESTON: Well, indeed it got my attention. I am inquiring what you meant to convey by that.

Mr Banks: As I indicated earlier, in response to the earlier question, coming up with a carbon price equivalent is very challenging in this area. So the whole methodology paper that we looked at explained that what was comparable, as I said earlier, was cost type notions—a

loose interpretation of price in terms of costs that different countries were bearing in relation to carbon abatement policies.

Senator EGGLESTON: I notice you did not look at Indonesia, which is often mentioned in the Australian context of Australian polluters being able to buy forests in Indonesia that thereby compensates for their pollution. Was there a reason for not including Indonesia, or did you not set the terms?

Mr Banks: Well, a number of countries were nominated for us. As indicated in that paper, they were the countries that we concentrated on. They are, I guess, the major emitters and the ones that had probably the biggest range of policies as well. So, in that sense, it certainly was not a comprehensive global review. In the time available, we found that we had plenty to do anyway just getting information for the countries that were specified.

Senator EGGLESTON: Did you say when this report would be available?

Mr Banks: The report has been submitted to the government. The government will release it.

Senator EGGLESTON: They are considering it.

Senator ABETZ: I have a few questions. The Productivity Commission, I assume, does some work in relation to labour productivity and workplace productivity?

Mr Banks: We have a stream of research that focuses on multifactor productivity in particular, Senator, as you know, that looks at both labour and capital inputs and the interaction among those inputs. I guess, with the commission's focus on productivity and efficiency, the multifactor productivity measure is perhaps the one that we find most appealing.

Senator ABETZ: It has been put to me that in the past four decades or so, 80 per cent of wages growth is in fact related to increased productivity. Is that in general terms a view that the Productivity Commission would share?

Mr Banks: It sounds plausible to me. I do not know if my colleagues would comment.

Senator ABETZ: Take it on notice. I do not want to make you commit to anything.

Senator Wong: Senator, I did not intervene. If you are going to put it on notice, we can take it on notice, but you are asking Mr Banks to give an opinion in that question.

Senator ABETZ: No. A professional assessment as to whether or not in the past four decades 80 per cent of wages growth has related to increased productivity. If we are able to measure these things, hopefully an answer can be forthcoming. It has been put to me that in this century or millennium—whatever we want to call it—over the last 11 years, this has not continued. In case the minister or anybody else thinks I am making a political point, the simple fact is that in the last 10 years or so both the coalition and Labor have been in government. The chances are that my side of politics has been in a little longer. So it is not a political comment that I am seeking to make. I am seeking to obtain data as to whether our productivity in the wages area has in fact slipped over the past decade or so.

Senator CAMERON: I have made a number of speeches on this, drawing attention to Peter Costello's failure in productivity.

Senator ABETZ: And if I had wanted to ask you, Senator Cameron, I would have. But I am actually asking the experts.

Senator CAMERON: Just making the point.

Mr Banks: The commission has looked fairly closely, as you would expect us to, at the productivity history. We made a submission to the House of Representatives committee at the time it was looking at the question of productivity. In that, we had an analysis of what happened to us both on the way up and on the way down. When you look at it in multifactor productivity terms and in terms of the productivity cycles that the Australian Bureau of Statistics uses to define and allow us to make proper comparisons over time, we found that a large proportion of the productivity decline that has occurred this millennium so far could be attributed to particular developments in a few sectors. One of them was mining, another one was agriculture and a third one, broadly, was public utilities. We have done work since then to try to burrow down and find out what was going on in those sectors.

To some extent, the productivity decline is, I guess, the other side of the coin from our economic success over that period in terms of our quite strong income growth. For example, in the mining sector case, we have seen very strong terms of trade, very strong export demand and we have seen the mining sector engaged in very substantial investment and use of additional inputs. There is a lag before that comes on stream. In the meantime, productivity is seen to have fallen. In the case of mining, there is also a secular decline, I think, in terms of the quality of deposits but probably compounded by the fact that even a lower quality deposit that costs more to get out of the ground, if the price has gone up three times, is still a very profitable thing to do. So part of what we did in that work was to show that we have had historically very high rates of sustained per capita income growth coinciding with, as you say, quite a drop-off in productivity growth. There is some relationship between the two, but not entirely. So currently we are looking at the public utilities sector—

Ms Gropp: Electricity, gas and water.

Mr Banks: Electricity, gas and water, and trying to get an understanding of what has been happening there. Again, I think it is not unrelated to the drought and some of the short-term circumstances there and some of the heavy capital investments that have occurred, again, and then the way that output is measured in that sector. So I would be happy to send you a copy of the analysis that we have conducted, Senator, in that area.

Senator ABETZ: If you could, I would be much obliged. Yes, thank you. Do you make any submissions to, or are you asked by Fair Work Australia when it considers, the national wage case?

Mr Banks: No. We have not made submissions. I guess we are busy doing the work that we have been asked to do. That, in a broad sense, I guess, can inform other work that is going on.

Senator ABETZ: But you have not been specifically asked or tasked by Fair Work Australia or the government to provide information, in your expertise, to Fair Work Australia?

Mr Banks: That is correct.

Senator ABETZ: Do we judge productivity as GDP per hour worked? Is that a measure? It is something that the ABS tells us about. They told us yesterday, in fact, that costs have risen by 1.3 per cent in real nonfarm unit labour costs in year trend terms while GDP per hour worked in the market sector has fallen 0.7 per cent. Who can assist with a comment on that?

Mr Banks: That is an economy-wide productivity measure. Terry, you might want to comment.

Mr O'Brien: It is one measure of labour productivity, and that is an interesting phenomenon in its own right. Labour productivity growth often rests on capital deepening—investment in more capital and better capital per worker. Because both labour and capital are valuable inputs, that is one reason why we prefer in our longer term pictures to focus on multifactor productivity, as the chairman mentioned before. The quarterly national accounts just released do capture a sort of arithmetically obvious point, though. Hours worked went up in that quarter, which we would perhaps normally consider a good thing. But for all sorts of reasons, including floods and the like, GDP fell. So you had the numerator and the denominator working in opposite directions and producing a weak number.

