



COMMONWEALTH OF AUSTRALIA

Proof Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Additional Estimates)

THURSDAY, 24 FEBRUARY 2011

CANBERRA

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Thursday, 28 April 2011

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SENATE ECONOMICS
LEGISLATION COMMITTEE
Thursday, 24 February 2011

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

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

Senators in attendance: Senators Boswell, Brandis, Bob Brown, Bushby, Cameron, Coonan, Cormann, Eggleston, Hurley, Ludlam, McGauran, Milne, Pratt, Ryan, Williams and Xenophon.

Committee met at 9.00 am

TREASURY PORTFOLIO

Consideration resumed from 23 February 2011

In Attendance

Senator Wong, Minister for Finance and Deregulation

Senator Sherry, Minister Assisting on Deregulation and Public Sector Superannuation

The Treasury

Markets Group

Mr Jim Murphy, Executive Director Markets Group

Mr Greg Divall, General Manager Standard Business Reporting

Mr Geoff Miller, General Manager, Corporations & Financial Services Division

Ms Vicki Wilkinson, Principal Adviser, Corporations & Financial Services Division

Mr James Chisholm, Principal Adviser, Corporations & Financial Services Division

Mr Andrew Sellars Senior Adviser, Corporations & Financial Services Division

Mr Mark Sewell, Manager, Corporate Reporting and Accountability Unit

Mr Tim Beale, Manager, Governance & Insolvency Unit

Ms Christian Mikula, Manager, Investor Protection and Credit Unit

Ms Alix Gallo, Manager, Market Integrity Unit

Mr Richard Sandlant, Manager, Financial Services Taskforce Unit

Mr Brad Archer, Principal Adviser, Infrastructure

Mr Paul McBride, Principal Adviser, Housing and Cities

Mr Brenton Thomas, Principal Adviser, Infrastructure

Mr Andrew Deitz, Manager, Competition Law & Policy Unit

Mr John Lonsdale, General Manager, Financial System Division

Mr Jonathan Rollings, Principal Adviser, Superannuation

Mr Justin Douglas, Principal Adviser, Banking

Ms Kanwaljit Kaur, Manager, Insurance Markets Unit

Mr Jerome Davidson, Senior Adviser, Insurance Markets Unit

Productivity Commission

Dr Michael Kirby, Head of Office

Dr Jenny Gordon, Principal Adviser Research

Mr Terry O'Brien, First Assistant Commissioner, Canberra

Ms Lisa Gropp, Acting First Assistant Commissioner, Melbourne

Treasury Portfolio

Australian Securities & Investment Commission (ASIC)

Mr Tony D'Aloisio, Chairman

Ms Belinda Gibson, Deputy Chairman

Mr Greg Medcraft, Commissioner

Mr Michael Dwyer, Commissioner

Ms Kathrine Morgan-Wicks, Senior Executive Leader

Australian Competition and Consumer Commission (ACCC)

Mr Graeme Samuel, Chairman, Australian Competition and Consumer Commission

Mr Brian Cassidy, Chief Executive Officer, Regulation

Mr Mark Pearson, Deputy Chief Executive Officer, Competition and Consumer

Ms Raybe de Gruchy, Deputy Chief Executive Officer, Competition and Consumer

Australian Competition and Consumer Commission (ACCC) cont

Ms Jo Schumann, Executive General Manager, Corporate

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

Mr Scott Gregson, Group General Manager, Enforcement Operations

Mr Nigel Ridgway, Group General Manager, Compliance Operations

Mr Michael Cosgrave, Group General Manager, Communications

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

Ms Michelle Groves, Chief Executive Officer, Australian Energy Regulatory

Mr Richard Chadwick, General Manager, Adjudication

Mr Sebastian Roberts, General Manager, Water

Mr Adrian Brocklehurst, Chief Executive Officer

Ms Lisa Anne Ayres, Director, Office of the CEO

Ms Lisa Campbell, Project Officer Office of the CEO

Ms Lynne Haultain, General Manager, Strategic Communications

Ms Sharon Clancy, Assistant Director, Office of the CEO

Ms Alison Noad, Project Officer, Strategic Communications

Ms Leonora Nicoll, Director, Strategic Communications

Australian Bureau of Statistics (ABS)

Mr Trevor Sutton, Acting Australian Statistician

Mr Peter Harper, Deputy Australian Statistician, Population,

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

Mr Michael Davies, First Assistant Statistician, Population, Labour, Industry and Environment Statistics Group

Mr Michael Belcher, Chief Financial Officer

Mr Paul Lowe, Assistant Statistician, Population Census Branch

Mr Michael Meagher, Director International Relations and Planning, Office of the Statistician

Revenue Group

Mr Paul McCullough, Acting Executive Director Revenue Group

Ms Brenda Berkeley, General Manager, Indirect Tax Division

Mr Phil Bignell, Senior Adviser, Indirect Tax Division

Ms Christine Barron, General Manager, Tax System Division

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

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

Ms Maryanne Mrakovcic, General Manager, Tax Analysis Division

Mr Colin Brown, Manager, Costing and Quantitative Analysis Unit

Mr Phil Gallagher, Manager, Retirement and intergenerational Modelling Unit

Mr Paul Tilley, Chief Adviser, Tax System Division

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

Mr Gerry Antioch, Adviser, Business Tax Division

Australian Tax Office (ATO)

Mr Michael D'Ascenzo, Commissioner of Taxation

Mr David Butler, Second Commissioner

Ms Jennie Granger, Second Commissioner

Mr Bruce Quigley, Second Commissioner

Mr Paul Duffus, Chief Operating Officer

Mr Neil Olesen, Deputy Commissioner, Superannuation

Mr Mark Konza, Deputy Commissioner, Large Business & International

Macroeconomic Group

Dr Ken Henry, Secretary, The Treasury
Dr David Gruen, Executive Director Macroeconomic Group (Domestic)
Dr Steve Morling, General Manager, Domestic Economy Division
Mr Simon Duggan, Principal Adviser, Domestic Economy Division
Mr Tony McDonald, General Manager, Macroeconomic Policy Division
Mr Roger Brake, Chief Adviser, International
Mr Patrick Colmer, General Manager, International Finance & Development Division
Mr Mike Kooymans, Manager, International Monetary Fund Unit
Mr Michael Anderson, Manager, Pacific Assistance Unit
Ms Vanessa Laphorne, Manager, Development Banks Unit
Mr David Crawford, Manager, G20 Unit, International & G20 Division

Fiscal Group

Mr Nigel Ray, Executive Director, Fiscal Group
Ms Luise McCulloch, Acting General Manager, Industry, Environment and Defence Division
Ms Meghan Quinn, General Manager, Macroeconomic Modelling Division
Ms Pete 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 Sue Vroombout, General Manager, Commonwealth-State Relations Division
Ms Jan Harris, General Manager, Budget Policy Division
Ms Elizabeth Clegg, Manager, Assets & Liabilities, Analysis Unit
Ms Angela Baum, Manager, Budget Priorities & Reporting Unit
Mr Russ Campbell, Principal Adviser, Budget Policy Division
Mr Robert Raether, Principal Adviser, Industry, Environment and Defence Division
Mr Nicholas Stoney, Senior Adviser, Social Policy Division

Commonwealth Grants Commission (CGC)

Mr John Spasojevic, Secretary Commonwealth Grants Commission
Mr Phillip Parkins, Director Corporate Services.

Australian Office of Financial Management (AOFM)

Mr Robert Nicholl, Chief Executive, Australian Office of Financial Management
Mr Andrew Johnson, Head of Reporting
Mr Brad Parry, Acting Head of Treasury Services

Australian Prudential Regulation Authority (APRA)

Dr John Laker, Chairman, Australian Prudential Regulation Authority
Mr Ross Jones, Deputy Chair
Mr Ian Laughlin, APRA Member
Mr Wayne Byres, Executive General Manager, Diversified Institutions Division
Mr Keith Chapman, Executive General Manager, Supervisory Support Division
Mr Charles Littrell, Executive General Manager, Policy, Research and Statistics

CHAIR (Senator Hurley)—Good morning. I declare open this public hearing of the Senate Economics Legislation Committee. The Senate has referred to the committee the particulars of proposed additional expenditure for 2010-11 and related documents for the Innovation, Industry, Science and Research; Resources, Energy and Tourism; and Treasury portfolios. Under standing order 26 the committee must take all evidence in public session. This includes answers to questions on notice. Officers and senators are familiar with the rules of the Senate governing estimates hearings. If assistance is needed 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)

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

Senator Sherry—I do not, thank you.

Mr D'ALUISIO—Just briefly, Chair. I appear today with deputy chairman Belinda Gibson, commissioners Medcraft and Dwyer and one of our senior leaders, Kath Morgan-Wicks. To point out some significant matters that ASIC has been involved in since we last met in October, we have commenced legal proceedings in Storm Financial to seek to recover compensation for investors and also enforcement of civil penalty proceedings. We have settled the Westpoint litigation—the main action in relation to the auditors. In that matter, we think that investors will recover \$160 million to \$170 million all up, with the various settlements that we have achieved with financial advisors, auditors, directors and also with what the liquidators have been able to recover. The total loss was something in the order of \$388 million.

We commenced legal proceedings through the Commonwealth Director of Public Prosecution in relation to ABC Learning's two former executives. The Fortescue decision on continuous disclosure was handed down by the Court of Appeal, which was in our favour. The defendants in that case have foreshadowed that they will seek leave to appeal to the High Court. Judgment was also received in the Court of Appeal in James Hardie. The action against the company was confirmed in ASIC's favour, but the decision in relation to the non-executive directors was reversed. We are seeking special leave to appeal to the High Court in that case.

Overall, in terms of our enforcement activities since we last met, some 45 cases have been resolved, of which we have been successful in 41. We have been successful in 14 criminal cases, eight civil, 12 administrative, and seven enforceable undertakings and negotiated settlements. Another significant case that has been resolved more recently is Sonray, with regard to the CFDs. Scott Murray entered a guilty plea in relation to aspects of misleading and deceptive conduct. We have also had a guilty plea from Mr Shawn Richards in relation to the Astarra Trio matter. So I think our record of continuing to run successful litigation that is in the public interest continues.

Another significant thing since we last met is the takeover of the licensing of credit. That is going well. You will recall that registrations closed on 30 June 2010, and we have received some 14,700 registrants. They then have the opportunity to convert to a licence and must apply by 31 December 2010. We have had some 6,882 applications for licences. So far we have granted 4,387, and we are in the process of granting a further 1,044. Kath Morgan-Wicks and her team have carried the responsibility for this registration process and she can answer questions if the committee wishes to go into that area.

The ASX supervision is another matter that we talked about at the last meeting. That concerns the transfer of ASX supervision to ASIC. As I said at the time, that went well, as has the work that we have done since. We are pleased that we have had a seamless transition. We are undertaking enforcement and compliance activities that are certainly well in line with what was happening before we took that over.

Finally, I want to put in a plug for the ASIC summer school that was completed yesterday. This year was the 14th consecutive year that we have run the summer school. We really use it as a means of promoting discussion on very leading opinions in terms of the areas we are in. The main benefit of that for ASIC is that it keeps us in touch with what is happening in the community and what the issues of concern are out there. It had a record attendance of over 400 people. Just to be clear, the ASIC summer school is, for those non-ASIC participants, a paying event—it is paid for by the participants, with ASIC running it.

In conclusion, you can see from these results that ASIC continues to deliver results and value to the Australian business and consumer community.

CHAIR—Thank you, Mr D'Aloisio. Senator Cormann.

Senator CORMANN—Mr D'Aloisio, how often has ASIC cracked down on any bank for imposing unconscionable fees or unfair contract terms?

Mr D'ALOISIO—Are we talking about exit fees or—

Senator CORMANN—No, I'm asking you how often ASIC has cracked down on any bank for imposing any unconscionable fee or unfair contract terms.

Mr D'ALOISIO—There are two aspects to that: there is the unconscionable legislation under the Corporations Act and there is the unfair terms legislation, which came in on 1 July. I do not have the figures for the unconscionable conduct, but certainly the Storm Financial case is one—

Senator CORMANN—Sorry, I am asking you about the banks.

Mr D'ALOISIO—Yes, well Storm Financial is against the banks. We are taking action under the unconscionable conduct provisions of the Corporations Act in relation to the Bank of Queensland—

Senator CAMERON—I am surprised you have forgotten about that one, Senator Williams!

CHAIR—Senator Cameron, I think that you are distracting the witness.

Senator Sherry—I do not think that Mr D'Aloisio had finished his answer when Senator Cormann cut in.

Senator CORMANN—It may assist you if I clarify the question. Obviously my interest is in the context of fees imposed by banks on residential mortgage holders and residential bank customers. How often, if ever—and I would be interested if you ever have taken action—have you taken action against any bank for imposing unconscionable fees or unfair contract terms on residential bank customers?

Mr D'ALOISIO—I cannot answer that this morning. From memory, I do not think so, but I would have to check that for you.

Senator CORMANN—I guess the reason I am asking is that the Treasurer asserted yesterday that, if banks were to increase fees in the context of the ban on exit fees, then regulators would crack down on any banks that sought to lift other fees to make up for lost revenue. I guess what I am trying to get from you is whether you have a regulatory power to crack down on banks that might want to increase fees or interest rates other than in the circumstances where those fees are seen to be unconscionable or unfair contract terms.

Mr D'ALOISIO—Our powers relate to misleading and deceptive conduct in the way that the fees may be proposed or recouped. They relate to unconscionable conduct, which we are discussing, and they relate to the unfair terms contract act. But in the end, in order to take an action we have to fit it within one of the existing regimes. So they would be the three regimes that we would look at if there was conduct that we felt needed to be examined. For it to be unconscionable, clearly there would have to be a special disadvantage that has been suffered by the borrower. For it to be an unfair term, again, legitimate interests would have had to be affected before we use the unfair terms contract legislation. In terms of the hypothetical that you are putting, in the current situation we look at our powers and at the unconscionable provisions. Where we have felt that there has indeed been special disadvantage or unconscionable conduct, and I gave you the example of Storm Financial, we have taken action against banks.

In relation to the unfair terms that recently came in, the major piece of work we have done there is to put out a regulatory guide on how we see that operating with exit and mortgage fees. That regulatory guide is being digested by the industry. We have a program over the next 12 months to see how lenders are complying with the regulatory guide that we have put out in relation to exit fees. I am sorry that I cannot be clearer than that.

Senator CORMANN—No, that is okay. I have a follow-up to question. Would it be seen as unconscionable by ASIC if a bank sought to recover their legitimate costs associated with establishing a mortgage by increasing interest rates or other fees?

Mr D'ALOISIO—I cannot comment on that sort of situation. We would look at it but I would have to take that on notice and look at it as a matter of law. That is a complicated issue. We do not have an actual fact situation; it is a hypothetical. At the moment, the law does not work in that way and there is not as yet any legislation that prohibits exit fees. So we are not seeing tactics of indirectly trying to achieve what is prohibited by a piece of legislation. I would really have to look at that in the context of a particular fact situation.

Senator CORMANN—I appreciate that, but I would suggest that you have never taken action against a fee imposed on residential customers for being unconscionable or for unfair contract terms, and I doubt that you would find that easy to do in the future. How would you assess, for example, whether a fee is legitimate in terms of recovering costs?

Mr D'ALOISIO—It would depend on the terms of the law that prohibits the exit fees, if there is such a law. If it prohibits it in certain circumstances and there is evidence that it is being done indirectly through another means, then clearly you would need to look at it. The broader debate is about costs incurred by lenders and how they pass those costs on. It is not really a matter of law at this point. I just do not know what the proposed legislation that you are referring to will actually contain.

Senator CORMANN—Under current legislation, unless the legislation changes, you would not be in a position to crack down on increased fees and increased interest rates unless you can prove that they are unconscionable and unfair contract terms?

Mr D'ALOISIO—You would have to bring it within one of the heads of responsibility that we have. At the moment there are heads of responsibility around, as I said, misleading and deceptive conduct, around unconscionable conduct and around unfair contract terms. It may be that other provisions in the Corporations Act could apply, but they are the main ones.

Senator CORMANN—I am conscious of time, so I will quickly go through some issues because my colleagues will have questions. In relation to what I am told is an increase in the number of unregulated market participants calling themselves stockbrokers, what action, if any, are you taking in relation to that issue?

Ms GIBSON—There are a number of people who have financial services licences who are in that category of non-market participants stockbrokers—that is, they are not registered with the exchange. To the extent that they have a financial services licence, we can monitor activities for compliance with that licence. To the extent that people in that category do not have a licence and operate through others who do have a licence or who are brokers, then our recourse would be, in the ordinary course, through those licensees—unless they are engaging in direct manipulative conduct or improper share trading themselves, which then gives them a direct input under our legislation. We are considering the scope of the market supervision powers and whether they should extend to these people who are not brokers and who are trading on the market. But at this stage it is just the fact that they are licensees.

Senator CORMANN—What are the regulatory requirements that do not apply to non-market participants who offer market exchange traded equities under their financial services licence?

Ms GIBSON—The non-market participants would not have the capital requirements that the ASX imposes. They would not be subject to our market integrity rules, or indeed to the ASX's trading rules or other exchanges' trading rules. So there is a valid question as to whether, to the extent that they operate, they should be so constrained. But to get onto the market they have to go through a broker, and the broker has some responsibility for managing their access to the market.

Senator CORMANN—Sure. But essentially people at the retail customer interface do not have the same level of protection. There is higher risk profile, I guess. If somebody calls themselves a stockbroker, the customer will expect that they have got all of the regulatory protection attached to them and all of the brand credibility of a stockbroker. While from the way that you have just described it, the risk profile is quite a bit higher, isn't it?

Ms GIBSON—It would be a misrepresentation if they called themselves a broker. That 'badging' is certainly a concern to the Stockbrokers Association. I do not believe that most of these non-market participants do call themselves brokers, although they do in fact provide services that look and feel like a broker, because with electronic trading they can provide an interface under what is called a 'white label'. They can provide access directly to a broker through their own computer shields.

Senator CORMANN—Have you got a handle on what extent this is an increasing problem or is it something that has always been there and is just sort of bubbling along?

Ms GIBSON—The number of non-market participants who are 'brokers' has increased in recent years. It is small groups of people, and they might think that they have a market advantage because they do not apply some of those rules. As to whether it is a particular problem, it is another area to watch in market oversight.

Senator CORMANN—Have there been any significant collapses, or have there been any significant issues, that have come to your notice from the demographic, I guess, of non-market participants offering market exchange listed shares?

Ms GIBSON—I believe Sonray was a non-market participant in that category. Its problem was CFDs rather than market participant access.

Senator CORMANN—But it does not seem to be a high priority issue in terms of your focus. You are across the issue, of course, but you do not seem to be focused on it as an operational priority.

Ms GIBSON—Operationally, when we took over market supervision, and indeed before then, we were very conscious of a number of these participants. We are very much focused at the outset on the market participants but we do also look at non-market participants on a regular basis. They tend to be smaller outfits, too.

Mr D'ALOISIO—It is important to emphasise that point. In looking at the whole market we are of course also looking at that segment of the market. And the work, as Belinda was saying, that our participants team does goes into that level as well. The prime obligation is on the market participant, and we want to make sure that they are ensuring that these other participants who work through them are doing things.

Senator CORMANN—Mr D'Aloisio, ASIC took over the supervisory and regulatory responsibilities for the market from the ASX. You mentioned that in your opening statement. Given that that has happened, what is the relevance of the ASX's ownership structure on the regulation of the market in Australia? Is it relevant or would that now no longer be relevant as a result of the change that has happened?

Mr D'ALOISIO—In traditional theory, ownership is separate from control, management and regulation. We take the market as it is.

Senator CORMANN—But the ASX had various regulatory functions before that you have taken over. What I am trying to find out is whether that now removes any issue in terms of potential ownership structures.

Mr D'ALOISIO—The issue of who owns the ASX and what happens with SGX is a government matter; it is not an ASIC issue. To the extent that the government asks us for advice, we will provide it. It is a matter then for government. Coming to the issue of the removal of the ASX's supervisory powers and giving them to ASIC, they were within a narrow compass of market and the operation of the market. The ASX continues to perform functions of a regulatory nature around listings and so on, and it continues to operate the Australian stock market. It is licensed and ASIC operates the licence. So all of those things will continue, irrespective of what is happening with the shareholding, each day as the market trades.

Senator CORMANN—If another stock exchange was licensed in the future, though, they would equally manage their own listing rules. There is nothing that is specific to the ASX as such, is there?

Mr D'ALOISIO—Traditionally, stock exchanges manage their listings, although some jurisdictions have taken the listings to a separate entity. There does not need to be a correlation between listing and a particular exchange. You can have exchanges trading that do not have a board, as you have seen with the proposed competition of Chi-X coming in. They will be offering trading services on ASX's board.

Senator CORMANN—Which takes me to my final issue. Chi-X lodged an application in, I think, April 2008 for a market licence. There were two others around about that time who lodged licence applications but who I understand are no longer actively pursuing them. It has been nearly three years. Is that an appropriate sort of time frame to process that sort of licence?

Mr D'ALOISIO—It does sound like a long time.

Senator CORMANN—It is a long time.

Ms GIBSON—I do not think they had lodged at that time. They indicated that they lodged an indication to generate discussion about whether there should be competition. The process from then has seen a lot of discussion with government about the suitability of competition. At the time the transfer of market supervision to ASIC was announced, the possibility of competition was foreshadowed. I think it was in May last year that we started an active consultation program on what the appropriate rules should be for a competitive market of this type. We finished our formal consultation with external parties in January of this year and we are moving towards those rules. There will be some transition point there, and one of the things that we are consulting on is the amount of time that the markets themselves, both the ASX and Chi-X or others, would need to work out how they work together to run a dual market and how the market participants would come into each of those markets given our rules.

Mr D'ALOISIO—This is a matter that is driven by government policy. The first key thing in relation to the Chi-X entry was whether or not the government, as a matter of principle, would admit additional operators. Once the government made that in-principle decision, the next stage was the transfer of the supervision because of the potential conflict. The third stage is the government's consideration of whether it will grant those licences. A precondition to those licences is that we have market rules. ASIC has moved to develop those market rules. We said to the market that we would move on those rules after the transfer of supervision had been completed. To do otherwise could have endangered the market by having too much change in the market at one time. We have moved quickly to do that consultation over the last few months. That is in the process of being finished. We will advise the market of the outcome of that and we will shortly issue a final timetable for the government, if it is so minded, to then grant the licence.

Senator CORMANN—There seems to be some discrepancy between the time lines that I have been advised of and the way that you have described it. Maybe, on notice, you can review those—

Mr D'ALOISIO—I think we can take you through all the steps.

Senator CORMANN—That would be really good because my understanding was that there was a formal licence application lodged with ASIC in April 2008 and that the government, Minister Bowen, announced in-principle approval of the Chi-X Australia market licence application on 31 March 2010. So that was about a year ago, and you are essentially still in the process of—

Mr D'ALOISIO—It has not stood still in that year. In the year since that in-principle decision, we have been getting the ASX supervision across. That happened on 1 August 2010, and we said at the time that that needed to be a precondition to going into the market with the new rules. As soon as the transfer occurred, at the end of last year we moved on the consultation paper in terms of the rules needed for competition to operate. As I said, that process is now at the final stages, and we will be in a position to issue a timetable. But there still needs to be a final decision from government on those licence applications.

Senator CORMANN—Do you have any responsibilities in the context of regulating the provision of property investment advice?

Mr D'ALOISIO—Are you talking about real estate agents?

Senator CORMANN—No, I am not talking about real estate agents, because I know that they are specifically excluded. But between real estate agents and financial advisers there is a growing category of so-called property investment advisers that seem to sort of fall between the real estate agent and investment

adviser crack. I am just wondering what, if any, responsibilities you have in relation to those people who provide property investment advice but do not fall under the financial services licence provisions?

Ms MORGAN-WICKS—We have seen over the years, with the rise and fall of the stock market, property investment advisers straying into the realm of giving financial product advice. If they are making comparisons to a financial product, like superannuation, we regulate. If they give advice that if you come into the scheme it is going to perform better than the stock market or it is going to be better than a managed fund et cetera, then that is when they do stray into our jurisdiction and we can have a look at them. But if they keep to property advice—so if it is in relation to making statements about the value of real estate—then it really falls outside of our jurisdiction.

Senator CORMANN—I would like to just test that a little bit. A real estate agent is essentially there to facilitate the transaction. Yes, they are there to sell the property on behalf of the person contracting them to sell it and they will sell the virtues of the property. But if they take it a step further and provide advice on how people should structure their financing arrangements to buy property, or on how to go into one property after the other and try to set them up as investments, but they do not compare it to products that you licence as such, they would not be regulated in doing so would they?

Ms MORGAN-WICKS—No. It is difficult sometimes. If they are providing advice similar to setting up a self-managed super fund, for example, at the moment that still sits outside. So it depends on the structure that they are advising on or that they recommend you purchase the property through. But property and residential investment property has come into our new consumer credit regime. So we would look at advice where they are recommending certain credit products, for example, to purchase a residential investment property.

Senator CORMANN—There is potentially a lot of money at stake when people take bad advice from people who have a conflict of interest in flogging certain real estate propositions. People are losing a bit of money. But you operate within the regulatory regime that is there, so I cannot take it any further.

Mr D'ALOISIO—It needs, I think, a bit of context. There are property investments in managed investment schemes. There are all sorts of property investments. ASIC does regulate those. So it is not like property is outside the advisory or the regulatory framework that ASIC runs. But there will be situations where, as you say, quite specific advice in relation to a real estate property may well fall outside the sort of structures we have.

Senator Sherry—Senator Cormann, I think you are referring to what are typically known as property spruikers. You could have a person who writes a book—and they do; there are a number of very prominent authors—on the virtues of this. Would you require them to be licensed because they have written a book on property spruiking, so to speak? It is a difficult area.

Senator CORMANN—I probably would not, no. I hear what you are saying, Minister, but it is different if you have someone who has arrangements with developers and so on and they present themselves as if they are providing independent investment advice related to property. I appreciate that things are structured to other investment vehicles like managed funds and so on. That is a separate issue altogether. But if an individual who has an arrangement with a property developer then presents himself as providing independent property investment advice, I do not think that they are captured anywhere at present. And there are people who, from time to time, deal with a lot of money in that—

Mr D'ALOISIO—There are the odd syndicates. You get your mates into a group—

Senator CORMANN—Yes, that too.

Mr D'ALOISIO—you buy a property, you develop it and you sell it off. They would generally be outside.

Senator CORMANN—Thank you, Chair. I might come back to that back later, but I am happy for now.

Senator CAMERON—Good morning. Have you seen the *Australian Financial Review* article of Tuesday 15 February headlined 'Directors focused on risk not growth'?

Mr D'ALOISIO—I think I recall the headline.

Senator CAMERON—The headline grabbed my attention because I thought, 'What are directors focusing on risk for?' But it was not about risk to increase wealth; it was about director's risk. Some of the views expressed in the article were quite concerning. Firstly they say that:

Many directors of top companies believe that growing investor class actions, greater regulatory scrutiny and the failure of government to cut red tape have forced boards to become too focused on risk, at the expense of growth.

Do you believe that is a fair proposition, given that we have just come through a global financial crisis where there needs to be some regulation and checks and balances in the operation of boards?

Mr D'ALOISIO—We just completed the ASIC summer school. The first session of the summer school sought to get a discussion around the issue of corporate governance, the responsibility of directors and whether the law is moving too far or not. Certainly we can make that material available. Issues about where the line lies between imposing responsibility on directors and at the same time wanting them to take risks and make decisions to grow the company are beyond ASIC. That is really a policy issue for government. Where you draw the line between the responsibility of directors and whether they are becoming too risk averse, if you like, and not engaging in activities that they otherwise should be engaging in for the benefit of the economy is really a policy issue for government. It is a big issue, but it is a policy issue and not an ASIC issue.

Senator CAMERON—The other issue here is raised by what is described as the ‘chairman of retail giant Pacific Brands, James Mackenzie’. This is the same Pacific Brands that accepted a range of government grants to buy machinery, which then ripped that machinery out and sent it overseas, sacked Australian workers and then gave their chief executive a massive pay increase. I am not quite sure that we can be lectured by people like Mr Mackenzie. Talking about the American system of AGMs, he says:

“What I like about the American AGM system is that you don’t get 250 people stacked in a room for probably not the right objectives—i.e., the free food and cup of tea afterwards, asking silly questions ...

I suppose he was asked some ‘silly questions’ about why he sacked all his Australian workers, why he took government grants and then sent the machinery overseas and why he increased the executive salary. Is there a problem with AGMs that you are aware of in that directors are now saying they do not want to be subject to scrutiny? And what is the difference between our system and the American system?

Mr D'ALOISIO—Again, there are a lot of major policy issues in that. In our system we have very active institutional shareholders when it comes to voting and attending AGMs—whether or not they use proxy advisers. We have very active shareholder associations and retail investor groups. We have very active retail investors. We have very active litigation funders who will also work with shareholders to take action where they feel that they have had their rights affected. So the system that we administer, from ASIC’s point of view, is working reasonably well. There has been discussion as to whether AGMs can be more effective. I think a lot of chairmen, to their credit, are trying to see how they can actually make the AGMs more effective, in the sense of getting difficult questions raised, not just more minor questions raised. We think that that is a good development. Some of the chairmen of AGMs have trialled getting questions in advance of the AGM so that they can answer them for the benefit of the broader shareholders at the AGM, or answer them through blogs and so on that are then made available to everyone. ASIC clearly monitors all of that, but we are not seeing a major regulatory issue here. One of the panels at the summer school had non-executive directors on it, and the feedback we got was that they feel they are being scrutinised by shareholders and that they welcome the sorts of questions shareholders throw up at them. So that comment does not make a lot of sense to me, given what I have said.

Senator CAMERON—A nonsensical comment?

Mr D'ALOISIO—They are not my words.

Senator CAMERON—If you say it does not make a lot of sense then I am saying that you are saying that it is nonsensical. That is okay. I have been concerned about AGMs for some time, and there has been consistent reporting about problems in elections at AGMs—no rules; no regulations. For other bodies within the country, such as the trade union movement, the AEC is involved in elections. If there is a continued concern from shareholders about the operation of elections at AGMs, isn’t there a role for the Australian Electoral Commission or a more regulatory role for yourself in elections at AGMs? You hear about these things when they happen but then they disappear. There is obviously a problem there.

Ms GIBSON—We did a small internal project looking at vote counting and how it works, and we are continuing a dialogue with the market, particularly the four share registry houses that do the voting. At present, the rules of conduct for meetings and for counting votes and so on are established by common law and by the boards. There is room for some more dialogue about how the counting goes. As to whether you appoint an independent scrutineer—sometimes that is the accounting firm—or whether you go to the AEC or others would be a matter of policy, I think. I have not heard that the system is so broken at this stage. We get very few complaints, and we have acted on them where the voting has needed revisiting.

Senator CAMERON—Ms Gibson, you say ‘the system’. There is no system; there are different systems, aren’t there?

Ms GIBSON—The system is established by practice, I suppose. Ultimately, the general law sets the manner of conduct and so on. There are many textbooks on how meetings have to be run in accordance with the law, and there are cases where shareholders have gone to court to contest the voting and the manner of counting. So there are definitely rules. The question is just around the efficacy and the degree of checking. With the new rules coming up on executive remuneration, their approval and the consequences of what might follow from their approval or otherwise, there is room for more discussions with industry about the level of scrutiny of the quality of votes.

Senator CAMERON—But it does not only go to scrutiny; it goes to the process as well as to scrutiny. You could be a shareholder of two or three different companies, you could be participating in votes at AGMs and you could have different systems at different companies, couldn’t you?

Ms GIBSON—The mechanics of the voting could be different; the general rules would be the same.

Senator CAMERON—So tell me how the mechanics would be different.

Ms Gibson—Well, it would depend on how the computer interface works in the calculation of various registers. That is what I suspect would be the major difference.

Senator CAMERON—Can you explain that to me?

Ms Gibson—Most votes would be compiled by brokerage houses. They would collate the proxy forms as they came in. They would compile them and prepare a report. It would be in their back offices as to how they receive the proxies, parcel them up and the manner of reporting through.

Senator CAMERON—What checks and balances are there against fraud at the brokerage houses?

Ms Gibson—I cannot answer that, I am afraid, Senator.

Senator CAMERON—Do you think that you should be able to answer that?

Mr D’Aloisio—Well, the companies themselves and the chairman—

Senator CAMERON—So is it self-regulation?

Mr D’Aloisio—You would appoint them to carry out the scrutiny and count the votes—and count them properly. You appoint them to perform. So the company itself would want to make sure that there has not been any vote rigging or pushing of votes. The fact that we are not aware of it being a problem, in the sense of complaints and issues to us, would indicate that, by and large, it works very well.

Senator CAMERON—What if there is a vested interest? What if there is a corrupt company director involved in establishing the process and there is corruption in the brokerage house? Is that beyond the realms of possibility?

Mr D’Aloisio—Well, it is possible, but the reality is that shareholders know. Institutional shareholders talk to each other, they put their proxies in, other shareholders vote and there is a show of hands at the meeting. I think they would be alerted to it pretty quickly if there had been any rigging. Where there are people who might have a conflict of interest, those conflicts of interest need to be disclosed. I think we could look at it further, but certainly it is not on our radar as a major problem.

Senator CAMERON—I hope that I am putting it on your radar—

Mr D’Aloisio—I am happy to put it on.

Senator CAMERON—because I intend to continue asking questions about this. You say that you are having a look at this issue within your organisation. Can you come back to me and let me know exactly what you are doing and whether you are prepared to have a look at some different processors where shareholders can be sure that there is some consistency in terms of the process, and there are some checks and balances in terms of ensuring that the votes are fair and above board?

Ms Gibson—We can do that.

Senator BUSHBY—I thank you the officers of ASIC for helping us today. Firstly, I commend you for placing the matter of ASIC’s use of coercive powers on your summer school agenda last Monday. It is good that these issues are getting a public hearing. I am not sure, but I suspect that to some extent the questions that have been asked by this committee over the past 12 months or so may have contributed in some way to the greater degree of focus that ASIC is giving to that. I see you nodding.

Mr D'Aloisio—We were onto it just before you raised it, but you certainly brought it to our attention!

Senator BUSHBY—Okay, thank you. How did the session go? I am interested in how many attended that session, what substantive points were raised and how it was received by those who attended.

Ms Gibson—I chaired that session. We had three that afternoon and the rooms were roughly split, so I think there would have been about 150. It was a full room. Frankly, I was a little surprised when everyone filmed it and said that it was a terrific and very interesting session.

Senator BUSHBY—Quite clearly of great interest to Australians!

Ms Gibson—Indeed. It was by and large the litigators. Richard Gilbert from the Rule of Law Institute and Steve Helmich from AMP presented their views on coercive powers. We are still going through our internal review that we mentioned the last time we were here. I reported that our study showed that we are substantially compliant with all of the ARC requirements but that there is probably room for more training on a day-to-day basis.

Industry feedback for some notices is that they would like us to ring up in advance and talk about them before they arrive. But they are very happy when they find that, if it is too wide or too short a time, we will then cut it down. So there is room for more dialogue. With our surveillance notices—which are the ones that we might send to industry looking for a review of industry practices—industry would prefer that we did not serve a notice before we did that. To the extent that they can provide that voluntarily, we will look to do so. They would also like some reports about the outcomes when we do industry surveillance. We will look at how we can do that whilst maintaining confidentiality. So it was a positive discussion. There was a lot of expression of interest in working with us, and for them to get some more value from the notice process, which they all accept is a necessary duty that they have to comply with as part of our industry.

Senator COONAN—Is Richard happy now?

Ms Gibson—He said that he was. He said that he was very happy!

Senator BUSHBY—So overall that particular summer school session has assisted you in a sort of intense focused way as part of the development processes of what you are doing?

Ms Gibson—Indeed.

Senator BUSHBY—Are you intending to go further? You are still developing and examining your processes and looking at how you do that. Are you putting in place specific procedures for things like data capture and release? Will you be putting together a policy procedure manual on the use of coercive powers? What are the possibilities going forward?

Ms Gibson—Our rules on how we use the powers and so on are in place and working well. That was our review.

Senator BUSHBY—They are in place, but you mentioned that there is a need for further training. Are you looking at how you can better enable the employees at ASIC to understand what those rules are and ensure that they are on top of them, comply with them and use them in the way that they are supposed to?

Ms Gibson—We all benefit from a refresher from time to time, and in fact there are training programs always happening on notice issues.

Senator BUSHBY—Is there a policy or procedures manual in respect of this?

Ms Gibson—These issues are built into our internal manuals. What we are looking at is what we can say more publicly about how and when we use that. That was certainly one of the requests of the—

Senator BUSHBY—Which is one of the reasons I have raised it before in terms of public confidence in the use of your powers, which I acknowledge are necessary. But public confidence is also necessary for you to be able use them properly.