We tend, for the reasons the chairman alluded to before, to try to look through those sorts of shocks quarter by quarter and not only to look at an annual number or a moving average of annual numbers but rather to take the ABS's productivity cycles, because it is a profoundly cyclical phenomenon. Companies hoard labour at the start of a downturn and can get more output from existing labour and capital at the beginning of an upswing. So I think the observations that were made about GDP per hour worked in the recent quarter are certainly true and not pretty to observe but easily understandable and not necessarily carrying much additional information about what is happening to the underlying concept of productivity over the course of the productivity cycle.

Senator ABETZ: Thank you for that. The March quarter suggested a reduction of 0.7 per cent. The December quarter, the previous quarter, had a reduction of 0.4 per cent. I understand the floods et cetera that you were talking about for the March quarter. How do we explain the December quarter?

Mr O'Brien: Well, it is a difficult story to track quarter by quarter. But, as I was saying, I think a sense of what our working practices and organisational abilities and so on are producing in terms of a sustainable rise in living standards and community wellbeing is better grasped over the productivity cycle. The ABS dates those cycles for us, but of course only after the event. We are at present three or four years into a still incomplete cycle. So it is rather hard to judge whether we have yet reached the bottom of the quite weak productivity performance of the last two complete cycles or not. So in terms of, for example, the submission to the House of Representatives standing committee that the chairman referred to, we tried to paint the big picture in terms of data from complete cycles and note the annual figures for the incomplete cycle but with the sort of caveat emptor that it is an incomplete cycle.

Senator ABETZ: But the last two quarters would suggest that there is an ongoing trend down?

Mr O'Brien: I am not sure, Senator. There is the sort of adjustment process that the chairman was mentioning in the case of mining, where you can be pouring in enormous amounts of capital to new facilities, working your existing labour very hard and using relatively expensive forms of capital operations to get the most out of the mining sites that you do have. That is a very good thing to do in terms of profitability and in the longer term, but it will produce some ugly numbers in that productivity span in the shorter term. Similarly, in utilities, we have had a period where we have wrung a lot of output out of an earlier capital

stock in electricity generation and water supply and so on, but we are going through a phase where we clearly need to be investing more in those areas.

There are all sorts of reasons on the horizon, which we also signal in that submission, to be just a little cautious about offering hostages to fortune in where measured productivity might go in the future. The community clearly values good health services and good education services. By national accounting convention, the output of those sectors is just valued at the sum of the value of the inputs. So in measurement terms we never get any productivity growth there, which does not seem right when you look at it as a consumer. The community wants more and better of those things. Our living standards are going up. Our wellbeing is going up. But our productivity growth as measured might not be performing as strongly as it had in previous periods, when more of the demand was in market sector activity, where productivity growth was better captured by the statistical conventions. So it is an area where we try to exercise a bit of caution in interpreting the numbers year by year.

Senator ABETZ: Thank you very much. Thanks, Chair.

Senator CAMERON: Mr Banks, does the Productivity Commission have a problem with productivity in the commission? Do you have a management system problem? Is there a lack of flexibility or efficiency? Why can you not answer questions on notice?

Mr Banks: We can and we have.

Senator CAMERON: I have not seen any of the answers to the questions on notice that I put in February.

Mr Scammell: We provided to Treasury responses to all the questions, but not all of them have been tabled, Senator. Two remain.

CHAIR: Mr Scammell, we cannot hear you very well.

Mr Scammell: Senator, we prepared responses and have provided them to Treasury through the normal means. As I checked yesterday, all of them have been tabled with the committee, but two remain unanswered and they are two questions that you put on notice at the last hearings.

Senator CAMERON: I thought more than two questions. Maybe you joined them up. But you have not answered any questions. So there has been no response to any of my questions on notice.

Mr Banks: Senator, we have answered all of your questions. We have submitted our answers to all of your questions; perhaps I should put it that way.

Senator CAMERON: So they just have not come through from the Treasurer?

Senator Wong: I think it is the Assistant Treasurer, Senator.

Senator CORMANN: If you do not get any answers, I will not either.

Senator Wong: This proves the point that sometimes when you think it is a conspiracy, it really is not.

Senator CAMERON: Can you give me the answer to the questions now?

Senator Wong: Me?

Senator CAMERON: No, Minister. I am not asking you.

Mr Banks: Well, I will do my best, Senator, but it requires my memory. I might have to go back to—

Senator CAMERON: To be fair, they are complex issues going to different sources of information and education statistics, so I would not do that.

Senator Wong: Senator, if you allow me—I seem to have had to do this twice this estimates period, once for a government senator and once for an opposition senator—to follow up with the minister I am representing to find out whether an answer can be tabled as soon as possible, I will do so.

Senator CAMERON: Of course, Minister. I want to go to the debate we had on productivity. Productivity measurement is extremely complex and quite contested both in theoretical and practical applications, is it not?

Mr Banks: It is probably fair to say that it is contested. In fact, issues of measuring capital and so on are particularly problematic. Indeed, that is why quite often labour productivity numbers are used in preference to capital productivity or multifactor productivity numbers. So it is quite complex. I would probably say that, with the good work of the Australian Bureau of Statistics, Australia is probably leading the way in grappling with some of those complexities.

Senator CAMERON: For instance, Quiggin has challenged the basis of some of the ABS statistics on productivity and problems associated with that and challenged some of the earlier analysis by the predecessor to the Productivity Commission. Have you seen some of that analysis?

Mr Banks: We had a good robust discussion with Professor Quiggin.