Ms Gibson—That is right. We are looking at what we can helpfully say, given the width of our powers. We are looking at what other regulatory bodies do in Australia and overseas and we are also looking at the question of continuing to report in annual reports or somewhere, as we did last time about historical usage. It is a data collection issue for us because it is manual data collection. There is not a central issuer of notices. We are now in train to collect that data.

Senator BUSHBY—As I mentioned, I am pleased to see that it is moving forward and I will no doubt take a greater interest in future to see how that develops. While we are still on the summer school, I note in the

Australian Financial Review today there is reference to Shane Tregillis making some comments at the summer school about a number of changes to ASIC, particularly with the real time surveillance body. He says that that is a fundamental change and that rather than being the cop that comes in after the accident, ASIC's new role as market supervisor meant it had to intervene immediately. He is talking about repositioning ASIC in a 'post global financial crisis world'. What does that mean? What is Mr Tregillis talking about?

Mr D'Aloisio—That comment has been given more prominence than was intended. What the question related to was that, in the normal course of its work, ASIC has to be proactive but we also have to come in when collapses occur to examine and, if you like, to be the policeman to look at what has happened and so on. Our powers have traditionally been that way. Shane was pointing out that with the ASX supervisory regime that has now come across, we have moved a further step in real-time surveillance and enforcement in the markets. That is something new and different for ASIC—

Senator BUSHBY—Different for ASIC but not necessarily for oversight.

Mr D'Aloisio—but that is not a reconfiguration of the whole role of ASIC. That is simply saying that not only are we doing the traditional surveillance and compliance work—the enforcement work where we go in as the policeman et cetera—but also we now have more real-time surveillance work in the markets area.

Senator BUSHBY—Which is something that the ASX would have done.

Mr D'Aloisio—It is what the ASX would have done. This requires us to ensure that we are properly skilled to be able to do that, as well as these other things. That was the context of the comment.

Senator BUSHBY—So the editorial comment, effectively, by Mr Durkin, who wrote the article, that Mr Tregillis had broken ranks with you to argue that the regulator should take a more broad proactive approach is not really accurate?

Mr D'Aloisio—Every commissioner can take a different view to mine, Senator.

Senator BUSHBY—So he is not breaking ranks with you on the direction that ASIC is heading?

Mr D'Aloisio—No, not at all.

Senator BUSHBY—I want to ask a few follow-up questions to the questions that were taken on notice. One of them was to do with exit fees, which my colleague Senator Cormann has already touched on in terms of the broader powers. I had asked whether ASIC had used any of the new powers that you have been provided with under the national credit code. You went through and outlined what you had done with exit fees, that you had put out regulatory guide 220, and what that approach was and so forth. What types of fees under that regulatory guide do you consider are reasonable?

Mr D'Aloisio—What we have done in the guide itself is to give the principles and some examples. I do not have the guide with me. Essentially we are saying that only losses caused by early termination can be recovered, that fees cannot be a source of profit and cannot be used to pay for general marketing or product development costs and cannot be used to punish borrowers who want to shift. We say that fees cannot result in double-dipping. So costs that are recovered through establishment fees cannot be recovered again through early termination fees. We give that sort of guidance when you look at each situation. So for us this guide is very much about saying to the industry: 'Look, this is a change in the law; this is a serious issue. You have to look at your processes'. Basically exit fees and termination fees are going to be unfair unless they meet the guidelines that I have just mentioned. Last month we commenced an industry review of early exit fees. We are writing to 20 major lenders, and we are going to assess over the coming months just how they have changed and how they are now complying with the changes. At the same time, we are working with industry, because it is a new area, to ensure that there is compliance with the new laws. Clearly, we follow up complaints that we receive. We have not received a lot as yet but we will follow them up as they come.

Senator BUSHBY—So you have not received many complaints?

Mr D'Aloisio—No. My notes say that we have not received many complaints. I do not have an exact number.

Senator BUSHBY—Would you mind taking on notice how many complaints you have received?

Mr D'Aloisio—Yes, I will.

Senator BUSHBY—You say that you are looking at the top 20 major lenders—

Mr D'Aloisio—We are just saying 20 major lenders.

Senator BUSHBY—Twenty majors, sorry.

Mr D'Aloisio—They will be both ADIs and non-ADIs. We are going to do a representative sample. It is really taking a snapshot. We have picked 20—ADIs and non-ADIs, large and medium—to look at what is happening. Of course, as you know, the industry itself has responded. Some banks have abolished exit fees and some banks have said they will pay your exit fee if you come across. We will look at that behaviour as well, in terms of how it is working and whether it is working positively. We have also put on our FIDO website a calculator for mortgage exit fees so that the borrower, the consumer, can actually plug in the relevant issues and find out when they are going to be in front by switching. So they plug in not only the switching fee but also the interest rate and the other terms. They can then work out a crossover point. Sometimes it is quite easy when you have a low exit fee or they will pay your exit fee, but not if the interest rate is much higher. What we have developed is a simple calculator to enable borrowers to do that.

Senator BUSHBY—So it enables people, if they see what looks like a better deal, to work out whether it really is?

Mr D'Aloisio—Yes. Basically, is it really a good deal when you plug in all the issues for your personal situation? That is up and running. We put that up at the same time that we released the regulatory guide because there is some complexity in the area in terms of how switching fees work, what they are and so on.

Senator BUSHBY—Absolutely, it is not a simple area. As your regulatory guide 220 demonstrate, there are some costs that are incurred by the financial institutions which are justified and are built into these things and some which quite clearly are not—in fact, quite a lot. The powers that have been given to you and the approach you are taking will hopefully address those that are unreasonable but allow banks to recover legitimate costs that are part of the process.

Mr D'Aloisio—That is our understanding of the current regulatory regime which we have been given to administer.

Senator BUSHBY—I will move on from there.

CHAIR—There are quite a lot of other senators on the list, Senator Bushby, so I might come back to you.

Senator EGGLESTON—A little while ago at a previous hearing we talked about some of the legal cases that you are pursuing—if you recall, as I am sure you do. I note that you now have won your appeal on the FMG case. But one of the issues that was raised at that time was the costs of these legal cases to ASIC and whether or not you were adequately funded for these cases. I see that you now say that you have won 41 cases. I wonder if you can comment on the financing of these cases and whether or not you feel happy with the adequacy of your funding for them.

Mr D'Aloisio—As I think I said on the last occasion, I can always use more money! Coming more seriously to the point, we fund enforcement through our general revenue allocation. Roughly 35 to 40 per cent of our budget—I can get those numbers confirmed—goes into enforcement and deterrent enforcement activity. We also have what is known as the enforcement special account, which is a fund of \$30 million a year that we can draw on once the cost of a matter gets beyond \$1.5 million. It comes out of general revenue and then we can access that fund. If the case gets to \$20 million then we have to notify the Prime Minister. They are the controls within which we operate. It has worked well over the years; it continues to work well. Clearly there are always unforeseen issues that arise in litigation. There was, from example, the substantial loss in One.Tel and what we need to pay out. We won Fortescue and James Hardie, but James Hardie was reversed on appeal. So the cost issue is a moving target that we need to manage. We are in constant discussion with Treasury about our funding and certainly are at the moment for the next round. We review it and if we feel that we need additional funds we raise it with government. Over the years that I have been chairman, the government has responded to ASIC's request for funding, whether it is for new activities and so on. So I have every reason to believe they will continue to do so.

Senator EGGLESTON—And you are comfortable with outcomes at the moment, quite obviously?

Mr D'Aloisio—Sorry to digress for a moment, but I will be quick, Chair. The summer school was actually ASIC's 20th anniversary and it was one of those situations where you could do a bit of reminiscing over the years and see what ASIC has contributed to the community. We really drew a sharp contrast between where Australia was in the late eighties with the collapses and so on—where we had a very embryonic NCSC—and where we are today with the financial crisis and the response of our regulators. One of the things that clearly came through about ASIC when you look over those 20 years is that while we get a lot of criticism in relation to some of the high profile cases that we lose, when you look at the underlying statistics of major matters,

ASIC in the criminal area on major matters has a success rate in excess of 60 per cent. In civil matters it has a success rate in excess of 80 per cent, and overall in litigation it has a success rate in excess of 80 per cent. It is not about winning and losing, as I keep saying; it is about spending public money properly to make a point to lift standards. Overall we do that and I think the community should be pleased with the results that we are getting, particularly as you look at those cases in a historical situation. Cumulatively, over that period there is no doubt that the deterrence activity and other activities of ASIC has contributed to the lifting of standards of corporate governance, lifting standards around how schemes are offered and lifting standards of what is offered to retail investors. So I think there is a reasonably good story there.

Senator EGGLESTON—Are the documents that you referred to in your summer school publicly available or on the net?

Mr D'Aloisio—Yes. The opening in terms of where we did this sort of history is on our website. We put that up at the same time as we delivered it because we felt that it would have a broader public interest in terms of what ASIC has contributed. I was not just talking about this commission; I am really talking about going right back to Tony Hartnell's era in kicking it off, Alan Cameron and so on. We looked through what had occurred over the last 20 years.

Senator EGGLESTON—There is one other issue that I would like to raise with you—the transfer of the supervision of the Australian Stock Exchange to ASIC, in terms of the implications if the Singapore takeover of the Australian Stock Exchange were to occur. What kind of regulatory issues do you see in that matter?

Mr D'Aloisio—Again, the ownership issue and acquisition are government matters. But the Australian market is being programmed to have competition at the trading level between ASX and other operators that come in. There is potential for competition at the clearing level, there is potential for competition in the data collection and dissemination area. Really, from our point of view, our rules will apply across markets irrespective of who comes into the market and who owns whom, if you like. Ownership is separate from the regulatory framework. Our emphasis is on having a regulatory framework that really promotes and supports confidence in the integrity of our markets. So we need to make sure that, if you trade on our markets, whether you are trading on securities that are listed here or listed elsewhere, you are properly regulated and so on. So the ownership issue is not about licensing and so on; we have a lot of international players in our markets and we license those. From a regulator's point of view, from ASIC's mandate, the ownership issue is separate from the regulatory issues.

Senator EGGLESTON—Thank you very much. Singapore's regulations: do you wish to make any comment on the regime there, just in brief? I know that time is moving on.

Mr D'Aloisio—Senator, I have enough trouble with ours.

Senator EGGLESTON—Is it a different—

Mr D'Aloisio—In broad terms—

Senator EGGLESTON—Is it fundamentally a different system?

Mr D'Aloisio—One of our commissioners, Shane Tregillis, has worked for the MAS for a number of years. His view is that there are a lot of comparable things between the two systems, and Singapore has borrowed a few things from Australia. I think we can get you a separate opinion on that, if you need it. That is just a broad view.

Senator EGGLESTON—I would appreciate that, if you could, and thank you for those answers.

CHAIR—Senator Williams.

Senator WILLIAMS—Thank you, Chair. Thank you, ASIC representatives, for your attendance. Mr D'Aloisio, I want to take you to the issue I have raised with you before about the naming of some of the smaller companies. I have been involved in the Senate committee's banking inquiry. I can understand where you come from—and Senator Sherry highlighted this once before—about these debenture issuing companies and commercial investments. You brought the axe down on them—perhaps that is a bit severe—or you took steps to see that people did not lose money in those directions. I want to take you back again to those secured lending investment companies.

A letter from a Mr John Price sent to the Probe Group just recently said that there is expected to be a decision in the next three to four weeks. He says in the letter: 'We would consult publicly before making modifications to our regulatory policy.' My first question is: is this to change a name? You know the companies that I refer to. They have LVRs of 40 or perhaps 45, conservative lending, real security—land,

houses, farms et cetera. Is it solely ASIC's decision to make this decision as to whether you make a change or does it require legislation?

Ms Gibson—I think there are some provisions in the legislation which seem to draw a distinction between just debentures and unsecured notes. So you need to vary that and, yes, it is an amendment, which we could do either by class order, regulation or statutory—

Senator WILLIAMS—I am referring to a secured note.

Ms Gibson—Yes, indeed. We are looking to consult, and I expect this to be ready by the end of the month, on whether, where the security is not, in fact, on land—with a security on land it can be called either a mortgage debenture or a debenture, depending on certain rules—but on something other than tangible property, which is by and large debts due from others, receivables, where the security is a first security, whether you could say that those are either secured notes or just notes. The concern is whether people investing in these products actually think they are investing in a bank deposit and that it has the benefits of a bank deposit which go with that.

We are looking to go to industry, and that would include banks and so forth, it would include the participants in this industry and it would include consumers and those who perhaps represent people who feel that they have lost out, about the question of naming and about the advertising question. We are looking to pull back from the current regulatory guide, which we consulted on at the time, which guides—it does not say that you have to, but it does suggest that the advertising that says, 'You may not get your money back', should be something that is more tied to a comparison to banks.

Senator WILLIAMS—They advertise, under the current system, 'If you invest with us, you may lose some or all of your money,' which is not a very good thing to put on the back of an advert when you run a TV ad, a radio ad or even put it in a newspaper. I can understand that that is for risk investments. But, as I have said, these are secured companies with conservative, secured lending. That is why I think they should be called as issuing secured notes instead of being unsecured, compared to some of the other less responsible lenders, I could say, in the past.

Ms Gibson—We are also looking at doing this in the context of some benchmarks about quality of security.

Senator WILLIAMS—Can ASIC just make that change and bring in a sector of secured investment companies or issuing secured notes? You can do that without legislation; is that correct?

Ms Gibson—We do not need legislation but it needs a class order; it is an action. So we need to consult and get an industry view on that, and we look to do that.

Senator WILLIAMS—An industry view: obviously you would talk to the banks and so on, would you?

Ms Gibson—This will be a public paper and anyone can come in and give us their—

Senator WILLIAMS—If it is a public paper, that is fine. I would be concerned if the big end of town came in and put up some argument where the little players could not have a decent advertising scheme—because I think it is very difficult at the moment.

Ms Gibson—I think we could spot that sort of vested interest.

Senator WILLIAMS—Yes, exactly. Just on another issue and a different topic: correct me if I am wrong, but I think section 420A of the Corporations Act basically says, for example, that when a bank sells someone up, they must sell their asset at or around market value. Mr Dwyer, is that the basis of that section of the act?

Mr Dwyer—Yes, 420A requires reasonable efforts to be undertaken by an external administrator to achieve market value.

Senator WILLIAMS—Does that also apply to people who are in the insolvency practitioners industry, like liquidators and receivers? Do they have to abide by that?

Mr Dwyer—I think 420A relates to liquidators.

Senator WILLIAMS—So if a business falls over, whether it be the bank, a liquidator or a receiver selling them up, that law does apply to all of those sectors? You must make all efforts to sell at or around market value; you just do not flog it off to your mates at half price or something?

Mr Dwyer—I think it is liquidators under 420A, but there obviously is case law around other areas, like receivers or administrators, that require them to achieve market value.

Senator WILLIAMS—Thank you for that issue about those smaller secured companies. It is something that has been raised in the banking inquiry and I know it drew a fair bit of attention. I personally want to see balance in competition in the finance industry. If you have the big players here and the little players here trying to compete, the little players have that bit on the advert and I do not think it is true for those secured companies. I think it is very unfair and, as I say, life is about fairness. Thank you, Chair.

Senator COONAN—I just have a couple of questions and then I will allow my colleagues to continue. I want to come back to the issue of progress of stock market competition. In particular, I am interested in how you are going with looking at what integrity rules you might put around electronic trading, algo trading and dark pools. Can someone at the table fill me in on where that is up to? As part of the consultation process, I know you have stopped short of demanding pre-trade transparency, and I am not surprised. Could you give me a bit of a walk-through as to where that is up to?

Ms Gibson—Certainly. Our consultation paper that we issued in November addressed these issues and sought people's commentary. We are still looking to finalise where we should land on these questions, because there is no uniform view in industry about the merit or lack of merit of dark pools. As you know, with dark pools there is no pre-trade transparency but under our laws there must be post-trade transparency—it must go straight through to a market so that you can see it there. There is no question that that would continue. The issue really is: should there be some threshold so that you cannot sell orders below a certain point or should there be some requirements? The concern is that, if so much goes into dark pools, you lose proper price discovery.

To foreshadow a little, the upshot of all the consultation is that there is certainly no uniform view that dark pools are necessarily bad, particularly where the rules are such that they can trade within the central limit order book. We are still working through exactly what rules would be appropriate here and it does require an amount of foreshadowing as to where the market might go with the introduction of competition.

On high-frequency trading, high-frequency trading is a subset or a particular program that goes with algorithmic trading, so the wider question is algorithmic trading. There are a number of concerns there that were particularly raised during the so-called 'flash crash'. The problem there would seem to be the fact that a number of algorithmic programs talked to each other without the benefit of human intervention and the market plunged and came back. We are having a lot of discussion with the exchange, with Chi-X, and with market participants about the right rules. The Americans have gone very much to some very quick circuit-breakers, and we are certainly looking at that. At the moment the ASX has some of those rules and we will look to what it should do in a developed market.

The very big focus that we have had since we took on market supervision is looking at the algorithms. There is a pre-vetting requirement on the brokers themselves and we are testing their testing, as it were, of that. My notes say that in the year to the end of December there were some 10 instances where we rang the brokers and said, 'That program in there looks funny; what are you doing?' That is either because it looks to be disrupting trading improperly or it might be a market manipulation problem, which is obviously an illegality issue. So we are monitoring and the attention on the industry is very much heightened. As for the detailed rules on access, the rest of the world is trying to work that out too. A system which has us checking each program before it goes in does not work.

Senator COONAN—That would not work. I think there was some suggestion, in your paper anyway, that there would be regular reporting. I think it is monthly monitoring—that there would be some sort of regular reporting?

Ms Gibson—I am sorry, I cannot recall—reporting to us?

Senator COONAN—Yes, that is right.

Ms Gibson—I think it would be.

Senator COONAN—To report to ASIC monthly on the nature of the pool, the number of Australian clients, the number of valuable trades executed et cetera.

Ms Gibson—There has been a diverse response. With many things—for instance, on best execution—there was a general consensus on what the rules should be. There is less consensus on this and I think we are still talking actively, trying to find one.

Senator COONAN—By the nature you are dealing with large institutional investors not eager to telegraph their trade, so you start, I suppose, with a fairly reluctant body of traders.

Ms Gibson—I have sat on our Market Supervision Advisory Panel, which talks about this, and there is equally a discussion about good price discovery. They all understand that if it is all in an unlit market price discovery is affected. High frequency traders tend to operate on the lit market because they are trying to look for fractional price changes on those markets. So it may be that with a lot more high-frequency trading, which you would expect with competition, the lit market is bigger and you do not have to worry about the relative volume of the dark markets. That is the nature of the discussion we have to have, but price discovery is fundamental even to the brokers so it is not quite as simple.

Senator COONAN—This is probably a difficult question but I would appreciate it if you would have a go at it. What does ASIC believe would be the impact of electronic trading, if and when it begins operation, on market integrity?

Ms Gibson—There is no reason why you would think market integrity would be any less because of the introduction of another market. When we introduced supervision, we included facilities to be able to supervise both markets. A lot of work needs to be done in an IT sense between all the markets, all the brokers and us to make sure that we have that supervision. I suppose a participant might say that it would be easier to hide it on two markets, but I do not think that would be a valid assumption.

Senator COONAN—What will it do to competition, do you think?

Mr D'Aloisio—Just on the first question of integrity, the whole point of our consultation on the new rules is in fact to ensure, as Belinda is saying, that the integrity of our markets is maintained. We are not alone in the world in having competition for trading services so we obviously have looked at what has happened overseas, particularly in Canada, which is very comparable. We have no reason to believe or to advise government that the integrity of the market would be impacted by having more than one participant in the trading services.

On the issue of competition and what impact competition will have, I think the market would say that at the moment the threat of a new entrant has impacted in terms of pricing in the market. So you would expect that that sort of price impact would occur, and the government has pointed out that that is one of the long-term benefits it sees in introducing competition. It is not in ASIC's realm, but we would have no reason to believe that would not be the case.

Senator COONAN—Did you consider the impact of electronic trading in your report on the potential impact between the ASX and SGX merger?

Mr D'Aloisio—The ASX-SGX merger is a matter for government. We need to come back. Electronic trading is not new; it is there whether ASX operates or not. It is not new in introducing a second operator. It is where the market is moving and it is not all that relevant that you have one, two or three. So electronic trading is with us, high-frequency trading is with us, and all the variations are with us. Deep, dark pools were with us and continue to be with us. This is an evolution and instead of one with all those things, you have two. ASIC's challenge is to bring in rules to regulate the two so that if you go to your broker and Chi-X is operating with ASX and your broker says, 'Which market would you like to trade on? I will direct you to one market or the other. My view is that you should go to this market,' you are given a choice at that point.

Senator COONAN—What is the time frame? I know that Shane Tregillis said 2011, when the framework is ready and the market is ready, or something very general. Minister, are you able to give us a better time frame?

Senator Sherry—No. I cannot give a time frame beyond the issue that I think the chair has indicated that he will give a schematical time line over.

Mr D'Aloisio—To be fair, Minister Shorten is waiting on ASIC's publication of a timetable, which I think I said earlier we will do shortly. We are nearly there to do that and give that to the market shortly. I am sorry; I know that you will push me on 'shortly'. I cannot go further than that at the moment.

Senator COONAN—I used to say it myself. I understand. All right: 'shortly'. Thank you.

Senator CORMANN—Mr D'Aloisio, you have said a number of times now that the ASX-SGX merger issue is a matter for government—and, of course, it is. But you have had some involvement in the process so far, haven't you?

Mr D'Aloisio—The key policy issue here is that the agency is Treasury, advising government. ASIC overall is an agency of Treasury. Certainly if we are asked for input we do that. But with the policy matter, we might advise on issues, but that is advice to government, and it is a matter for Treasury and government on what it wants to do with what we may say and in running this issue. It is not an ASIC policy issue at all.

Senator CORMANN—No. I am not trying to pin you on the policy direction or the ultimate decision by government; I guess I am just trying to get an understanding of your involvement in the process from a process point of view.

Mr D'Aloisio—Our role in a process sense is that we clearly want to look at and draw to government any sorts of regulatory issues that should be considered as part of what it might be considering in a broader view. That is not unusual. That is similar if you go to competition for trading services.

Senator CORMANN—What sorts of regulatory issues are we talking about?

Mr D'Aloisio—Clearly we would have assisted government with the sorts of rules that may be needed if you go to competition. Beyond that, I am not really in a position to go further in relation to ASX-SGX.

Senator CORMANN—There has been some media coverage suggesting that the ASX-SGX merger could result in a loss of Australian regulatory sovereignty over the activities of ASX. Would that be the case, from your point of view?

Mr D'Aloisio—I think that is a matter that should be directed to Treasury rather than to us.

Senator CORMANN—So you do not have a judgment on that?

Mr D'Aloisio—No, I do not.

Senator CORMANN—Interesting. I have a series of other questions. Is it correct that your financial advice stakeholder team does not have a senior manager and has not had one for some time?

Mr Medcraft—The leader of the financial advice stakeholder team is Delia Rickard.

Senator CORMANN—So it does have a senior manager?

Mr Medcraft—She is actually a senior executive leader.

Senator CORMANN—So that is bad market intelligence, is it?

Mr D'Aloisio—The confusion may be that the financial advice area—I think they were put together.

Mr Medcraft—What we did was to put together two areas. The actual team was called 'consumer advisers and retail investors'. We effectively merged it to create one team under Delia Rickard, basically because we saw a lot of synergies between consumer advice and retail investor literature.

Senator CORMANN—Is the effect of what you have done that the financial advice stakeholder team has essentially been downsized in recent years?

Mr Medcraft—In all of our groups, we have people leave. I cannot tell you what the numbers are currently. It is a merged team. In fact, what is interesting in that team is that many of the people who were in the consumer and financial literacy team are actually now starting to get involved in surveillance of financial advisers, and vice versa.

Senator CORMANN—Because I want to give Senator Bushby some time, I will quickly ask you, perhaps on notice, to give us some advice on what actually happened. You have said you have merged those two sections. How many staff were in those two sections before? What did they do before? How many staff are now in the merged section and what are they doing? I am just trying to get a sense of to what extent financial advice reform remains a priority in the context of what the government is doing.

Mr Medcraft—All I can say is that we will come back to you with that information. I think it is a very important priority, particularly with the initiatives announced.

Senator CORMANN—The suggestion on the street is that the whole focus has lessened somewhat. So I am giving you the opportunity to prove them wrong.

Mr Medcraft—Sure. We will come back to you.

Mr D'Aloisio—We will do that.

Senator SHERRY—We will take it on notice.

Senator BUSHBY—I want to go through some answers to questions on notice that you provided. Just looking at one question, SBT 65, about the enforcement special account, you listed the amount paid out of the ESA over the last four years. It will go from \$16 million to \$23 million to \$23 million to \$57 million in the 2009-10 year. That is a big jump. Obviously there is a lot of activity in terms of how much you are spending on enforcement. Also, you noted that you had \$17.7 million in the ESA as at 31 October. Can you give me an update on where it currently stands and maybe a short explanation of why it has gone up so much?

Mr D'Aloisio—There are a couple of things. Certainly, there are major matters and where they have reached court some of them have gone up. There is also in that \$57 million the \$13½ million we paid in costs in OneTel. So the increase is relevant to activity, relevant to GFC, relevant to the collapses—major matters. As at the end of January or the end of December or January, it would probably have been standing at about \$20 million, I think, in terms of—

Senator BUSHBY—How much have you expended?

Mr D'Aloisio—what we will have spent in this year's allocation.

Senator BUSHBY—What is the balance?

Mr D'Aloisio—The balance gets to 30 each year; that is the balance.

Senator BUSHBY—So that is the balance of what you would expend.

Mr D'Aloisio—And, clearly, you look at that as you run your matters. As for the reason that it jumped to \$57 million, it is \$30 million a year but you can bring forward what you do not spend in one year to the next.

Senator BUSHBY—Do you need to pool the whole amount that you have not spent?

Mr D'Aloisio—You can bring that forward. If you average that out, you are not exceeding the \$30 million.

Senator BUSHBY—Has it been \$30 million every year from 2006-07?

Mr D'Aloisio—My understanding is yes. Since I have been chairman, it has been \$30 million.

Senator BUSHBY—So, effectively, \$120 million has gone into the ESA over that four-year period—\$150 million including this year—and you are down to about \$10 million left out of that.

Mr D'Aloisio—Yes.

Senator BUSHBY—If you can give me the updated figures, it would be appreciated.

Mr D'Aloisio—Sure.

Senator BUSHBY—Also, in SBT 151, I asked questions about the hospitality spend. You indicated that you were not able to provide a break-up of your hospitality spend. When I ask other agencies, they are able to provide that, and I would like to request that you look at your record keeping to see whether it is possible to do that in future.

Mr D'Aloisio—Is there an agency that we can follow—

Senator BUSHBY—I have copies of it and—

Mr D'Aloisio—I am all for transparency, so it is not an issue in giving you the—

Senator BUSHBY—We ask others and they can tell us how much they have spent—for example, how much a Takeovers Panel dinner cost. Those are the sorts of things we would get from others. It would be very useful for transparency. Similarly, at SBT 146, I asked about consultancies. Your answer referred me to the AusTender website. Other agencies actually give me the list. I went to the tenders website and had a look, and it is a quite complicated procedure to work out the answers that I want, which I imagine you probably have at your—

Mr D'Aloisio—I apologise. We will get you that information.

Senator BUSHBY—Thank you. I have some questions on staffing levels. In SBT 144, in response to my question, 'Have any voluntary or involuntary redundancies been offered to staff; if so, how have staff been identified for such offers; are there such plans for the future?' you say there have been voluntary and involuntary redundancies offered to staff. Then, in SBT 162, when I was asking about the efficiencies, you say that there were no voluntary or involuntary redundancies offered to staff in order to meet the 2010 MYEFO—which is more specific, I would note. How do those two answers sit with each other?

Mr D'Aloisio—Can I take that on board and give you an explanation? I am sorry if there is confusion.

Senator BUSHBY—Thank you. With respect to government payments of accounts, in answer to question on notice SBT 156, you say 91 per cent of all invoices were paid within 30 days. Most of the ones that were not were due to the receipt of incorrect invoices or differences in respect of amounts charged. The use of the word 'most' just struck me. With the ones that are not, what is the cause of delays?

Mr D'Aloisio—It could be disputes, but I will get you more detail.

Senator BUSHBY—Okay. In SBT 191, which talks about the challenges to the use of ASIC's compulsory powers, you noted that, since 1 July 2007, ASIC's use of compulsory powers has been challenged in court seven times and you also noted that in two instances ASIC's use of powers was found to be invalid. What were those circumstances?

Ms Gibson—I cannot remember exactly. We will need to come back to you.

Senator BUSHBY—If you could, please. You also go on to note that some of these challenges are tactical actions by people or entities who are subject to investigation and they are trying to delay or do whatever. You refer to those seven court challenges and notices included actions by Firepower, two instances, and AWB, two instances. Of those four out of seven, were any of those four the two where your use was found to be invalid? If that is the case, it does not sound like they are tactical.

Mr D'Aloisio—No, I understand.

CHAIR—That brings us to the end of the ASIC section. Thank you to ASIC for coming in again.

Proceedings suspended from 10.30 am to 10.48 am

CHAIR—The committee will recommence its consideration of the Treasury portfolio with the Revenue Group of the department and the Australian Taxation Office. I note that it has set Friday, 8 April as the date for the return of answers to questions on notice. At this time, the committee would like to note the exceptional public service of Dr Ken Henry throughout his tenure as Treasury secretary. We think this is his 22nd appearance at estimates as secretary, and we thank Dr Henry for his assistance at estimates and at other inquiries over the past decade. We wish you all the best for the future and whatever undertaking you go on to after this phase of your life.

Dr Henry—Thank you.

CHAIR—The deputy chair might wish to say a few words as well.

Senator EGGLESTON—Yes, thank you, Chair. Dr Henry, on behalf of the coalition, we thank you for your long and distinguished service to the federal government under both jurisdictions. I believe that you are the architect of the GST, which was certainly a very significant tax reform for this country, and you have made many major contributions over the years. So we thank you for that and wish you all the best in the future.

Dr Henry—Thank you. I appreciate those words greatly.

CHAIR—Minister, do you have an opening statement?

Senator Sherry—Only to endorse the remarks made by the chair and the deputy chair about Dr Henry's great public policy contribution. I would also note, of course, the stimulus package, which was a major contributor in itself in ensuring that Australia did not have a recession, unlike most other advanced economies. I will just put that on the public record as well. It has been a pleasure to have worked with Dr Henry.

Dr Henry—Thank you.

CHAIR—Dr Henry, do you have an opening statement?

Dr Henry—What can I say after what has been said thus far, other than to welcome very much those very generous remarks. I was not aware that I had appeared 22 times before this committee as secretary. I guess, given that degree of familiarity, there is a chance that I might miss some of this—there is a chance. Thank you very much.

CHAIR—Thank you. Mr D'Ascenzo, do you have any opening remarks?

Mr D'Ascenzo—I have had the pleasure of working with Dr Henry in his capacity over many years, both in the Public Service and when he was adviser to the former Treasurer. During all of that time, I found him to be a person of high integrity who thought deeply about policy, and policy that would be beneficial to the future wellbeing of Australia. It has been a pleasure and an honour to work with him.

CHAIR—Thank you. Senator Cormann.

Senator CORMANN—Thank you, Madam Chair. With your indulgence, may I also associate myself with the comments made by you and the deputy chair. I am sure, Dr Henry, that you will miss us in the months ahead. Just to make sure that your experience is as enjoyable as possible today, we will give it our best! Perhaps I could start by asking you where we are at with the government's promise to the Independents to hold a tax summit by 30 June 2011.

Dr Henry—It is my understanding that details of the tax summit have yet to be finalised. I think the Prime Minister has indicated that the summit is likely to be in the second half of this year. But, beyond that, I am not aware of details having been provided publicly of the summit and, as I say, it is my understanding that those details are still under consideration.

Senator CORMANN—You can confirm that it will not be happening by 30 June, by the sound of it.

Dr Henry—I cannot confirm it, because I have been told that the Prime Minister made a remark to the effect that it would be in the second half of this year. I did not myself see the Prime Minister make that remark but it has been reported to me. I would not want to confirm for the committee that the summit will not occur before 30 June because, until details are finalised, there is obviously some uncertainty about the precise date.

Senator CORMANN—It has been reported to me that the Treasurer, in fact, made some comments to some business people in Melbourne to the effect that it was most definitely not going to happen by 30 June, although I have not seen that reported, that it may happen by the end of this year but it could well be as late as next year. Is that a line of discussion that you are aware of?

Dr Henry—I was not aware of that.

Senator Sherry—That is hearsay. I will take on notice, though, the question about the dates or date.

Senator CORMANN—But is it fair to say that Treasury will be the lead agency in organising the logistics for the tax summit?

Dr Henry—I would expect that Treasury would be expected to take leadership of logistical matters.

Senator CORMANN—That has not been decided yet?

Dr Henry—As I said, the details are yet to be finalised.

Senator CORMANN—Including which agency is the lead agency?

Dr Henry—Yes. The decisions have not been taken. As I say, it would be my expectation that Treasury would take charge of logistical arrangements. Indeed, it is the Treasury that is providing advice to government on those logistical arrangements, so that would seem to make sense. But those matters have yet to be finalised by government.

Senator CORMANN—Has somebody within Treasury been given specific responsibility for tax summit preparations?

Dr Henry—Indeed. We have somebody in the department who has been thinking about these matters. He has devoted quite a lot of his time to thinking about these matters.

Senator CORMANN—Is that their sole focus or do they have other responsibilities as well?

Dr Henry—I am not aware myself. I am not that close to it myself to be able to tell you whether that particular officer has other responsibilities.

Senator CORMANN—Is there a tax summit team or is it just one person at the moment?

Dr Henry—I would have to take that question on notice.

Senator CORMANN—Is it fair to say that so far we do not have a date, a venue, an agenda or terms of reference? We have to wait and see?

Dr Henry—That is my understanding, yes.

Senator CORMANN—In relation to the mining tax, I have an initial question in the context of the FOI release which was reported on two occasions now in the *Financial Review*. You would be aware, of course, that through two Senate committees and various questions and orders of the Senate, the Senate has sought access to specific information in relation to the mining tax. I refer specifically to the breakdown in revenue estimates under the MRRT model between coal and iron ore. Over seven or eight months Treasury and the government have refused to provide that information to the Senate without giving us much of an explanation as to why it would not be in the public interest to do so and without providing a statement of reasons. Yet, under FOI, the information has been released. Obviously, from the Senate's point of view, that is a little bit confronting. Given our role in scrutinising the activities of government and our reliance on obtaining information from government, to essentially not be provided with any of this information for seven months only to see it released to the media through an FOI request seems a bit inappropriate. I invite you to comment on that.

Dr Henry—What can I say? This is the way that our parliamentary procedures operate. You may consider it—and I understand why you consider it—an unfortunate outcome of the way that our parliamentary processes operate, but there we are.

Senator CORMANN—Information was sought, questions were asked, answers were not being provided. The chair just read out in her opening statement a reference to an order of the Senate in relation to one of our standing orders in relation to public interest immunity claims. The question was ignored. No statement was made as to why it was not in the public interest to provide us with the information. The information was subsequently released by other means.

Dr Henry—Sure. We have traversed these issues on other occasions and, on one of those occasions—in fact, in one of the hearings that you referred to—I indicated that I was not claiming public interest immunity in not providing information to the committee. I think I also said that, as far as I was aware, I had never made a claim of public interest immunity in any Senate committee hearing. I also said that I doubted that I ever would. I think it is pretty safe now to say that I never will. Instead, what I was doing on those occasions was taking the opportunity afforded to me by resolutions of the Senate to refer the question to the Treasurer for the Treasurer's consideration—nothing more or less than that.

Senator CORMANN—Thank you, Dr Henry. I, of course, understand that the person to blame in all of this is not you; it is the Treasurer. It is the Treasurer who has been absolutely desperate to keep information secret, quite frankly, that should have been released in the public interest. But I ask the question again: the MRRT model has now been released—the MRRT model that was put together presumably by Treasury which is based on the initial \$10½ billion revenue estimate over the forward estimates. That figure has since been adjusted to \$7.4 billion over the forward estimates in MYEFO. Have you got an equivalent model over 10 years on the revised MYEFO estimates—similar to the MRRT model for the \$10½ billion version?

Dr Henry—Yes, I understand the question. We have done a lot of numbers inside the department on various scenarios, as you would not be surprised to hear. I have previously said to this committee—and I think it was understood very well by the committee—that those numbers are of such poor reliability that I was very reluctant to see those numbers in the public domain. So, if I were to be asked to construct a public interest immunity argument, I would not find it very difficult to do so; but I am not doing that.

Of course, when a request is made under freedom of information laws for access to numbers, whatever view I may take, the burden on the decision maker in the department is that the information is to be released unless, in the decision maker's mind, there is a clear public interest against release. That is becoming, and has become, over the years an increasingly difficult hurdle for decision makers in departments to jump and that is one of the reasons why I think you are seeing more information released under freedom of information.