Senator CAMERON: Because it goes to this question that Senator Abetz is raising. Obviously Professor Quiggin raises the issue of multifactor productivity coming in to try to overcome some of the problems about measuring labour productivity. He argues that the issue of casualisation, composition effects in the labour force, work intensity, the pace of work, changes in average hours coupled with data limitations make it not a dedicated and very comprehensive science in terms of measurement because you have to juggle all of these and make judgments on all these issues, do you not?

Mr Banks: I do not know whether my colleagues would like to comment.

Dr Gordon: It is hard to measure labour input, because you are trying to adjust for quality. But it is even harder to measure capital input because you have to try to adjust that for quality. So it is an ongoing program and the commission is quite involved. We have an ARC linkage grant with the University of New South Wales on some of the challenges in productivity measurement. We continue to work with the ABS to try to improve the quality of measures. So it is an ongoing process. No measure is wonderful. When you start unpacking any data source, you find some problems with it. But the question is, overall, does it track the trends fairly well and does it remain robust and not vulnerable to out-of-left-field influences? So as long as it is tracking the trends and the changes fairly well, it provides very useful information.

Senator CAMERON: Professor Quiggin even draws attention to the fact that an increase in productivity by technology is cleaned in some data but is not matched by other data which shows a declining investment in some periods of technology. So there is no investment in technology through some aspects of the data, but there is a claim that technology is improving

productivity by increased technology. There are all those issues that are genuinely a conundrum, really, are they not?

Dr Gordon: Well, the way we measure multifactor productivity is really to try and find what is left after you have explained the growth in the labour input and explained the growth in the capital input. The residual is what we describe as multifactor productivity. That is sort of attributed largely to technology, but there will also be some potential for measurement error if you did not fully capture the improvement in the quality of your labour force or the improvement in the quality of your capital. So they may be picked up in that measure as well.

Senator CAMERON: I know, for instance, that Richard Lester from MIT was the main author of *Made in America: regaining the productive edge*. He defines multifactor productivity in a much wider way than I have heard you defining it here. He also includes the input of management systems.

Dr Gordon: We actually had a research paper that came out last year that was looking at what we are calling organisational capital, which is sort of intangible capital services. There are a number of experimental estimates that are trying to capture just how big that is. That paper found, very interestingly, that in fact while we saw investment in the growth of fixed capital trending down, that was offset by a trend increase in intangible capital services. So we saw that the overall investment was actually remaining fairly constant but there was a mix in investment between physical capital and this kind of organisation-managerial capital offsetting each other. So overall investment was remaining more constant. We are quite happy to send you a copy of that research paper, if you are interested in it.

Senator CAMERON: I would like to see that. Is that the first time you have done research on that?

Dr Gordon: That was the first research paper where we actually tried to apply some of these experimental techniques for measuring the intangible capital. There had been some work previously done in various areas, but I think that is our first published research paper with that background.

Senator CAMERON: I am just surprised it has taken you that long to do it because I think *Made in America: regaining the productive edge* is probably 14 years old. It raised these issues 14 years ago.

Mr O'Brien: A lot of the problem, I think, Senator, is that these issues of quality differences in labour and capital and technological progress and intangible capital investments are just intractable. Areas where the statisticians have made the greatest progress in trying to capture quality improvements, for example, in key products like computers or motor vehicles, still leave many unanswered questions. In the intangible capital study that Dr Gordon was referring to, we were looking, for example, at the investment that firms make in maintaining their brands and reputations. We were just experimentally copying some international quantitative approaches that had been taken and applying those approaches to the Australian data. But when you look into how those experimental estimates were made, they in turn were really just taking an arbitrary assumption of the proportion of the firm's investment that was a sort of an enduring investment in its position in the marketplace, as distinct from ephemeral brand launches and things like that. So it is worth testing whether all of these ideas can be

better measured and whether they make an improvement in your understanding of the ability to sustain a rising standard of living.

But productivity is our first name. You might think we would be mad-cap enthusiasts for these numbers, but we are at the forefront of people who actually recognise many of the problems that you have signalled with Professor Quiggin's work. Indeed, in the House of Representatives submission, we invested a little upfront in trying to say measured productivity is not an end in itself. The concept of productivity growth is advantageous to sustaining real living standards, but always stop and ask yourself whether the number is properly capturing the concept. Often, for all the reasons you have alluded to, you do have to exercise caution.

Senator CAMERON: I do not want to belabour this much more. I note that Professor Quiggin did publish a paper going back to 2001 entitled 'The Australian productivity miracle: a sceptical view'. He looked at the whole issue. He raised all these issues 10 years ago. I am surprised that you guys have not engaged with Professor Quiggin on these issues, distinctly seeing them as a problem in the area.

Mr Banks: We engage with him every time we go to Queensland, Senator. We have dinner with him.

Senator CAMERON: You do engage with him, do you?

Mr Banks: We do. We invite him to roundtables and we invite him to workshops and so on. He has made a very good contribution, in part by challenging work that we have done and others have done.

Senator CAMERON: That is good. I want to come to this nonsense about a public interest test on dumping. Your Productivity Commission report on dumping said that there should be this public interest test. I was looking at your speech entitled 'Markets: how free?' In it you talk about the productivity of society and not just the productivity of the economy. How can we believe that you take the productivity of the society seriously if you are advocating a position where a company can actually be engaged in this country legally employing Australian workers and if you simply dump goods on it, you can destroy that company? Then you set out these nonsense tests about why that should be allowed.

Mr Banks: I guess the productivity of society is related to the productivity of the economy in the sense that wellbeing is in part driven by material prosperity. As we know, trade is an important source of material prosperity. So then a judgment has to be made whether the trade is fair or unfair, and then we come to the nub of the antidumping question. But that, too, depends on all sorts of calculations about normal value and whether this price in the Australian market is below normal value and so on. So it is quite a complicated matter. I guess the point we were making was not denying that you need to have provisions that promote fairness in trade, if only in part to ensure that you can keep a liberal trading order, which we all benefit from. But the question is how you devise those rules to ensure that decisions are being made precisely in the public interest. So the notion of a public interest test, which is not an Australian invention—we have not had such a provision explicitly, but the Europeans have and so on—is, in some cases, to be able to have the opportunity to look at wider impacts, where you are making a trade-off between the situation of a particular firm or

industry and the wider impacts on other firms and industries that are also employing people who would lose jobs if their costs went up.

Senator CAMERON: That is a debate that has to be had, in my view. It will be quite a robust debate because I do not agree with the analysis that you have made there. The other issue I want to raise with you is: do you have expertise within the Productivity Commission to help you with the presentation of the report itself?

Mr Banks: You mean the look of our reports?

Senator CAMERON: Not the look of it, but the language.

Mr Banks: Well, I guess we always strive to write as clearly as we can. From time to time—

Senator CAMERON: Sometimes you fail, I would postulate.

Mr Banks: I think we all could probably do better. But we certainly would have from time to time consultants come in and help us with aspects. We have had training programs for our staff on writing plain English and so on. We are conscious that—

Senator CAMERON: How many fails were there?

Mr Banks: We are conscious that on some topics—we were just talking about one earlier in relation to carbon policies—it is quite hard to put some of these things into plain English. But we do our best, Senator.

Senator CAMERON: I accept that. But I must say that some of the technobabble in this dumping report is incomprehensible. I just think for an organisation like yours, you really need to do something about trying to present not in plain English but in comprehensible English. It really is bad in some areas. I have had to read it three, four and five times and I have asked other people to explain to me what it means. These are people with economics degrees and they go, ‘I don’t have a clue what that means.’ I am just asking you because these are very important pieces of literature out in the public arena. People in my position and people with economics training do not understand what you are saying, and it is not because it is full of econometric formulae or algebraic formulae; the language is just poor.

Mr Banks: One of the problems with the dumping area is that the language comes out of the WTO and the General Agreement on Tariffs and Trade.

Senator CAMERON: That is probably one of your problems, yes.

Mr Banks: And it has a lot of legal and technical language in it. But I do take that point very seriously. If you tell us the parts of the report that were particularly dense and difficult to follow, we will certainly take that to heart.

Senator CAMERON: Maybe I am dense, but I must say there are real problems in terms of the grammar.

Senator EGGLESTON: You are Scottish.

Senator CAMERON: Senator Eggleston, it is not because I am Scottish. This is the second time. We had sexism yesterday and we have racism tonight. Now, you guys had better pack it in.

Senator CORMANN: Do not give us this pathetic outburst, Senator.

Senator CAMERON: You guys need to pack it in.

Senator CORMANN: Senator Cameron, do not confound this.

Senator CAMERON: I know Tony Abbott has you all fired up, but do not treat me in a racist manner.

Senator CORMANN: You have been dishing it out all day. You cannot take it.

Senator CAMERON: Do not treat me in a racist manner.

Senator CORMANN: Do not talk to me about that.

CHAIR: We can have this—

Senator CAMERON: Do not treat me in a racist manner.

Senator EGGLESTON: Can I assure you, Senator Cameron, I had no intention to be offensive.

Senator CAMERON: Well, apologise.

Senator EGGLESTON: I apologise for any offence caused.

CHAIR: Are there any further questions for the Productivity Commission?

Senator EGGLESTON: I want to ask a question. This goes to your resourcing. Senator Cameron referred to the antidumping inquiry. We have heard in this committee evidence about that. How well resourced are you to gather in information and travel to other countries to observe what is done and to gather information for your reports in general? Do you feel your resourcing is adequate?

Mr Banks: Well, we are a very cost-effective organisation, Senator. I guess we spend our money pretty wisely. We are actually resourced to conduct seven to eight inquiries. In recent times, we have been doing more like eight to 10 and we have been finding ways of doing that. But we certainly are not at the point where we think the quality of our work is compromised. But on your point about international travel, I guess the internet saves a fair bit of international travel these days. That has been an important source of low-cost information for us.

Senator EGGLESTON: I return to the public interest test, which Senator Cameron referred to. What other countries have tests like that or are other practices used?

Mr Banks: I mentioned the European Union. I am not across all the detail of this, but the European Union, I think, is one important country or entity that does have it. However, other countries also have a public interest provision whereby, for example, in the United States, the President can override the findings of the international tribunal in the national interest. That is rather vaguely expressed and it depends on how the President chooses to interpret that term. What the commission had been proposing is a constrained public interest test. In certain circumstances where action would have a disproportionately negative impact on some other part of the economy, for example, and you would have trade-offs in jobs here versus jobs there, this provision could be invoked. But it would be specified fairly clearly. Everybody would know what the particular aspects of the wider public interest were to come into play. Again, it would be a time-bound response in relation to those matters.

Senator EGGLESTON: Thank you very much. We have heard that the Canadians and the Americans have a different approach to antidumping and a different methodology perhaps

or a different level of interpretation of the rules. That perhaps provides some sort of legal basis for a different approach.

CHAIR: Any further questions? If not, we thank the Productivity Commission for coming in this evening.

Australian Office of Financial Management

[20:53]

CHAIR: Good evening, gentlemen. Thank you for coming in a little early. Do you have an opening statement that you would like to make, Mr Bath?

Mr Bath: No, Chair. I do not.

CHAIR: We will go straight to questions, then.

Senator CORMANN: Mr Nicholl, in the budget papers, it says that the face value of total stock of Commonwealth government securities is expected to be \$192 billion by 30 June. Given the program in place, do you know when the face value of Commonwealth government securities is expected to reach \$200 billion? Have you got a date by which you expect, according to your current program, to reach \$200 billion?

Mr Nicholl: No. We do not have an exact date—

Senator CORMANN: Roughly?

Mr Nicholl: but we have late August, I think, as a date when we would expect that.

Senator CORMANN: So late August 2011?