As to my own view on the provision of such information publicly, including in forums like this, my view remains as it was the last time we met, that the figures are of such poor quality, there is so much uncertainty attaching to them, particularly the figures in the out years—that is, beyond the forward estimates period—that they are not figures that should be accorded the significance that they have been accorded in public debate.

Senator CORMANN—It is obvious that there is poor reliability because the figures keep bouncing around and secret underlying assumptions change. There may well be poor reliability around the revenue estimates, but the spending commitments that are connected to it are pretty certain to continue to grow moving forward while the revenue continues to bounce around. Isn't that the case?

Dr Henry—It is the case. As we all know, these particular revenue estimates, and, indeed, of course, the actual revenue eventually collected, is highly dependent upon the exchange rate and commodity prices for individual commodities—iron ore and coal. It is a matter of fact on the historical record that the exchange rate, particularly the Australian dollar-US dollar exchange rate—and that is the one that matters most with these revenue estimates, as you know—and also the world prices of iron ore and coal have been amongst the most volatile parameters that economic forecasters or revenue forecasters would confront. That is something that is very well understood. We have discussed it many times in the Senate Select Committee on Fuel and Energy.

Senator CORMANN—We have indeed, and what a great committee that was. But the issue that you raise here—and I see you smile; I know that you enjoyed your time there—is a very important policy issue in terms of the way this mining tax is proposed to be introduced by the government. One of the board members of the Reserve Bank recently made the point that the revenue from such a tax, if we have such a tax, should be invested into the Future Fund or a fund of that nature; whereas what the government is doing is actually using the revenue estimates and committing them to spending. Even the \$6 billion out of the original \$100 billion

over 10 years that was committed to the so-called Regional Infrastructure Fund was structured as a spending program and not as a fund as such.

Senator Sherry—That is not right. If you look at the use of the funds, there are tax cuts. I will not go into them in detail but, for example, there is an effective tax cut on low income earners' superannuation contributions, there is a cut to company tax and, in addition to that, there is the increase in the superannuation guarantee, which is going into savings. So it is not correct to say that it is for expenditure.

Senator CORMANN—Let me rephrase my question, Minister. I hear what you are saying. Over the 10 years, the related fiscal impact on the budget from the measures that you have just outlined and others is essentially going to continue to grow moving forward, pretty well like this, whereas the revenue from the mining tax, with the way it is structured, is going to bounce around. If you were to put that money into savings in a Future Fund, it does not really matter whether one year you get \$10 billion or the next year you get \$20 billion, \$3 billion or \$5 billion because you have not got an ongoing fiscal impact. It is not going to hit your budget bottom line to the same extent. But the way the government has structured it—and I would like to get Dr Henry's perspective on it—is such that your revenue is going to fluctuate dramatically as exchange rates, commodity prices, production volumes and a whole plethora of other assumptions change, whereas your related fiscal impact on the budget in terms of these other commitments the government has made is going to continue to grow. What is the implication of that in terms of the fiscal sustainability of the way the budget is currently structured?

Dr Henry—On the matter of fiscal sustainability, what obviously matters is the average level of commodity prices and the exchange rate and so on through time. That is what matters—its average level—if you are talking about fiscal sustainability. Volatility is a separate issue. It is not an irrelevant issue. It is not even a small issue. It is quite a significant issue. But it is a separate issue; it is quite separate from sustainability. As far as the various proposals that I have seen concerning fiscal stability funds go, there are really two strands of thinking. The first is that, recognising volatility in commodity prices and exchange rates, it might be sensible to accumulate a fund in the good years in order to finance government spending—if you like, a budget deficit—in the bad years. So that is one argument.

Another strand of the argument is that the years that we presently find ourselves in are highly unusual and they will not last—that is, the terms of trade boom that we are experiencing at the moment is a transitory phenomenon and we will at some point, nobody knows when, go back to a lower level of commodity prices and at that lower level of commodity prices there will not be as much revenue. The argument there is not a financing one at all; it is not to do with financing the budget. It is that, if this really is just a one-off boom in commodity prices, in forming judgments about the average level or the trend level of revenue to support trend government spending and, therefore, in thinking about the question of fiscal sustainability, one would want to look through this period—essentially ignore this period—for fiscal sustainability purposes.

So those are the two strands of the argument that I am aware of that people have used in supporting the case for some sort of fiscal stability fund. As to the first of those, dealing with volatility, of course, the first question that has to be confronted by those who put the argument is: in the bad years, why wouldn't the government borrow? Why wouldn't the government issue Commonwealth government securities and then in the good years repay those Commonwealth government securities? That is, in order to finance the budget, one does not have to sell, let us say, US treasuries that one had accumulated in some fiscal stabilisation fund. Instead, one could sell Australian government securities to finance the budget in the bad years. So I must say that I find the fiscal stability fund to manage volatility in the budget a little peculiar, but that is just me. There are a lot of people who do not find it peculiar.

As to the second strand of the argument—that this is just a one-off boom and it is transitory and will go away and we should be careful not to lock in government spending programs thinking that this boom will go on forever—that, it seems to me, is a very serious matter and we should be thinking very deeply about that. Nobody really knows. Even those who believe that this is a transitory phenomenon are unable to say when it is going to end. As you know—and I am not being critical—we have projected the end of this commodity price boom on numerous occasions, only to be caught short confronting higher commodity prices the next year than what we are presently experiencing. For that reason, in the budget, our commodity price projections are downward sloping—that is, for prudent budgetary reasons, we factor in a very substantial fall in commodity prices over a 10-year period. But that is not to say that that will happen. And, by the way, it is those projections that form the basis for the revenue projections for the MRRT. That is not to say that that will actually be the outcome. We do not know that commodity prices really are going to trend down in the way that we have set

out in the budget over a 10-year period. We just put that there as a possible scenario, a prudent scenario, to support the sort of fiscal sustainability discussion that you are referring to.

Senator CORMANN—But you never even know whether the budget cycle is going to eventuate. So that is nothing unusual. That is why you assess performance against what you plan for. Have you revised your MRRT revenue estimates further since MYEFO?

Dr Henry—I am not aware of revisions since MYEFO. Certainly there would have been scenario work done, people asking, for example, the questions, ‘What if commodity prices were to stay at present levels?’ and ‘What if commodity prices were to follow a different trajectory?’ I am sure that there is that kind of work being done.

Senator CORMANN—But between the RSPT and the 2 July deal, obviously there was a formalised revision of various assumptions.

Dr Henry—Yes.

Senator CORMANN—There was another formalised revision of various assumptions for MYEFO.

Dr Henry—Yes.

Senator CORMANN—There has not been any further formalised revision of assumptions by Treasury since—

Dr Henry—No, not that I am aware of.

Senator CORMANN—You would be aware of it, I would have thought.

Dr Henry—I would hope so.

Senator CORMANN—So this article in the *Fin Review* of a little while ago that senior Treasury sources claimed that the MRRT would raise less than \$5 billion over the forward estimates is not an accurate statement, as far as you are aware?

Dr Henry—As far as I am aware, it is not.

Senator CORMANN—The argument in the *Fin Review* today, which I think is a legitimate argument, is that, if you want to compare the impact of the mining tax deal of 2 July to what former Prime Minister Kevin Rudd put forward, you really have to compare the RSPT and the MRRT based on the same assumptions. Given that you revised your assumptions for the MRRT, to really test the fiscal impact you have to apply the same commodity price and other assumptions to the RSPT model. Have you gone through that exercise in Treasury?

Dr Henry—I am not aware of it myself. I would have to take it on notice.

Senator CORMANN—If you have done it, now that you have taken it on notice, could you provide us with information about the outcomes of that—

Dr Henry—As with all of these matters, I will of course be referring the question to the Treasurer.

Senator CORMANN—Of course. But just to put on record that, if the Treasurer was inclined not to respond to these things, given that the information has otherwise been provided under FOI requests to media outlets—

Dr Henry—No. Actually, I do not think information on this matter that we have just been discussing has been provided under FOI to anybody.

Senator CORMANN—If I also can then put on notice the \$7.4 billion estimate, the modelling that was done for that. Could I obtain on notice the equivalent information to the one that was released under FOI for the MRRT model but under revised estimates that happened for the purposes of MYEFO? Just looking at the MRRT model, over the 10 years there has been \$38.5 billion worth of MRRT revenue, with \$25 billion of it coming from iron ore. That is about 65 per cent. It is fair to say that the iron ore share of the MRRT revenue is a proxy for the Western Australian share of the MRRT revenue, is it not?

Dr Henry—That is probably a reasonable proxy, I would think.

Senator CORMANN—I see people behind you sort of nodding.

Dr Henry—That is encouraging.

Senator CORMANN—It is encouraging for you and it might be encouraging for the federal Labor government but it is not encouraging for those of us from the great state of Western Australia, because it

means that over the forward estimates 80 per cent of the MRRT revenue would come from Western Australia: 87.5 per cent in the first year, 76.9 per cent in the second year and, of course, 64.93 per cent over 10 years. It sort of makes it a tax on Western Australia, does it not?

Senator CAMERON—So it should.

Senator CORMANN—I am pleased to hear you say that.

Senator Sherry—And your point is?

Senator CORMANN—The question is: is it fair and reasonable to have one single new national tax targeted at one specific state economy to the extent that this tax is, with the way it is structured, with all of the other resources excluded and the main chunk of it coming from iron ore? Is it a fair proposition for a national tax to target one specific state economy like this MRRT does?

Dr Henry—I will say two things about it. The first is that Australia has a comprehensive system of horizontal fiscal equalisation. That is concerned precisely with those questions: what is a fair distribution amongst the states and territories of the national tax revenue? So that is a matter for the Commonwealth Grants Commission to reflect on in its advice to the Commonwealth Treasurer. It is a horizontal fiscal equalisation matter. The second thing I would say about it, which I think is relevant—and it is certainly relevant to horizontal fiscal equalisation—is that we are seeing the consequences playing out in Europe right now of countries having a common currency and lacking a comprehensive system of horizontal fiscal equalisation.

Senator CORMANN—Just talking about horizontal fiscal equalisation, I was thinking really of a fiscal imbalance, which of course is a different issue altogether. But on horizontal fiscal equalisation, has the Treasurer made the determination for 2011-12 in terms of the share of revenue—

Dr Henry—No.

Senator CORMANN—Is it unusual not to have made that determination?

Dr Henry—No. That determination is usually made, I think, in March. It is a question that would better be put to the fiscal group people when they are here. But my understanding is that the determination is typically made in March.

Senator CORMANN—We will. In terms of the flood tax, what options has Treasury provided to the government to fund the reconstruction package?

Senator Sherry—That is a policy option to government, so we cannot go there.

Senator CORMANN—Why can't we go there?

Senator Sherry—It is policy advice to government.

Senator CORMANN—Are you claiming public interest immunity?

Senator Sherry—No. I will take it on notice. But you are well aware of it. You can chuckle and laugh, but I have sat where you have, Senator, and posed similar questions and made similar vain attempts. We are very consistent in our approach, as you were when you were in government.

CHAIR—There are a couple of things that I want to check. The committee, in our break, agreed to go to 1.30 with this session. So I am just letting people know that in advance.

Senator Sherry—Can I just ask: are there any consequential changes to the program this afternoon?

CHAIR—We will be back from lunch at 2.30.

Senator Sherry—What happens then? There are some logistical issues here. What about afternoon tea and macro, because it involves different ministers?

CHAIR—We will finish with revenue at 1.30 and we will be back at 2.30. We will just shorten the time for those three agencies and we will be back on track.

Senator Sherry—And then macro—

CHAIR—Will start as planned, at five o'clock.

Senator Sherry—I am not sure whether Dr Henry is coming to macro, but I do not expect that he will be coming to the other three.

CHAIR—Senator Cormann, perhaps I could have your indulgence. I am sorry to interrupt your questioning, but Senator Brown needs to go. So I will hand over to him and get back to you.

Senator BOB BROWN—Thank you very much. I will not take too long. On the same matter of the minerals tax, the *Financial Review* story this morning, front page, refers to \$100 million forgone over the coming decade, under the price and volume assumptions that have not been released. Are those price and volume assumptions held by Treasury and, if so, can the committee have them?

Dr Henry—Obviously we have within the department the price and volume assumptions on which the MRRT revenue estimates in MYEFO were constructed. In previous committee hearings, I have indicated that the price and volume assumptions rely very heavily on information provided by the companies to the department. The companies tell us that they regard that information as being commercial-in-confidence. In fact, so far as we know, they have not shared the information among themselves. They have independently, that is, one by one, shared the information with us, on condition that it remain commercial-in-confidence, that it be protected. We have been through this before. Of course, the assumptions on which the revenue estimates are based can be aggregated in ways, I suppose, but we have not provided that information publicly. It would be a matter for the Treasurer, in my view, whether that information were to be provided to this committee or indeed provided publicly.

Senator BOB BROWN—I make that request.

Senator Sherry—We will take it on notice.

Senator BOB BROWN—Thank you. The headline story that \$100 billion would be forgone, if those assumptions are correct, is right?

Dr Henry—I cannot confirm that. I can simply say what I was saying earlier, that the revenue estimates are very sensitive to the exchange rate and to assumptions made about commodity prices. You can get very large changes depending upon what assumptions you make. For example, as I was explaining to Senator Cormann earlier, in the methodology that we use that underpins the MYEFO estimates we have commodity prices falling by a substantial amount over a 10-year period. Without having looked too closely at the numbers, I feel confident enough to say were we, instead, to maintain commodity prices at their present level our revenue estimates for the MRRT would be some multiples of the revenue estimates contained in MYEFO. That is just to illustrate that the estimates, the projections, are extremely sensitive to the commodity price assumptions that you use.

Senator BOB BROWN—So the assumption is that \$100 billion forgone under the prescription adopted by the government cannot be discounted?

Dr Henry—Let me put it this way: it would be possible, I am sure, to construct, without having done it myself, a scenario for commodity prices and for the exchange rate that would generate such a gap in revenue projections over a 10-year period. I am sure it would. Whether that scenario for commodity prices and exchange rates would be considered a reasonable one, a realistic one, is really a matter of individual taste, I think.

Senator CORMANN—Can I just quickly jump in for a second because—

Senator BOB BROWN—I just want to ask on that: is there a more reasonable assumption to be made?

Dr Henry—The assumption that we consider most reasonable for commodity prices and the exchange rate is the one that we have used, or the set of assumptions we have used, to construct the MYEFO numbers.

Senator CORMANN—The thing is, you talked about a scenario. You can construct a scenario but it is not really so much about constructing a scenario, it is about comparing apples with apples.

Dr Henry—Yes.

Senator CORMANN—If you change your commodity price assumptions and your volume assumptions for the MRRT model when you do the deal on 2 July, in order to compare the impact of what the RSPT would have collected with what the MRRT is likely to collect, then you should really be using the same assumptions to assess the impact. That was not done at the time. I understand your reasons why. It is not picking one scenario. In order to achieve what Senator Brown is after, what I have been after for the last seven months, you need to apply the same commodity price, volume and other assumptions to the RSPT construct as you have applied to the MRRT construct on 2 July. That is where the \$100 billion in lost revenue over 10 years comes from, or perhaps even more, quite frankly.

Dr Henry—I do not discount the logic of what you have put to me at all. I understand perfectly well what you are saying. I am not taking issue with that at all. Senator Brown asked me whether a particular number,

which has appeared in the public domain this morning on the front page of the *Financial Review*, is or is not correct. I was just saying that—

Senator BOB BROWN—Really whether it is reasonable or not.

Dr Henry—Well—

Senator Sherry—Senator Brown, I just make the point that, when I was sitting there in opposition, I would be asking Treasury in macro, not here, and testing the underlying assumptions about revenue from mining. They outlined the approach that Dr Henry has outlined today. It turned out that that very conservative and correct approach did not happen. The mining price did not come down.

Senator BOB BROWN—Dr Henry is telling us that the basis of the \$100 billion figure is reworked figures on data coming from the mining corporations themselves. I again say: it is not an unreasonable assumption that that headline entails.

Dr Henry—In constructing a scenario to provide advice to government in the formulation of policy we have relied quite a lot on information provided by the companies, and we then have made judgments about what might be a prudent future trajectory for commodity prices over a long period of time, not because we think it is a plausible scenario or not because we think it is the most reasonable scenario but rather that we consider it a prudent basis on which to formulate it. If you like, it is a conservative approach that provides a degree of prudence for decision making over an extended period of time.

If you are asking me whether I consider a particular number to be reasonable or not, I am in a bit of difficulty. Frankly, there is something actually quite unreasonable about producing 10-year revenue estimates for a tax like this.

Senator BOB BROWN—But those figures—

Dr Henry—That is actually something which is quite unreasonable.

Senator BOB BROWN—But we are dealing with that, Dr Henry. That is how the proposed mining tax is constructed, on a basis that comes out of forward projections.

Dr Henry—It is true that the structure of the tax will have an impact on the revenue collected in every year, and obviously over 10 years. I guess what I am suggesting is that there are some risks in basing your tax design on a 10-year comparison of revenue collections between two different approaches when the revenue projections are so sensitive to economic parameters which are, as I said earlier, amongst the most volatile economic parameters that revenue forecasters have to confront.

Senator BOB BROWN—Can you see why, as legislators, I and other committee members might be concerned about forgoing \$10 billion per annum—

Dr Henry—Yes, of course.

Senator BOB BROWN—if we ignore the figures that we see coming out, or predictions which are based on those coming from the corporations themselves?

Dr Henry—I guess what I am saying is yes. You say ‘forgoing \$10 billion a year’ Maybe, yes. Alternatively you might be forgoing \$5 billion a year or \$1 billion a year or perhaps even nothing. It just depends on what happens to commodity prices and the exchange rate.

On the other side, it would be possible to construct scenarios which had you believing you were forgoing \$20 billion a year. This is very uncertain. These are very uncertain bases on which to be taking decisions about policy design.

Senator BOB BROWN—But, in a world in which \$2 billion to Australia may mean a universal dental healthcare system, it matters. You have just acknowledged that.

Dr Henry—Yes, I understand that.

Senator BOB BROWN—Is Treasury able to provide the committee with the figures for other minerals being included in the proposed tax—uranium, gold, nickel and so on?

Dr Henry—I do not believe we have done that work. I could be wrong. Again, I will take the question on notice and refer the question to the Treasurer.

Senator BOB BROWN—Thank you.

Senator CORMANN—Following on from Senator Brown, I hope that the Greens will support future motions in the Senate to order the production of that information—all these volume and quality price

assumptions. I am very interested in your line of questioning, Senator Brown. I will work very happily with you to force this government to be accountable.

Senator Sherry—I suspect they probably will, but for totally different reasons.