Mr Nicholl: That is correct.

Senator CORMANN: Thank you for that. Could you bring us up to date on the dollar value of RMBS purchased by AOFM?

Mr Nicholl: Since we last met with the committee, I think we have completed two deals. We have done about six deals. I think at the last committee I said we had about four or five proposals in the pipeline, as I recall.

Senator CORMANN: Yes.

Mr Nicholl: We have supported six deals since then, which takes our total investment at present to \$13.17 billion.

Senator CORMANN: And the credit quality of this RMBS is assured, from your point of view?

Mr Nicholl: They are AAA rated, yes.

Senator CORMANN: So what are the impacts of the recent Fitch rating on the overall Australian RMBS market?

Mr Nicholl: None, as I understand.

Senator CORMANN: None, no, or none?

Mr Nicholl: No impact on the mortgages underlying the investments that we are part of.

Senator CORMANN: But when you say 'as I understand', is that something that you have considered or sought advice on?

Mr Nicholl: Yes. When the Fitch announcement was made, I had a report handed to me which confirmed that the downgrades did not affect any of our portfolio.

Senator BUSHBY: Earlier when Markets Group from Treasury were in here, I asked whether any of the 54 tranches that had been put on negative watch included RMBS that the AOFM had invested in and they thought that it had. I am not arguing with—

Senator Wong: But they also said that the AOFM would be the ones to ask that question of.

Senator BUSHBY: Absolutely. I am just seeking clarification to make sure that there is no misunderstanding in terms of the wording that I used to ask the question earlier. Are any of those—

Mr Nicholl: Our portfolio is not affected.

Senator BUSHBY: Not affected in any way. Thank you.

Mr Bath: I will add something. The question you asked was about the Fitch announcement of a week or two ago. Correct?

Senator BUSHBY: Yes.

Senator CORMANN: Is there another announcement that we should be aware of?

Mr Bath: Well, S&P announced late last year that they changed their methodology and that there might be some ramifications of that when they work their way through it.

Senator CORMANN: So when are they working their way through it?

Mr Bath: Well, you would have to ask them, Senator. They announced it in August. They have not had any impact to date. There may be some downgrades in the future, but it would be a small number.

Senator CORMANN: On the basis of that information to you today and on the basis of announcements that have been made so far, there has been no impact. There is work underway at the moment that may have an impact on the future, but you do not know. Is that what you are saying?

Mr Bath: Yes.

Mr Nicholl: There is no impact; that is right. And the Fitch announcement is the one that is relevant.

Senator CORMANN: Is the Fitch review prior to the private sector credit enhancement of RMBS, dare I say, of questionable value?

Senator Wong: Senator, you are asking him questions about the Fitch review, which he has just indicated affects none of the AOFM's investments.

Mr Nicholl: It does not impact on any of our portfolio.

Senator Wong: Correct.

Senator BUSHBY: I did ask questions this afternoon about the broader RMBS, not just in terms of AOFM, and they did say that we should ask the AOFM.

Senator Wong: Maybe I am misunderstanding the question. I thought you were asking them to respond to some analysis.

Senator CORMANN: AOFM is obviously operating in the market and would be making judgments on these sorts of things. While your current investments are not impacted by it, presumably it will impact on your decision-making into the future. Is that a fair assumption?

Mr Nicholl: No. Because we have criteria that direct us to investing only in deals that have underlying mortgages that are AAA.

Senator CORMANN: Indeed. So does the Fitch announcement have any impact on the decisions that are you likely to make in the future, given your criteria?

Mr Nicholl: No. I cannot see how that would be because we are not changing our criteria.

Senator BUSHBY: Does it change the pool of available RMBS securities here if those tranches that are—

Mr Nicholl: I would have to talk to the lead managers and the originators about what they had in mind. We would not know about that.

Senator BUSHBY: But if those tranches have been put on negative watch, anything that is on negative watch is not something you are going to be interested in it, is it, or similar RMBSs looking to be issued with similar characteristics? I think the problem was to do with the LMI. You would need to be avoiding those when are you looking at future deals with private issuers?

Mr Nicholl: Well, if they meet AAA.

Senator BUSHBY: But it might impact. That is AAA that is available.

Mr Nicholl: We could only know about what is rated at the time we do a deal.

Senator CORMANN: I want to go to pages 7-16, 7-17 and 7-18 of the budget papers.

Mr Nicholl: Is that Budget Paper No. 1?

Senator CORMANN: Budget Paper No. 1, yes. Statement 7, and then pages 16, 17 and 18. On page 17 in particular, there is a note:

The panel agreed that the Commonwealth government securities market should be maintained around its current size—that is, around 12 per cent to 14 per cent of GDP over time.

Who was on the panel who made that decision?

Senator Wong: Senator, this is Treasury, I think, not AOFM.

Senator CORMANN: So it is not AOFM?

Senator Wong: I will just check.

Mr Nicholl: No.

Senator Wong: It was a review, Senator.

Mr Nicholl: We were a member of the panel, but we did not conduct the review. That was the Fiscal Group from Treasury.

Senator CORMANN: So who else was on the panel with you?

Mr Nicholl: There were a number of market participants and the Reserve Bank and Treasury.

Senator CORMANN: So the Reserve Bank and Treasury. When you say market participants, who?

Mr Nicholl: Banks. I cannot remember exactly who, though.

Senator CORMANN: Any state organisations?

Mr Nicholl: Yes. I think there might have been one or two state central borrowing authorities that were represented.

Senator CORMANN: Like the New South Wales Treasury Corporation, perhaps?

Mr Nicholl: Yes.

Senator CORMANN: And Victoria?

Mr Nicholl: Yes.

Senator CORMANN: Any other state?

Mr Nicholl: Not that I recall.

Senator CORMANN: And APRA perhaps?

Senator Wong: Senator, this is not a debate.

Senator CORMANN: No. I am just trying to find out—

Senator Wong: Well, you are asking. This is in the note on 7-17. Is that what you are asking him to confirm?

Senator CORMANN: I am trying to find out who else was on the panel.

Senator Wong: Reading out of a budget paper and asking if it is correct. It just gets sillier.

Senator CORMANN: I am just trying to get any number of private sector organisations. Who were they?

Mr Nicholl: I do not recall.

Senator Wong: We will take that on notice for Treasury, Senator. I am advised that it was chaired and run by Treasury, so why don't I take on notice your question as to who it comprised and the number of private sector market participants that is reference 7-17? Senator, is that what you want me to do?

Senator CORMANN: That is what I would like you to do, yes.

Senator Wong: Thank you.

Senator CORMANN: I am interested to know. Obviously, all the organisations that are on there have an interest in maintaining a large number of Commonwealth government securities on issue. It is not really a balanced panel to review. That is a question for you, Minister. It is not really a balanced panel reviewing the needs of the Commonwealth government securities market, is there? They are all people who have a vested interest in maintaining—

Senator Wong: I think statement 7 goes through a range of points at which the Commonwealth government securities market has been considered under both the previous government and under this government. It references some of the policy issues that need to be considered in terms of both the size of the bond market and, if you look at the 'Recent developments' paragraph, some of the liquidity and other requirements as a result of Basel international banking regulations. If you want a more detailed discussion, Senator, I am happy to take that question on notice.

Senator CORMANN: Thank you. It is obviously always a bit annoying when in Treasury you are told to ask these sorts of questions when AOFM comes on, and when AOFM is on, we are told to raise these sorts of issues with Treasury.

Senator Wong: Well, I do not think you asked us who conducted the panel, Senator.

Senator CORMANN: Well, we have raised these issues.

Senator Wong: I think if you had asked us. I was at the table for all of the fiscal and the macro group estimates. I do not recall you saying, 'I want to discuss the Basel committee for banking supervision and what that means for the Commonwealth.'

Senator CORMANN: I put the rest of the questions on notice. But, yes, Minister, we did.

Senator Wong: Well, if that is the case, I stand to be corrected. I do not recall that, Senator, as a policy matter as opposed to the functioning of the AOFM and what it handles in terms of government debt.

Senator CORMANN: In an answer you provided to a question taken on notice at the February estimates, you stated that around \$2.7 billion of Australian infrastructure bonds will be issued in 2012 to fund the government's investment in the NBN. Can you tell us the total value of Australian infrastructure bonds or other Commonwealth debt instruments estimated to be required to fund the NBN over the forward estimates and over the entire life of the NBN project?

Mr Nicholl: Senator, it was actually Treasury that answered that question.

Senator CORMANN: You took it on notice.

Mr Nicholl: We took it on notice and passed it to Treasury, who we said at the time would be able to answer it. They did provide an answer.

Senator CORMANN: It would have been good for that to be clearer at the time so we could have pursued that question with Treasury as well. So you will not be able to assist us with this any further, will you, in terms of what the expectations are over the forward estimates and over the life of the—

Mr Nicholl: They are Treasury estimates. We would not have a hand in—

Senator CORMANN: You have that instruction and then just do a deal, but you have not been told how much?

Mr Nicholl: That is correct.

Senator CORMANN: So you only know what it is going to be over the 2011-12 financial year but not beyond. How much advance notice do you get?

Senator Wong: Of what, Senator?

Senator CORMANN: Of the program of issuing Australian infrastructure bonds.

Mr Nicholl: Well, it is all swept up in the aggregate budget financing task, so that is just included in our gross financing task for the year.

Senator CORMANN: So from your point of view, it is not broken down by purpose? You get told, 'Our borrowing requirements are up to \$240 billion', or whatever. So you go out and just issue bonds and securities?

Mr Nicholl: Yes. We would know from the budget that the financing task for the coming year is, say, \$51 billion, and that is what we factor into our program. How the money is used is a matter for the government. But our task is to raise those funds.

Senator CORMANN: That is it from my point of view.

Senator BUSHBY: First of all, I wonder whether you have prepared a graph with the yields.

Mr Nicholl: We have anticipated—once again, we are happy to table—the nominal CGS yields.

Senator BUSHBY: It has been indicated that the total face value of issued debt by 30 June is to be \$192 billion. Is that correct?

Mr Nicholl: \$192 billion by 30 June 2011?

Senator BUSHBY: Yes.

Mr Nicholl: Yes. That is correct.

Senator BUSHBY: It is already there, is it not? Am I looking at the total?

Mr Nicholl: Yes. According to our website of last Friday, it was \$192.7 billion.

Senator CORMANN: Is that face value or market value?

Mr Nicholl: Face value.

Senator CORMANN: \$192.7 billion. So you are already past your 30 June target?

Mr Nicholl: Well, yes. In fact, today it would have been \$193.9 billion. As of tomorrow, it will be \$194.7 billion.

Senator CORMANN: So it seems that you are going to \$200 billion much more quickly.

Mr Nicholl: Well, on 15 June we will have a maturity of a bond line. I think that will reduce the outstanding stock of issuance by a bit over \$11 billion. The number goes up and down.

Senator CORMANN: Sure. I understand.

Senator BUSHBY: By \$100 million, did you say?

Mr Nicholl: By \$11 billion.

Senator BUSHBY: Reduced by \$11 billion?

Mr Nicholl: \$11.2 billion.

Senator BUSHBY: So, according to your projections, it is still on track to be around \$192 billion, what it is now at the end of this month?

Mr Nicholl: Yes.

Mr Bath: Senator, just to clarify, there is also a \$1.2 billion T-note maturing next week. So we have a total of \$12.4 billion in maturities between now and 30 June.

Senator BUSHBY: And what else are you going to be putting on in that time?

Mr Bath: Well, the difference between that and \$192.2 billion.

Senator BUSHBY: To bring it back to \$192 billion.