Senator CORMANN—That is okay. That suits me fine. Dr Henry, you made the point that these revenue estimates are extremely sensitive to assumptions. Of course that has been a matter of discussion for some time. Given the revenue estimates are so sensitive, surely that makes the transparency of the assumptions used even more important. Why can the state government in Western Australia, which also collects revenue that is sensitive to changes and those assumptions, publish those assumptions openly and transparently in their budget papers while the Commonwealth government is not in a position to be equally open and transparent?

Dr Henry—That is properly a question to the Treasurer rather than me, I think.

Senator CORMANN—I take it that you would rather not answer.

Senator Sherry—I will take it on notice.

Senator CORMANN—That is excellent. ABARE is about to release its new forecast next week. Have you seen those ABARE forecasts around commodity price production volume assumptions?

Dr Henry—I have not. It is possible that—

Senator CORMANN—Has somebody in Treasury seen them? Would you see them in advance before they get published in the normal course of events?

Dr Henry—No. You may have observed that gentleman shaking his head.

Senator CORMANN—I have seen the shake of the head from the second row. Hansard finds it very difficult to pick that up.

Dr Henry—Yes. Apparently the answer is no.

Senator CORMANN—Would you be expected to revise your mining tax revenue estimates after ABARE releases its commodity price and—

Dr Henry—Not for that reason. We are, of course, thinking about revenue projections for budget purposes. We are continuously revising various heads of revenue as we get more information but really only to support the preparation of the budget.

Senator CORMANN—Last time that ABARE came out with more short-term forecasts you were very quick to seize on them to, of course, revise your assumptions to facilitate the MRRT deal, I guess.

Dr Henry—If the government was asking us for advice—policy advice—on a major redesign of a tax, of course we would always use the most recent information.

Senator CORMANN—Just going back to the flood tax, were you instructed by government to provide advice on a flood levy or was that something that was put forward by Treasury?

Dr Henry—I do not know the answer to that question.

Senator CORMANN—Is there somebody coming forward? Perhaps they can assist us?

Mr Wilcock—I have to confess that I was not in the country at the time that the Queensland floods took place and therefore I do not have any personal knowledge of the exact sequence of events. We would have to take that on notice.

Senator CORMANN—Is there somebody in Treasury who knows when the proposition to increase the income tax for the purpose of the flood levy was first raised?

Dr Henry—I doubt that there is in this room.

Mr Wilcock—We would need to take that on notice.

Senator CORMANN—I just assumed that Treasury would have been quite central to that discussion—or is that a wrong assumption?

Mr Wilcock—As I said, I think we would need to take on notice the issue specifically. It is generally the case that the government recognised that it would have some funding requirements arising from the floods in Queensland.

Senator CORMANN—Mr Wilcock, you were out of the country. Dr Henry is not really clear about it. Was Treasury involved at all in the decision to fund part of the reconstruction package through a flood tax?

Dr Henry—I think I can answer that question. I know we were involved, of course, because we were certainly advising government on it. So I can confirm that we were involved.

Senator CORMANN—When did you first provide advice?

Dr Henry—That I do not know.

Senator CORMANN—You do not know whether it was initiated by Treasury or whether it was initiated by the government?

Dr Henry—No. Of course that is sometimes a rather difficult thing to find out after the event.

Senator CORMANN—It gets lost in the backwards and forwards of—

Dr Henry—No, it is not really that. It is that, in my experience over a long period of time now, in advising governments quite often various options are kicked around, perhaps, in discussion and it is often very difficult to recall after the event whether the first person to raise a particular option was sitting on one side of the table or on the other side of the table. That is all. That is all I am saying.

Senator CORMANN—Has Treasury conducted any modelling of the impact of the flood tax on the economy?

Dr Henry—The impact of the flood tax, the flood levy, on the economy? I am not aware of any such work having been undertaken. I will take that on notice too. I do not want to mislead you, but I doubt it.

Senator Sherry—It is a levy; it is not a tax.

Senator CORMANN—It is an increase in the income tax, so it is a tax.

Senator Sherry—No, it is a levy.

Senator CORMANN—Is it an increase in the income tax?

Senator Sherry—It is a levy in a similar way to when you were in government. You may not have been party to the decision. I can recall a milk levy, a sugar levy, an Ansett levy, an East Timor levy and a gun levy. I can recall a few levies in my time. I can recall a surcharge too, if we want to go to the difference between a surcharge, a tax and a levy. I can recall plenty of levies when—

Senator CORMANN—Yes, I am sure you can recall plenty of levies in Australia's—

Senator Sherry—you, the Liberal-National Party were in government.

Senator CORMANN—Australians can recall plenty of tax increases over the last three years too.

Senator Sherry—I can recall quite a lot.

Senator CAMERON—Senator Sherry, that does not affect the three lines—

Senator CORMANN—Describe for me how the flood levy is constructed. What is it? How do you raise the money through the flood levy? What is the construct of it?

Dr Henry—It is a levy that sits on top of personal income tax payable according to a person's taxable income.

Senator CORMANN—For all intents and purposes, it is an increase in the income tax paid by individuals paying income tax, isn't it?

Dr Henry—Certainly it has the effect of changing the amount of a payment that a taxpayer would have to make to the Australian Taxation Office.

Senator CORMANN—For all intents and purposes, it is an increase in income tax?

Dr Henry—My colleague is reminding me that it is certainly not for all taxpayers.

Senator CORMANN—You are talking there about people who are excluded from it and who get exemptions and so on. But that applies to the income tax arrangements generally: some people qualify for exemptions and some people do not.

Dr Henry—Yes.

Senator CORMANN—But it is for all intents and purposes an increase in income tax unless you qualify for one of the exemptions.

Dr Henry—Like the Medicare levy.

Senator CORMANN—Which is also increasing the income tax burden.

Dr Henry—And it is a levy.

Senator Sherry—In this case it applies for one year.

Senator CORMANN—We will see.

Senator Sherry—Have a look back over the transcripts and the debate we had on surcharge levies and taxes over the last 20 years or so. It has been thrown around. The issue of levies, taxes and surcharges has been extensively debated.

Senator CORMANN—When looking at the funding obligations of the Commonwealth or their share of the recent flood damage bill in Queensland and through, mostly, eastern Australia, there are three options, as I understand it: defer the surplus and add to the government's current expenditure, hence the deficit; cut existing programs and reallocate that funding towards the damage bill; or impose a new tax to raise revenue to cover the damage bill. What is the impact of each of those three main options, according to Treasury?

Dr Henry—The principal impact is, of course, distribution. All of these are simply answering the question, 'Who is going to pay?' With respect to adding to the deficit and adding to borrowings, if that were the preferred approach, what that is saying is that, rather than today's taxpayers paying, future taxpayers will pay. It is a distributional issue.

With respect to financing the flood-related expenditures through cutting other government spending, then the view is being taken that, rather than taxpayers per se paying, it is recipients of various forms of government expenditure who will be denied benefits—yes, largely denied benefits—who will pay. With respect to a flood levy, the decision is, of course, that current taxpayers pay. It is essentially a distributional question.

Senator CORMANN—Given the current state of the economy, why was the mix of a levy and some spending cuts chosen?

Dr Henry—That is a policy question. It is properly one for the Treasurer to answer.

Senator CORMANN—Maybe you could take it on notice.

Senator Sherry—I will take it on notice.

Senator CORMANN—Thank you. The government has now reversed, of course, some of its proposed cuts in order to get support from either key House of Representative members or key senators in these sorts of negotiations. There is a hundred million dollars from the Solar Flagship program in the forward estimates and \$264 million for the National Rental Affordability Scheme. Have you identified alternative savings to replace these spending cuts or these spending cuts that have been reversed?

Dr Henry—Not to my knowledge. These would be matters for Fiscal Group, who will be appearing before you later, or alternatively, of course, the department of finance.

Senator CORMANN—Fair enough. The advice we have had from the finance department is that there is still uncertainty as to what the actual exposure of the Commonwealth is going to be. If the bill ends up being more than the \$5.6 billion or whatever that has been talked about, would any further increase in that bill be funded through the levy/increase in income tax or through spending cuts?

Dr Henry—That is a question for the Treasurer.

Senator Sherry—It is a hypothetical, but I will take the hypothetical on notice and see whether the Treasurer wants to respond.

Senator CORMANN—I have some other questions, but I am happy to let somebody else go.

CHAIR—All right. We have a number of other people. I can come back to you.

Senator CORMANN—Particularly on ATO because I do not want Mr D'Ascenzo to feel ignored. As much as all of our love is going to Dr Henry today—

Senator Sherry—I was just thinking, 'The ATO's not getting much attention.'

Senator CORMANN—we have some stuff for you.

Dr Henry—I would prefer that the commissioner not be ignored.

Senator CAMERON—As long as, Dr Henry, there is not a group hug when we finish.

Dr Henry—Indeed.

Senator Sherry—So far I am feeling like that. Maybe we should have the photo opportunity—get them back in.

Senator CAMERON—Dr Henry, you talked about how sensitive the medium-term forecasts are to different assumptions. What kinds of fluctuations have you looked at in your assessments?

Dr Henry—I was reporting earlier that, without doing too much work on this, I am sure that, were commodity prices to remain at about their present levels rather than fall in the way that we have outlined in the budget, the MRRT revenue would be several multiples of what we have in MYEFO—that is, the 10-year revenue would be several multiples, if you held commodity prices constant at present level, which is not what we do. We take a much more prudent approach.

Senator CAMERON—Sorry, Dr Henry, can you just remind me: what is the figure that we are talking several multiples of? Do you have that?

Dr Henry—The MYEFO figure? I do not have the 10-year MYEFO figure here.

Senator CAMERON—Does anyone have it?

Dr Henry—I do not think it has been made public. I do not think it is a matter of public information, the 10-year figure for the MYEFO. For the reasons I mentioned earlier, I am a bit hesitant—well, more than a bit hesitant. There is so much uncertainty surrounding these numbers that I would prefer the 10-year estimates were not in the public domain. For various reasons they are, but I do not think this 10-year estimate or 10-year projection for the MYEFO is in the public domain. I do not think so.

Senator CAMERON—If prices stay high, even within a shorter time span, it is still substantial amounts of income with this tax, is it not?

Dr Henry—That is right. The MYEFO reports \$7.4 billion over the forward estimates. That is not an insignificant amount of revenue.

Senator CAMERON—Can I come back to another issue, and that is the horizontal fiscal equalisation.

Dr Henry—Yes.

Senator CAMERON—I have asked in the past, I am sure, in committees about the benefits that Western Australia have received from horizontal fiscal equalisation over many years. I think I have continually been told that there are no statistics available. I think I have even asked the ABS whether they have the statistics. Given that there are no statistics available, is it a fair and reasonable proposition to say that Western Australia have been a beneficiary of horizontal fiscal equalisation over a lengthy period of time?

Dr Henry—Yes, I think that is a fair proposition. I do not think anybody would argue the contrary. Indeed, for most years that I have been in the federal Treasury Western Australia has been the strongest supporter of horizontal fiscal equalisation.

Senator CAMERON—Is that still the case?

Dr Henry—It does not seem to be, no.

Senator CAMERON—So it is an argument that changes—whether you are a beneficiary or whether you are putting the money in to help other states. Is that what is happening?

Dr Henry—I cannot say for sure, but that conclusion would certainly be consistent with the observed behaviour.

Senator CAMERON—What would you—

Senator Sherry—Tasmania is still in favour, I can assure you of that! We are very consistent in Tassie. We have a hundred years of consistency on this matter. We are very pleased to have it.

Dr Henry—Are you talking about the past or the future?

Senator Sherry—And, I suspect, a hundred years into the future.

Senator CAMERON—So it is not going to be the republic of Tasmania very quickly, is it? Dr Henry, what would be the implications if horizontal fiscal equalisation was not there?

Dr Henry—Maybe it was a bit obtuse but I was referring earlier to one set of possible implications that is being revealed right now in Europe, or at least in parts of Europe, where there is a federation of sorts. But it is not a very well-developed federation. It is certainly not a federation as developed as the Australian federation—nothing like it. A group of countries have decided to share a common currency without a system

of horizontal fiscal equalisation. I think it fair to say—well, it is obviously more than fair to say; it is patently obvious—that that is causing a few problems. In a federation where various parts of the federation are likely to experience quite different economic performance, depending upon various external shocks, whether it is an increase in the terms of trade or some other external shock—and of course for much of our post-war history we thought we were dealing with a decline in the terms of trade, a long-term decline in commodity prices.

Whatever the source of the shock, if the various parts of the economy share a common currency, those shocks will be better dealt with if there is a system of horizontal fiscal equalisation to redistribute essentially windfall gains—perhaps not all windfall gains—to other parts of the economy that are not experiencing the same benefit. That is particularly important where the external shock produces a change in the exchange rate—particularly where the external shock is, if you like, a positive external shock, so it causes an increase in the exchange rate. Horizontal fiscal equalisation is then not just a matter of distributing a windfall gain more broadly; it could also be seen as a form of compensation to people who, beyond being denied access to a windfall gain, in fact suffer a windfall loss.

Senator CAMERON—Kenneth Rogoff, Professor of Economics and Public Policy at Harvard, and formerly the Chief Economist of the IMF, made a speech last week about the growing problem in Africa, Europe and worldwide of inequality of income, wealth and opportunity, which he argues is greater than at any time since the last century. You have spoken about how horizontal fiscal equalisation can improve these things. Given that there is still a lot of instability worldwide, what are the implications for us? Reading the financial press here you would think there never had been a financial crisis and there never had been a problem, and you would not know that all these problems still exist everywhere else. If people like Professor Rogoff are pointing to these huge issues, are there implications for us in what is still happening worldwide?

Dr Henry—Yes, there are. You are referring to what is sometimes characterised as a two-speed world economy. We talk domestically about a two-speed Australian economy, and the two are certainly not unrelated. Indeed, they are very closely related. The two-speed or three-speed Australian economy—anyway, it is multiple speeds—owes a lot to the extraordinary growth presently being experienced in China, to a somewhat lesser but nevertheless important extent in India and, excluding Japan, pretty much in East Asia as a whole. That presents the Australian economy with very high prices for iron ore, coal and other commodities that we have in abundance and which feature significantly in our exports. The consequence of those strong increases in commodity prices, and particularly of the investment that is made off the back of them, is an appreciating Australian dollar. If the Australian dollar does not appreciate then the alternative consequence—and it is unavoidable—would be rapidly accelerating inflation and wages, which would achieve a real appreciation and a loss of competitiveness in the Australian economy by a different route. But whether it is an appreciation of the nominal exchange rate or inflation rates well in excess of inflation rates of our trading partners, one way or another we would suffer a loss of competitiveness. It does not matter too much to those sectors of the Australian economy that are benefiting from the higher commodity prices—a loss of competitiveness for them would barely be felt, given where the commodity prices are. But obviously it is a loss of competitiveness that is being felt by a lot of industries and businesses in Australia. This is going to be a fact of life for some time to come.

That is one way global developments are impacting on domestic economic developments. In that, there is a challenge for macroeconomic policy and microeconomic policy in Australia. There are other parts of the world economy which, largely as a consequence of the global financial crisis, are not growing in the way China and India are growing. In North America—particularly the United States—and in both the United Kingdom and continental Europe, the prospects are for subdued rates of economic growth; in my view for a considerable number of years. Some are more optimistic about the United States economy than I am, and with good reason. I do not discount the arguments, but I think the US economy is going to experience subtrend rates of growth for some time. I think the same is true for most of continental Europe and the UK.

On top of that, there is a risk that we have been talking about for some time associated with sovereign debt, in Europe in particular—although the Europeans, with the assistance of the International Monetary Fund, have managed these risks quite well to date. The risks are nevertheless there. Greece, Ireland and Portugal, in particular, stand out as countries that present some risk of volatility in sovereign debt markets. That volatility would not be helpful to the international economy, and it probably would not be helpful in Australia's case as well. Some are more sanguine about this and take the view that global finance has to go somewhere and, if there were to be a sovereign debt crisis, Australia might look like a very attractive place for savers globally to want to put their money. That is probably true; I understand that argument. But, going back to my earlier point, that would mean an even higher exchange rate and an even greater loss of competitiveness for those trade-

exposed sectors of the Australian economy that are not benefiting from the high commodity prices. Australia's economic performance has been outstanding in global terms, but one should not get complacent about the risks that are out there in the international economy.

Senator CAMERON—For many years when I was the Secretary of the Manufacturing Workers Union I argued for a broad based economy—that we did not become a quarry, a farm and a tourist destination. It seems to me now there is an argument for taking off the tourist destination; we should simply be a quarry and a farm. Tourism and manufacturing must make room for the investment boom in the mining sector. I know the red book advice to government was along those lines. I am just wondering how we can maintain a balanced economy and how can we ensure that we do not end up with the problems Professor Rogoff is arguing. If we have made a miscalculation and the commodity prices come off quicker than we think, or interest rates in China rise, or there are domestic problems in China of the scale in other countries, it is a big problem for us and we need to have a broader base. What is the thinking on that?

Dr Henry—There is quite a lot of thinking on that. One of the issues you are raising is: when the commodity price boom is over, what sort of industrial structure is the Australian economy left with? As we have already discussed, we do not know how long this commodity price boom is going to last. It could last for a very long period—that is, it could last for decades. It is not difficult to construct a plausible scenario that has this commodity price boom lasting for several decades. It could. On the other hand, either because of a sharp retraction in demand for commodities from the Chinese economy or the Indian economy or because we get an unusually strong increase in supply of commodities, the commodity price boom could come off sooner than anybody is presently anticipating. Again, the question would be asked: what sort of industrial structure are we confronting in the Australian economy? Let us suppose that in 20 years time commodity prices have come off quite significantly. The structure of the Australian economy then that would be consistent with Australia maximising at least its gross domestic product would be an industrial structure quite different from the one we have had. That is, I do not think we would want to go back to an industrial structure of 20 years ago. That is what I think. It seems highly unlikely to me that, even in the absence of strong international prices for coal and iron ore, 20 years from now the optimal industrial structure for Australia would be the industrial structure we had 20 or 30 years ago. We need to keep that in mind.

However, even having said that, things can be done to take out some insurance against an outcome that has us locked into particular industries that are presently benefiting from high commodity prices. The team who put together the tax review focused on this issue in some detail. One of the questions the tax review group asked ourselves in preparing Australia's future tax system was: what can be done to reform the Australian taxation system that would take out some insurance against the Australian economy ending up too heavily specialised in a world in which commodity prices then fall? There is quite a lot in the report on that topic.

CHAIR—Thank you.

Senator CAMERON—Dr Henry, I thank you for the contribution you have made during the time I have been here, and for your long-term contribution to the Public Service.

Dr Henry—Thank you, sir.