Mr Bath: The best estimate is still \$192.2 billion, give or take.

Senator BUSHBY: I will move to Treasury notes. I notice that the government significantly increased the issuance of short-term debt Treasury notes, with a maturity of less than a year in the past few years and in the past year in particular. The effect of this is to lower the weighted average interest on government debt for short-term debt trends to have a lower interest rate than long-term debt. Last year's budget said in regard to the issuance of Treasury notes that it is anticipated that approximately \$10 billion of Treasury notes will be kept on issue at all times. That is in Budget Paper No. 1 for 2009-10 at page 7-11. I note that in the three quarters reported so far this financial year, it has gone up and there is a lot more than \$10 billion worth of Treasury notes kept on issue. According to the RBA, there were \$15.6 billion in September 2010, \$15.5 billion in the December quarter and \$13.8 billion in March 2011 quarter. The budget reports that Treasury notes outstanding will amount to \$17 billion at 30 June 2011. These are significantly higher than the approximate \$10 billion referred to and seem to be climbing. Is this a deliberate change in strategy, or is it just an accidental thing that is occurring for various parameter reasons?

Mr Nicholl: It is not accidental. The budget provides estimates. I think the comment you are referring to is that we would keep at least \$10 billion. Is that right?

Senator BUSHBY: Yes. I think at the time last year it said approximately. I think this year it says at least. So there has been a change in the wording, which seems to be quite significant in terms of its meaning as well.

Mr Nicholl: Certainly for cash management purposes throughout the year we have tended to rely on the issuance of Treasury notes. I think we might have said in our operational notice that we intend to, in the coming year, reduce the amount of outstanding notes on issue. We will substitute some of those notes for bonds during the year.

Senator BUSHBY: So it is likely to come back down?

Mr Nicholl: Yes. It will come back down because we will make a deliberate effort to do that.

Senator BUSHBY: You will be looking to get back to around \$10 billion? Last year it did say approximately and in this year's budget papers, that word 'approximately' has been removed and replaced with 'at least'. It looks like there was a deliberate decision to change the words, but does that reflect a deliberate decision in terms of—

Mr Nicholl: Well, we are balancing two things here. On the one hand, we think that our financing task will be as effective and cheaper if we reduce the amount of notes on issue. But at the same time we have to be careful that we do not reduce the outstanding stock of notes on issue below a level at which liquidity is impacted in the market. That means that if we have a need in the future for short-term funding, it will be impacted if the liquidity of the notes is affected.

Senator BUSHBY: I understand that. That is why the note was in last year's budget about liquidity.

Mr Nicholl: So it is a balancing consideration.

Senator BUSHBY: I understand that. I am still interested in the change of wording. Somebody has decided to remove approximately \$10 billion, which means around or in the vicinity of, to at least \$10 billion. In the context, the quote is:

...is anticipated that at least \$10 billion of Treasury notes will be kept on issue at all times to maintain the liquid market in Treasury notes.

Mr Nicholl: Yes.

Senator BUSHBY: Has there been a change in policy to consider that at least \$10 billion is now required to maintain a liquid market whereas previously it was thought around \$10 billion was enough?

Mr Nicholl: What I can say is that the circumstances have changed over the last two years. We do our cash flow and cash management on a weekly basis. So we are just trying to meet the market conditions and the changes in the budget outcome. As we move into a more stable environment, we think that we will be able to rely less on that short-term funding issue. That is reflected in those words.

Senator BUSHBY: Were you aware of the words changing? Were AOFM aware that those words were being changed?

Mr Nicholl: Yes.

Senator BUSHBY: So your answer is not just telling me why there is a high level of Treasury notes out there at the moment? It is actually addressing why that has changed. It is probably not an accurate reflection of what you will be doing this year to leave the word 'approximate' in? You think it needs to say 'at least', for those reasons?

Mr Nicholl: I am advised that the change in the wording from last year and this year is of no policy significance.

Senator BUSHBY: That is interesting. The primary use of Treasury notes is to meet a within-year financing requirement resulting from differences in the timing of receipts and payments. That is actually taken from your Treasury note tender result spreadsheet. That is the reason why Treasury notes are issued rather than the longer term bonds?

Mr Nicholl: We use a mix of funding instruments.

Senator BUSHBY: But the reason why Treasury notes are used primarily is to meet within-year financing requirements?

Mr Nicholl: Yes. Short term.

Senator BUSHBY: Resulting in differences in the timing of receipts and payments?

Mr Nicholl: Yes.

Senator BUSHBY: And your answer to my earlier question is, effectively, that the differences in timing of receipts and payments has led to the need to issue a much higher level of Treasury notes. I think this year \$55.1 billion of Treasury notes have been issued, which is more than has been the case in the past. It is those differences in timing that has led to that high level. Is that the case?

Mr Nicholl: Yes. It is a range of a whole lot of things.

Senator BUSHBY: Well, what are they?

Mr Nicholl: Effectively, we are moving into a more predictable environment. We will have a lesser need to rely on the issuance of Treasury notes.

Senator BUSHBY: How has the increased issuance of short-term debt been consistent with the government's goal to continue to lengthen the CGS yield curve incrementally?

Mr Nicholl: Well, they are two completely different issues.

Senator BUSHBY: If a larger proportion of—

Mr Nicholl: Issuing Treasury notes is a within-year, less than one-year funding instrument, so that does not relate to extending the yield curve, which is about issuing longer bonds—12 years and beyond.

Senator BUSHBY: But if a larger proportion of funding requirements of the government were moved into the Treasury note and removed out of the bond market, that would have an impact on the bond market for the time that that money was in Treasury notes, would it not?

Mr Nicholl: When you say ‘moving it out of the bond market into Treasury notes’, I am not sure I understand.

Senator BUSHBY: If there was the sort of volatility that you are talking about which led to a greater need to issue Treasury notes because of the timing mismatches, which meant that you were not putting as much into the longer term, that would have some impact on how those yields would look in the longer term and the CGS yields at that point, because you have shifted more out of there?

Mr Johnson: Mr Nicholl has referred to the fact that Treasury notes are going up in the short term for this year, but the intention is to wind that back over the coming years. So even though in the short term Treasury notes have gone up over the coming year, we expect them to go back down again and restore that funding through bonds again.

Senator BUSHBY: Mr Nicholl mentioned that. I did understand that. If you are looking at the total interest servicing costs of all government debt and the larger proportion of it is in Treasury notes—if you have a quarter of it in Treasury notes instead of 10 per cent in Treasury notes, on average, given the yields that apply on both, what would the impact—

Mr Nicholl: The yields are lower for Treasury notes.

Senator BUSHBY: So it would actually lower the overall servicing costs of that debt?

Mr Nicholl: Sure. But it increases your refinancing risk too because you have to be going to the market more regularly.

Senator BUSHBY: Absolutely. But in the short term, you can make your actual interest payments lower?

Mr Nicholl: All other things being equal, that is correct. But all other things are never equal.

Senator BUSHBY: I know that. I appreciate your job is a very complex one in terms of matching, timing and ensuring that you have money available for the government as it needs it and trying to minimise—

Mr Nicholl: Minimise the cost.

Senator BUSHBY: Over the longer term. I understand that.

Mr Nicholl: Balanced against the requirements.

Senator BUSHBY: Quite clearly, there has been an increased trend towards Treasury notes. That does have an impact on the overall debt servicing cost. I was just curious as to the reasons, but I think you have satisfied me. I did receive a copy of the yield curve with the nominal CGS yield. Mr Nicholl, would you like to talk to that at all?

Mr Nicholl: I do not think it has changed much since we were last here. The fact that the lines are getting closer together suggests that the yield curve is flattening.

Senator BUSHBY: The overall trend in the last few months does look like it is down.

Mr Nicholl: Yes.

Senator BUSHBY: So it is lower overall as well as flattening. Presumably, that will be feeding into lower interest servicing costs over the periods that these will apply?

Mr Nicholl: Well, yes. Our expected yields are lower on average.

Senator BUSHBY: I think you have already answered most of the questions on RMBS that I would probably ask. I note that, on RMBS, we had a discussion about markets earlier. I think it indicated that \$13.1 billion had been issued.

Mr Nicholl: Yes. We will just confirm that.

Senator BUSHBY: But AOFM involvement in deals has dropped off to some extent and the market is becoming more self-sustaining and self-sufficient. Is that an accurate conclusion?

Mr Nicholl: Certainly the trend for our involvement has been a declining trend. In fact, I think there was one deal that we supported this year where we did not have to invest anything. We got scaled out because other private investors came in and took up all of the investment on offer. So we also saw that as being a positive outcome.

Senator BUSHBY: That is good. The market group was telling us that it had dropped. You have \$20 billion available. Do you think you are going to need it?

Mr Nicholl: That is a really hard question to answer. We are still receiving inquiries about potential deals. We have several proposals still in the pipeline.

Senator BUSHBY: And are they substantial or potentially substantial deals? I am not asking for the figures or the details.

Mr Nicholl: They have not been launched.

Senator BUSHBY: I also asked this afternoon in markets group whether the rerating by Fitch of those 54 tranches of RMBS would be likely to have an impact on investor appetite for RMBS in Australia. Does it put at risk the recovery that we are seeing and the good work that the AOFM has done in any shape or form, in your view? Could it be an issue?

Mr Nicholl: I am not sure I am well placed to comment on that.

Senator BUSHBY: Markets group did tell me to ask you that.

Senator Wong: He is just a very measured man and he is conscious of what he says.

Senator BUSHBY: He is a Tasmanian, so he is very, very careful, I am sure.

Senator Wong: I did say when he walked in that he is the Tasmanian with all the money.

Mr Nicholl: That is right. If only it were true. I have not really stopped to give that a huge amount of thought, to be honest. You could think it through and think that it could have all sorts of possible implications, but you would have to actually talk to the market participants to understand how they viewed it—the people who are actually buying these investments.

Senator BUSHBY: But it is very pleasing to see the extent to which the securitisation market in Australia has recovered. I am aware that in America they got very excited, I think,

when they had a \$50 million issue earlier this year. That was the first RMBS issue that they had had since the GFC. We are up to about \$30 billion?

Mr Nicholl: Yes. I think that is about right.

Senator Wong: I think you should recognise the importance of the stimulus, Senator.

Senator BUSHBY: I recognise the importance of AOFM's involvement in the RMBS market. I think it has done a great job. Malcolm Turnbull made the right call when he first called for it publicly, and there has been bipartisan support for it all the way through. So it is good to see it. I see what Fitch have done. Discussions with Markets Group this afternoon confirmed my suspicions that it had far more to do with lenders mortgage insurance practices outside Australia than in Australia, but we are wearing the consequences. It does worry me that that might have some repercussions in Australia that are unjustified, and it should not when we have a very healthy RMBS market recovering. We would not want anything to shake that at all.

Mr Nicholl: Well, healthy, I think, is a word I have used in the past. I think we do see a relatively healthy comeback in the market.

Senator BUSHBY: The prospect of it coming back to where it was is probably slim.

Mr Nicholl: I would not like to comment on what the market will look like in the future.

Senator BUSHBY: Thank you very much.

CHAIR: Thank you. There being no more questions for AOFM, I thank its representatives for coming in tonight. I thank the minister for surviving a cold throughout the last two days. I thank members of the committee and the participating members and, more importantly, the secretariat for their hard work through the last couple of days, and Hansard and Broadcasting. Thanks very much.

Secretary: And the chair.

CHAIR: The chair has already been thanked. The committee is adjourned.

Senator Wong: We will miss you, Senator Hurley.

Committee adjourned at 21:27 pm