Senator BOSWELL—I have questions about the minerals resource rent tax as it relates to the smaller and mid-sized companies. The smaller mid-cap companies will have to implement compliance measures to approved relevant agencies such as the ATO. They have not hit the \$50 million threshold. The burden of proof falls to these small- to mid-cap mining companies. This all costs money and is a further disincentive to invest in our resource sector. What arrangements will be put in place to manage the compliance and administrative burden that the MRRT is likely to place on growing exploration of small mining companies?

Dr Henry—My colleague Paul McCullough will take that question.

Mr McCullough—I missed a little bit of the question. To the extent that it goes towards details of compliance activities and those sorts of things, those details have not been sorted out yet, for the simple reason that the legislation, for example, has not been completed and there has been no opportunity to consult on that. A couple of processes have been running that you would be aware of. The policy transition group was meeting for the last half of 2010 and published a report in December of 2010 that goes to some of those issues and recommends a further process for consultation with industry over the next period of implementation that should address those sorts of things. Treasury, the department of resources and the Australian tax office would be involved in that implementation process, and those issues would be worked through collectively.

Senator BOSWELL—Can you explain the operation of the MRRT threshold—specifically how the mechanism will work with those companies which are operating between the \$50 million and the \$100 million bracket?

Mr McCullough—No final decision has been taken by government about exactly how the threshold would work. Again, the policy transition group has made some recommendations. I can refer you to a particular page; I might even be able to give you a copy of the report. The government has not had an opportunity to consider that yet or announce precisely how that is going to work.

Senator BOSWELL—In relation to the method of managing deductions for mining companies' MRRT liability, can you explain the operation of the safe harbour? What are the methods available to go there?

Mr McCullough—Again, it is just a little bit early for some of those details to be fleshed out. We are still well before a process of any legislation having been finalised.

Senator BOSWELL—When is this legislation due to be put in place?

Mr McCullough—I think the Treasurer has made a commitment to an exposure draft around May. I think the plan then is to have further consultation on the exposure draft with a view towards introduction before the end of this year—so the end of 2011.

Senator BOSWELL—If the exposure draft is due in May, surely there must be some answers to the questions that I have proposed. You cannot just put out an exposure draft missing all those inquiries.

Mr McCullough—I am not suggesting that it will necessarily be missing all of that detail. Obviously, there is an iterative process. The high-level policy issues were settled with the heads of agreement in the middle of last year. Then the policy transition group made 90-odd recommendations on matters of what I would call lower level policy detail. The government is yet to announce its position on those. Once that happens, then, the way these things develop, a range of technical, compliance and administrative issues need to be worked through in the finalisation of the legislation. Then there is usually a process where the tax office makes known its position on things to do with compliance, administration and interpretation.

Senator BOSWELL—You said earlier that you would give me some information. What information can you give me?

Mr McCullough—It is not in a very digestible form. There is, for example, the policy transition group's report, which covers those 94 recommendations. I do not think we have time to go through each one of those in detail.

Senator BOSWELL—No, I do not expect you to.

Mr McCullough—I think we have a spare copy of the report we can give you. It is publicly available. It is on the website, if we do not have a hard copy.

Senator BOSWELL—Thank you. Dr Henry, for the first time in my political career I find myself agreeing with the former Secretary of the AMWU. What the good senator says is accurate. You may be well above it, but because of the increasing dollar and the two-speed economy you refer to there is a great deal of hurt out there in the manufacturing industry right across the board. People are telling me that the order books are empty and that in another month they will have to make some serious decisions on where they go. I take this opportunity to pass that on to you. We have crossed swords a few times, but I wish you the best and success in your new venture.

Dr Henry—Thank you very much, Senator.

Senator XENOPHON—Dr Henry, I asked you some questions on 27 May about the KPMG Econtech modelling of the RSPT, particularly in relation to whether there was any modelling of the regional and sectoral effects, and also what the definition of 'long run' was. Thank you for the response on notice saying that the KPMG Econtech model was the MM900 model, it is not a regional model and no modelling was undertaken of regional effects. Do you think modelling ought to be done of regional effects, given that there could be marked differences in the impact in a regional area with such a tax? To put it another way, there would be a degree of finessing, or a greater degree of information, if regional effects were considered.

Dr Henry—That is clearly true. But, firstly, we do not have the modelling capability and, secondly—

Senator XENOPHON—Also there are no regional models available?

Dr Henry—No, I am not saying that. We do not have the modelling capability in house that would allow that sort of modelling to be undertaken. With the models that do exist that allow for regional differentiation,

there is a lot of judgment involved in putting the models together. For example, most of the models that support the kind of impact analysis that you are talking about—computable general equilibrium models—have at their core a detailed input-output system that records the interindustry linkages with respect to usages of intermediate inputs. That is not the primary factors of production—labour, capital, land and so on—but the intermediate inputs: materials principally, fuel and so on.

In Australia at the national level, the Australian Bureau of Statistics publishes an input-output table roughly once every five or six years. Obviously, if you are going to construct a computable general equilibrium model for the Australian economy you want to have that most up-to-date input-output system sitting at the core of it, and you will have to put up with out-of-date data from the Australian Bureau of Statistics. It is unavoidable. It is not a criticism. This is difficult stuff to do. If you then want to construct a model which has, let us say, eight regions in it—six states and two territories—you have to construct eight input-output systems out of that one national system. You do that yourself. The ABS does not do it. Doing that, an enormous amount of judgment has to be applied. If you then want to go down to substate level or subterritory level, into regions, you have to construct even more input-output tables. Again, the ABS does not do it; you have to do it yourself. In doing that, you will have to exercise a large amount of judgment.

There comes a point where one has to wonder about the quality of the information that is coming out of the models. Firstly, we do not have the models in house. Secondly, the construction of models to allow the sort of analysis you are talking about involves so much judgment on such little information that one would have to question the quality of the output.

The second thing I would say in response to the question is that we have just had a discussion about some of the macro-economic and industry—and by implication regional—consequences of commodity prices being where they are. Whatever one thinks about the size of the MRRT as against alternatives, frankly, the regional impact of the MRRT is likely to be tiny relative to the regional impact of the large increase in commodity prices we have had on the other side. I am not saying it is an unimportant issue, but it is very much a second, third or fourth order issue relative to the regional impact of commodity prices.

Senator XENOPHON—There was also discussion as to what the ‘long run’ meant. I think your answer on notice was that KPMG Econtech suggested it was a five- to 10-year range.

Dr Henry—Yes.

Senator XENOPHON—Do you acknowledge that if you are looking at that long-run effect there could be some transitional effects in the first one, two or three years before things smooth out that could cause dislocation in regions?

Dr Henry—Absolutely. Senator Cameron was referring to some of these earlier, and so was Senator Boswell. With commodity prices being where they are and the exchange rate being where it is, some businesses feel dislocated. This stuff does not tend to happen seamlessly and incrementally. Rather, a business may confront the very real question of whether, with the exchange rate being where it is, it is able to remain in business.

Senator XENOPHON—Is it worth doing the modelling in the first place if there are so many variables?

Dr Henry—The increase in the exchange rate that we have experienced is not largely an artefact of government policy. It is largely an artefact of the external shock that the Australian economy has experienced, and is experiencing, because of very strong commodity prices. I do not want to be misinterpreted on this. I am not saying that this is an uninteresting question; it is a very interesting question that you raise. What I am saying is that we do not have the technology in house to do the work. If we did have the technology, I would have serious concerns about the quality of the output that comes out of it. The other thing I am saying is that, frankly, with the MRRT on one side stacked up against the very large increase in commodity prices that we have had on the other side, worrying about the regional impact of the MRRT but not worrying about the regional impact of the very strong increase in commodity prices to me seems a little peculiar.

Senator XENOPHON—Minister, the Inspector-General of Taxation was referred by you on 19 April for a comprehensive review of the implementation of the ATO’s Change Program. I understand that report was delivered to government on 3 December and handed to the Assistant Treasurer on 5 December. The government has 25 sitting days to table that report. How close are the parliament and the Australian public to seeing that report of the inspector-general?

Senator Sherry—Firstly, it was referred by me when I was Assistant Treasurer. Obviously, I have had a change of portfolio responsibilities, so my successor, Minister Shorten, now has responsibility. I will have to

take it on notice. I will make best endeavours over the next couple of hours to see whether I can be more precise than that.

Senator XENOPHON—I would appreciate that. In terms of natural justice, as I understand it the ATO would normally have a chance to respond to that report—or has that process already occurred? Perhaps Mr D’Ascenzo can answer.

Mr D’Ascenzo—Yes, we have already responded and included that in the report.

Senator XENOPHON—Mr D’Ascenzo, your understanding is that the natural justice process that the inspector-general undertakes has already been done? Mr Butler is indicating yes. So the ball is in the government’s court?

Senator Sherry—I think the ball is always in the government’s court.

Senator XENOPHON—Not necessarily, if there is an opportunity for the tax office to respond.

Senator Sherry—I accept your point. I cannot give you an indicative date. Under the 25-sitting-day rule, it is 6 July, which is obviously some months way.

Senator XENOPHON—It is a new tax year.

Senator Sherry—Yes, it is. The operational rules are that we have 25 sitting days. I understand your interest because I took many of those inquiries that were generated as a consequence of your being interviewed around the country. I will recall your interest in this.

Senator XENOPHON—Always happy to help, Minister.

Senator Sherry—You certainly did, given the number of shock jocks I had to be interviewed by!

Senator XENOPHON—I was very kind to you, Minister, in the media.

Senator Sherry—Yes, I know you were. I think you were very considered. I accept that you have an interest in this. I will make some inquiries. I will get one of my staff to speak to the Assistant Treasurer’s office and see if we can get you a more accurate date.

Senator XENOPHON—If the response could be given today that would be useful. Mr D’Ascenzo, these are things you may wish to take on notice: how many staff, including SES staff, both ongoing and non-ongoing, currently work at the ATO, including the classifications by number and percentage? How would that compare to the 2009 year and the 2010 year? I appreciate that you might want to take that on notice.

Mr D’Ascenzo—That information would be in our annual report, but we can make it available.

Senator XENOPHON—Yes, but specifics in terms of the classifications and percentages. Also, what are the projections in terms of staff levels and classifications for ongoing and non-ongoing staff and SES for the current tax year? In terms of the amount that was paid by the ATO to taxpayers in interest for delayed returns, that is higher this year, isn’t it, than it was in previous years? Is that the case?

Mr D’Ascenzo—I think that is the case. I think there are two large payments for two large companies in relation to the outcome of court decisions. You have to see interest in the light of adjustments to previous assessments through court processes.

Senator XENOPHON—Is it just that, or are more taxpayers being paid for delays?

Mr D’Ascenzo—We have further details there. Mr Butler might be able to give you more details. That has influenced the greater number. That is the significant material change.

Senator XENOPHON—Again, Mr Butler, I am happy for that to be taken on notice, unless you want to elaborate on it now.

Mr Butler—I will take it on notice, but generally speaking there were certainly more cases where taxpayers received interest because of the delays this time last year in processing returns.

Senator XENOPHON—As I understand it, Mr D’Ascenzo, the whole idea of the Change Program was to go to the new Siebel system. I think Mr Butler has had a key role in that system.

Mr D’Ascenzo—It is not quite as simple as that. The Change Program has a number of components. We started off with new portals for tax agents, taxpayers and businesses. That was a precursor. Release 1 was the new client relationship management system. Release 2 was a new work plan and case management system. Release 3 is about an integrated system. The whole range of processing and accounting systems, many of

which were brought from the 30-year-old National Taxpayer System, is in the new integrated platform. There are a lot of different components to it.

Senator XENOPHON—I understand that. Is there is a distinction between the legacy system and the Siebel system?

Mr D'Ascenzo—Release 3 is an integrated core processing system, which is not the Siebel system. The Siebel system is our case management and workflow program.

Senator XENOPHON—In terms of the contract with Accenture, the idea is to streamline the processing of tax returns?

Mr D'Ascenzo—That is right.

Senator XENOPHON—And the initial contract with Accenture would have included BASs as well?

Mr D'Ascenzo—Yes.

Senator XENOPHON—Are BASs now being processed under the new system?

Mr D'Ascenzo—No.

Senator XENOPHON—Will they be processed under the new system?

Mr D'Ascenzo—We have to work through when in our scheduling we want to do that. We had contractual arrangements with Accenture that compensated for that extra work.

Senator XENOPHON—Was the BAS system due to go to the new system but did not do so because of some technical difficulties?

Mr D'Ascenzo—Not so much technical difficulties, just program scope issues. We wanted to make sure that information was integrated. Part of the overall process was to make sure that our AIS system interfaces with our warehouse and that our warehouse then interfaces with the information from our new integrated core processing system so that we have the information that we get from both of those systems. So, from an information-gathering perspective, we have that integration in the back end. As to whether we move the BAS system onto our new system, I think that is still within our long-term projections.

Senator XENOPHON—Is there any time frame at this stage for BAS coming onto it?

Mr Butler—We have discussed this in a previous hearing. The business activity statement work was delayed. We decided to defer that work. Right now we are working on part of it, which is called pay-as-you-go instalments, with a view to that being finished at the end of this calendar year and further testing early next calendar year. We are doing it by components. Right now we are working through a more comprehensive program of work around information technology; we plan to have that plan finished by 30 June. Then we will clearly set out when we will be able to pick up the rest of the accounting system. We need to factor into that recently announced government changes, such as the review of superannuation.

Senator XENOPHON—Was it intended for the new system to include GST or is that still being done under the legacy system?

Mr Butler—The AIS system is not nearly as old as the National Taxpayer System, which we replaced with the Income Tax System. AIS was built as part of tax reform, so it is a much newer system. It was intended that it would all be together. For a range of reasons, which we discussed in other hearings, that did not happen. We took it out of the scope of the contract—

Senator XENOPHON—GST was initially in the scope of the contract, wasn't it?

Mr Butler—That is correct. The business activity statement system includes GST. The remittances are paid by business through business activity statements, so it is GST, income tax and those sorts of things.

Senator XENOPHON—Can we go to the issue of service standards? I understand that it is to process 94 percent of returns within 14 days. Is that right?

Mr Butler—Ninety-four percent of individual returns lodged electronically within 14 days.

Senator XENOPHON—Thank you for clarifying that. Are you confident of meeting that service standard for this current year and for the previous year?

Mr Butler—In July we did not meet that service standard. The volume of returns we typically receive in July means we now cannot recover that service standard for the whole year. But August was 90.9 per cent and September was 93.8 per cent—so it went over 90 per cent. It was 95.7 percent in October. All this information

is on our website. So we exceeded the service standard in many months, but because of the volume of returns in July—

Senator XENOPHON—Because time is limited, I do not want to go to things that are available on the website. The website indicates that you have details of finalised days—70. With respect to returns sent electronically, you have details finalised at 29-plus days. Could you indicate on notice how many delayed returns there were from 30 to 60 days, 61 to 90 days and in 30-day increments up until six months? Because that would be an issue. Hopefully there are not very many after 90 days. Those figures only go to 29-plus days, don't they?

Mr Butler—That is correct.

Senator XENOPHON—They do not tell us about longer delays.

Mr Butler—With the longer delays, there would be particular reasons why returns were delayed. In those returns would be returns we have stopped because we think there are fraudulent claims. Identity theft cases would be in those ones which are more than 30 days old. We give that break up.

Senator XENOPHON—To be fair to the ATO, you would be able to do a comparison of before the Siebel system came on line?

Mr Butler—Siebel was the case management system before the new system was put in place.

Senator XENOPHON—Okay, let us say the new system.

Mr Butler—That certainly is the case. With this new system we report it differently. In the past, of those returns that finished in December, we used to report how many were completed within 14 days. Now we say, 'Of those returns received in December, here is what has happened to all of them.' It is more complete reporting.

Senator XENOPHON—It would be good if you could provide those details on notice, particularly for those that blow out. There are some returns that you key manually; is that right?

Mr Butler—Very few, but there are some.

Senator XENOPHON—On notice, could you provide me with details of what percentage and number of tax returns were keyed manually for the 2009 and 2010 years and what do you envisage the level of any manual keying to be for this year?

Mr Butler—I will take it on notice. I am not sure how far we can go back accurately for manual keying.

Senator XENOPHON—I am just trying to get a sense of whether there is any difference in manual keying before the new system and post the new system. Presumably there would be less manual keying.

Mr Butler—Manual keying is a very small part of the work. Returns go through a system. They come out for exceptional review items. We know there are fewer exceptional review items in the new system than in the old system. In the old system our staff could only action one at a time; now they can do three or four at a time. We can give you the information about that, if that is of interest to you.

Senator XENOPHON—I want to go to the issue of error codes. We had a long discussion a couple estimates hearings ago about error codes. You indicated there were a number of error codes, or systems errors. For this year are there any error codes or system errors that are stopping or delaying the electronic processing of tax returns?

Mr Butler—There are always error codes in the system. Even the national taxpayer system was 30 years old. There were error codes. So there are, yes.

Senator XENOPHON—Could you supply some more details about the extent of that? How many hardship cases have there been in the 2009 year compared to the 2010 year, and how many are you expecting this year?

Mr Butler—I will take that on notice.

Mr D'Ascenzo—That is hardship cases in relation to people—

Senator XENOPHON—I think there is a definition of hardship cases in there.

Mr D'Ascenzo—Yes, there is, but that is not related to the system. If individuals cannot pay tax because of desperate circumstances they seek hardship provisions to waive the liability. So I am not sure how that relates to your line of questioning.

Senator XENOPHON—It is fair enough to clarify that. My understanding is that there have been applications in respect of hardship cases because of delays in the processing of returns, insofar as people have raised issues about the delays of processing returns.

Mr Butler—I think we have answered questions in previous estimates hearings about cases where people were anxious for their refund. We opened our criteria for ‘hardship’, treated them as ‘hardship’ and pushed them through the system.

Senator XENOPHON—That is right; Mr D’Ascenzo has clarified that. I am grateful for that. Have any legal actions been lodged in respect of delays, including any class actions? I have not heard of any.

Ms Granger—No.

Senator XENOPHON—In terms of the ATO’s relationship with Accenture, I note there have been some significant problems with the UK inland revenue office and Accenture. I am not sure whether that relationship has been terminated. Are there any ongoing discussions about renegotiating or terminating the contract with Accenture as a result of any problems with the implementation of the Change Program, for which Accenture is responsible?

Mr Butler—We still have Accenture doing work with us. We have a very positive relationship with them. The Change Program contract finished in June last year. We negotiated compensation for not doing business activity statements. As the commissioner said, that was a very positive, constructive environment. So we have a good, a positive and a professional relationship with Accenture.

Senator XENOPHON—I will put my question about compensation claims lodged for delays on notice. I do not know whether that is a different category. Perhaps Ms Granger can assist on that. Is there is a distinct category of compensation claims being lodged with regard to delays in returns being processed? I mean in terms of consequential loss. There is the interest payment. That is one aspect, and that is a straightforward interest payment. But there is another category, isn’t there, for compensation for any consequential or other losses?

Ms Granger—Certainly, as some of the claims included that ground, you have to specifically have a different process for that.

Senator XENOPHON—Sure.

Ms Granger—We had 104 claims for compensation.

Senator XENOPHON—Was that for 2010?

Ms Granger—Those statistics are as at 17 January this year.

Senator XENOPHON—For the current year?

Ms Granger—Yes.

Mr D’Ascenzo—Those are the total number of complaints we have had.

Senator XENOPHON—I am sorry, compensation claims.

Mr D’Ascenzo—Compensation claims.

Senator XENOPHON—Can you provide details of how that compares with the 2009 and 2010 years, given there is that specific category of compensation as distinct from the interest payments.

Mr Butler—We may not be able to make that comparison. These were compensation claims in respect of a new system. Of course, we did not have new systems in the earlier years. We can certainly give you the detail about the number of claims made for compensation from taxpayers and tax agents.

Mr D’Ascenzo—We could probably give you the details of any that we have actioned as well. I do not think we have actioned any in a way that the claim has been substantiated.

Ms Granger—In fact, 85 claims have been declined.

Senator XENOPHON—Obviously, just because you make a claim it does not mean it is a valid claim, I understand that. I have a general question about the issue of staff, Mr D’Ascenzo. I know there will be some answers on notice. Is it fair to say that you have to take on more staff to cope with the change program or the new system because of a number of technical glitches or issues with the implementation of the system?

Mr D’Ascenzo—Maybe Mr Butler can answer that more specifically. The system is working very well from our perspective. In fact, we think it has been a great achievement for this country to be able to have a

new system that manages flows of processes that go to the order of three to four million a month at its peak times. Most countries in the world aspire to that. We have had a number of independent reports that have indicated how well the implementation has gone, given the complexity and size.

Mr Butler—We do not have additional staff. We have additional staff during tax time, as we always do, because it is our busiest time of the year. We can take it on notice and give you comparisons over the past three years, for example, of tax time staffing full-time equivalent numbers, if that is of interest to you.

Ms Granger—Perhaps I can give a couple of statistics. Our staffing level at 30 June last year was 24,277. At 31 December, the end of this calendar year, it was 23,902, so it was slightly less. About nine per cent of those were non-ongoing staff. That was coming out of our peak processing season. So it is slightly less, but there are a lot of ons and offs in tax office staffing, as you know.

Senator XENOPHON—And you have your peak periods. Without going to the content of the Inspector-General's report, Mr D'Ascenzo, are you satisfied with the process that was undertaken and that the tax office was treated fairly in that report?

Mr D'Ascenzo—It is a question of the capabilities of people. We have had a number of reports from specialists in the implementation of major IT systems, both here and internationally. That has been made public. Everything has to be weighed up in light of those different perspectives.

Senator XENOPHON—You are satisfied that the process undertaken by the Inspector-General was a fair one from the tax office's point of view?

Mr D'Ascenzo—We had an opportunity to respond to the recommendations or the findings, and we did that. The extent to which they were taken into account is a matter for the Inspector-General.

Senator XENOPHON—But on the question of fairness, you do not want to comment on that?

Mr D'Ascenzo—It is a question of whether or not the processes have gone through. The other question is whether or not people's different perspectives were balanced in an appropriate way. That is for others to judge.

Senator BUSHBY—I have a question for the revenue group. Has Treasury updated its economic modelling on a carbon price since 2008?

Dr Henry—That is a question for the macroeconomic group.

Senator BUSHBY—The macroeconomic group?

Dr Henry—I can understand why you think it would be a question for the revenue group, but it is not.

Senator BUSHBY—Has there been an internal change in how that has—

Dr Henry—No, I do not think so.

Senator BUSHBY—We have asked many, many questions on economic modelling—

Dr Henry—Of revenue?

Senator BUSHBY—on the ETS and carbon price of this group in the past.

Senator CORMANN—The Prime Minister has just announced that we will have a carbon tax by 1 July 2012, so it is clearly a revenue measure.

CHAIR—The macro group are on later.

Senator BUSHBY—We can follow up aspects of this that are relevant for macro later. This is in the context, exactly as Senator Cormann says, that the Prime Minister has announced that we will have a carbon tax.

CHAIR—Yes, but the Secretary of the Treasury has said that this is a question for the macro group.

Senator BUSHBY—I will try to focus the questions on the tax side of it.

CHAIR—Sure.

Senator CORMANN—The carbon tax—it was not to be before the election and it is now looking like—

Senator Sherry—We know your political rhetoric.

Senator CORMANN—We like this broken promise of this government.

Senator Sherry—Perhaps we should focus on the question. You are wasting your own time—

Senator BUSHBY—I think he was just outlining—

Senator Sherry—and the very valuable time of the officials.

Senator BUSHBY—I think Ms Quinn used to answer questions, and I am quite sure it was in this section.

Dr Henry—No, I do not think so.

Senator BUSHBY—It certainly was not macro.

Mr McCullough—She might have been part of the fiscal group. She probably has the policy carriage of that sort of issue.

Senator BUSHBY—In terms of modelling, is that still within the fiscal group?

Mr McCullough—There is a special modelling unit that straddles both macro and fiscal. Meghan Quinn heads that unit.

Ms Mrakovcic—Meghan Quinn is the general manager of the macroeconomic modelling division.

Senator BUSHBY—So we will be able to ask questions about the modelling of the carbon tax of macro and Ms Quinn will be present to do it.

Ms Mrakovcic—This is the economic impact of carbon prices? This is the CGE modelling around the carbon price?

Senator BUSHBY—For instance, the 2008 modelling estimated the carbon price at \$26 was necessary in 2012-13 to achieve the government's five per cent carbon reduction by 2020—that type of thing.

Ms Mrakovcic—Those types of questions should be referred to macroeconomic modelling.

Senator BUSHBY—I might hand those over to them and focus on a few questions for the tax office. Firstly, in today's *Australian Financial Review* Mr D'Ascenzo was quoted as expressing his frustration at his lack of power to modify tax rules on excess superannuation contributions. I have asked you questions before about how many people have applied for the application of your discretion. First of all, is that report an accurate description of your feeling in respect of that particular issue? If it is, and even if it is not, to what extent do you have the discretion to recognise that some people are getting into a situation, through mistake or the mistake of advisers, that has serious consequences for them and their superannuation?

Mr D'Ascenzo—Unfortunately, the reporting has mixed a few terms. My key point at the SPAA conference was to highlight the policy rationale of superannuation. It comes from two perspectives. One perspective was: how do we safeguard retirement incomes for Australians? Parliament, in trying to encourage that, has provided a number of concessions, tax expenditures, that allow superannuation to thrive in this country. That means that the parameters of those concessions are outlined by the rules. So when people disregard the rules, whether it be the rules for self-managed super funds or super guarantee, what you have are two things: (1), you do not have an adequate safeguard in the retirement outcomes or, (2), concessions being provided to others that were not intended under the original design to access that. That was my key point.

Then we started to talk about the super review recommendations. In the super review recommendations—this was the Cooper review—the proposition was mooted, which I think the government has agreed to subject to further consultation, that there should be a review of the penalty structure for self-managed superannuation funds. At the moment, even for trivial breaches, the commissioner's sanction is to make funds non-qualifying. That has a very significant impact on the viability of those funds. That is the area that we were referring to. If you were to take out of that first line in the report 'excess contributions tax' and throw in 'self-managed super funds' then that would be what I was talking about.

Senator BUSHBY—The report mentions the self-managed super funds as well—it goes on in the next paragraph.

Mr D'Ascenzo—That was the penalty regime. The sliding scale of penalty applies to self-managed super funds, not to the question of excess contributions tax. In a sense, not maliciously as it turned out, people got the two references wrong.

Senator BUSHBY—You think that there needs to be some tweaking of the self-managed super funds rules, maybe a sliding scale of penalty—

Mr D'Ascenzo—The point is that the sanction that currently exists is to make a fund not qualify.

Senator BUSHBY—It is 'draconian', to quote you?

Mr D'Ascenzo—It is for trivial offences, which is the context of my statement.

Senator BUSHBY—Ultimately, government should seek to achieve a balance between protecting the revenue but enabling people to get on and make appropriate arrangements to look after themselves post-retirement. Protecting the revenue in an overly ‘draconian’ way, to quote you, eats into their ability to do that because it makes them non-compliant.

Mr D’Ascenzo—Basically, you stop them from conducting that process of building their nest egg for retirement through these self-managed super funds.

Senator BUSHBY—Hopefully, having raised it and put it squarely before the government, as you have publicly, and also I believe more directly—

Senator Sherry—There was the same issue with the APRA-regulated funds. I think the SI(S) Act changed the penalty regime from an absolute black-white remove tax concessionality to a more appropriate graduated regime. I am not aware of the history of why that does not apply to the self-managed super fund sector. I do not think there is any dispute of this issue, but it is a separate issue from the—

Senator BUSHBY—I was going to get to that.

Senator Sherry—tax treatment of excess contributions.

Senator BUSHBY—Hopefully the government will take this issue on board and we will see some action down the track.

Senator Sherry—As to the issue of the graduated penalty regime, yes, I would have to double-check our policy announcement on Cooper, but I—

Mr D’Ascenzo—No, the government has agreed to that recommendation, subject to consultation.

Senator BUSHBY—In terms of the excess superannuation contributions, the article says that about 90,000 people have been caught since 2007. I was intending to ask you anyway for an update on how many people have been caught. Is that an accurate figure?

Mr D’Ascenzo—As to the situation of excess contributions, the points I made—and I think it was just good context—were that people sometimes confuse what the different impacts of the rules are. Impacts do change, depending on whether or not you are breaching the concessional amounts and the non-concessional amounts and all by the same amount. Normally, if you have just breached, say, the concessional amount, the tax payable there is 31.5 per cent, which is equivalent to the marginal rate. What it says, in effect, is that you have had this tax concession, you are not really entitled to it and so it brings it back into the revenue pot. I wanted to make the point that the people who are subject to a potential 93 per cent rate is a very small proportion of the total population. Sometimes in the media it gets confused. All of this is subject to 93 per cent, whereas it is the very small tip of the—

Senator BUSHBY—It probably makes better press.

Mr D’Ascenzo—It does. That was the point I wanted to make in that context. The other one was that we have done something like 15,000 assessments. Of those 15,000 assessments we have had eight per cent of people coming back to the ATO and saying: ‘Commissioner, you have discretion. Can you exercise it in my favour?’ So that is eight per cent of the assessments raised. We have always taken the view, in fact in a recent AAT decision supports the approach we take, is that that is a very narrow concession. We have exercised that discretion favourably in about 20 to 25 per cent of the cases we have. Of that eight per cent—

Senator BUSHBY—That eight per cent—

Mr D’Ascenzo—We allow two, which means that 98 per cent are still there, subject to the liabilities that we have imposed under the law.

CHAIR—We will leave it there. We have run out of time.

Senator BUSHBY—I had not finished on that particular topic.

CHAIR—There are other senators wanting to ask questions.

Senator BUSHBY—I have had, what, about five minutes—

CHAIR—I am sorry. Senator Pratt.

Senator PRATT—Thank you very much, Chair.

Senator BUSHBY—out of 2½ hours—10 minutes. I am a permanent member of the committee. Bob Brown got more time and he is not even a permanent member.

Senator PRATT—I wish to go to the R&D tax bill in the Senate. Does anyone have information on the implications of those amendments?

Mr Antioch—Senator, the bill that has come to the Senate from the House last year does not contain any further amendments. I am not entirely sure—

Senator PRATT—As I understand it, there have been some amendments moved in the Senate by opposition parties. I am looking for an analysis of those. You may not have that information. If I am correct in my question then perhaps you could take that analysis on notice.

Mr Antioch—We could. There were some amendments mooted by the opposition the last time the bill came to the Senate. It is not clear whether those are still the amendments that the opposition intends to move.

Senator PRATT—As to the R&D, perhaps my colleagues can enlighten me as to whether we will be subjected to those again and whether there is an analysis of that approach. Anyway, I have plenty of other questions. I do not want to waste the committee's time. In the interests of brevity, I might just move on from that topic.

Mr Antioch—Sure.

Senator PRATT—There have been a number of comments about flood levies, exemptions. There has been a lot of debate in Western Australia about calling for people who have been victims of bushfires and floods there to be exempt. There seems to be some misunderstanding about that. I am seeking confirmation in a public forum that people who received the Australian government disaster recovery payments for both the recent WA bushfires and the Carnarvon floods are exempt from the flood levy.

Senator CORMANN—It is a decision—

Senator Sherry—You are not answering the questions.

Mr McCullough—I think Mr Wilcock can clarify—

Senator PRATT—Any misinformation—

Mr Wilcock—There will be exemptions from the flood levy in respect of people who receive an Australian government disaster relief payment. That payment is available in relation to people who suffered certain specified types of damage from floods in Queensland, Cyclone Yasi and the WA bushfires.

Senator CORMANN—Was that policy decision made to include—

Senator Sherry—Chair, firstly, he is cutting in on the officer as he is—

Senator CORMANN—No, it is a follow-up question.

Senator Sherry—He should be courteous enough—he is not yet a minister—just be patient.

Senator CORMANN—It is normal practice to have follow-up questions.

Senator Sherry—Just be patient. The government will not tolerate, and you did not either, when you were in government, witnesses being interrupted, Chair. Secondly, someone else was asking a question, Chair.

Senator CORMANN—It is normal practice in committees like this to have follow-up questions and you know that.

CHAIR—Just ignore the interjection. If you could finish your answer.

Mr Wilcock—So the WA bushfires, the Carnarvon floods and the floods in Victoria.

Senator PRATT—Thank you. I would like some advice on the significance of the flood levy legislation being passed in a timely manner. I suppose you would need to deal with things like finalising your withholding schedules as well as enabling other people to be ready with software et cetera.

Mr D'Ascenzo—Yes, that is correct. The earlier the better, in terms of the administrative arrangements that need to be made. As you pointed out, trying to get out the withholding schedules is quite an important matter for employers. Software developers need some time to prepare their packages, and also to try to explain to the community where ultimately people are exempted, who is and who is not eligible. It is going to be quite a task.

Senator PRATT—To get that ready for the next financial year we have to start now and have some certainty about what that legislation is like.

Mr D'Ascenzo—From an administrative perspective, the earlier the better.

Ms Granger—If I could just add to that. In relation to the commissioner being able to do new withholding schedules, he actually does need legislation in place in relation to that. He would not be able to do those schedules without that. It is also important for lead times as well.

Senator PRATT—Thank you very much. Dr Henry, I would like to ask you a question. Senator Cormann has been speaking about the fact that a large proportion of the MRRT will be raised in WA. I would like to ask what the ramifications are of a state government that does not have high enough royalties. It helps drive up the value of the dollar et cetera. It puts its hand out to the Commonwealth for health, education and infrastructure funding. You talked about the regional impacts of the commodity boom. Might these be things like the fabrication shops on the Kwinana strip? They were expecting a lot of work from the commodities boom but they are finding that a lot of that work is going offshore. That is characterised by, I suppose, high rents in towns like Port Hedland where families are paying \$1,500 a week but cannot get their kids into child care because childcare workers cannot afford housing. Can you talk through some of those issues that I have raised?

Dr Henry—It is certainly the case that the regional impact is not as straightforward as saying that a state that has a lot of iron ore and coal is a state in which everybody benefits from high iron ore and coal prices. That is certainly the case. The state of Queensland probably provides a very stark illustration of the dangers in coming to such a conclusion.

Senator Cameron referred earlier to the impact on tourism of the high currency and that seems to have impacted Queensland more than any other state. It is certainly the case that even within a state, even within a region, different businesses are being impacted differentially, largely because of the impact of high commodity prices on the Australian dollar.

It is quite complex, and I think it is very difficult to generalise with any confidence. For example, some businesses that are being impacted severely—I am thinking of some manufacturing entities even that have been impacted negatively by the high dollar—and some have found opportunities to supply product to mining and engineering construction associated with mining. It is quite a complex story.

CHAIR—We will move on to Senator Eggleston.

Senator EGGLESTON—Thank you, Chair. I had some questions on a carbon tax yesterday which I sought to ask in the minerals and energy section. I was asked to ask them in this section of Treasury. I am not sure whether or not it is appropriate.

Dr Henry—Perhaps I can assist the committee, Chair. The appropriate group would be fiscal group—anything to do with climate change, whether it is an emissions trading scheme or whatever. That includes, Senator Bushby, questions on the modelling. We will ensure that Ms Quinn is here with the fiscal group colleagues to take those questions.

Senator LUDLAM—I would like to change the subject and put some questions to whoever feels best qualified to deal with housing. Some of the issues that were raised in your tax review, Dr Henry, that do not seem to have received a great deal of play since you wrote about housing. Specifically, we have a range of tax incentives that encourage investment in property. Do you consider that we have effectively got a tension in Australia between tax policies designed to encourage appreciation in real estate markets for the benefit of investors at the same time as we are ploughing money into housing affordability initiatives to try and keep housing within range of the rest of us? Is there a tension inherent in the way that we are taxing the housing sector?

Dr Henry—This is a policy question, but it does relate to material in the tax review that I chaired, so I am happy to respond to the question, at least in a general policy way. I think the features of the tax system that you would be referring to in particular probably—I am guessing—relate to the way that the capital gains tax interacts with deductions permitted for income tax purposes, something that in this country we colloquially refer to as ‘negative gearing’. It is likely that the combination of our fairly concessional capital gains tax treatment of rental housing—a combination of that with negative gearing—does provide an incentive. There is no doubt that it provides a strong incentive for investors to invest in rental property, when there is an expectation of significant capital gain.

We saw precisely this behaviour in the early part of the last decade, particularly running up to the end of 2003, where a lot of the finance that was approved for housing—a very large proportion; I cannot remember the precise proportion, but it was a very large proportion of the finance approvals—was for investor housing. I do not think there can be any doubt that at least when there is an expectation of strong price increase in

housing generally there is then a shift in the pattern of housing investment from owner-occupier housing, which itself is generously treated, of course, under capital gains tax, to investor housing, to rental housing.

It has been argued by many, including a number of academics who undertake research in this field, that the tax incentive itself contributes to house price increases and underpins expectations of further house price increases and that, therefore, there is some feedback into market behaviour. To the extent that that is true, obviously there is a distortion in the pattern of investment in the housing sector, which affects not only owner-occupier housing but also the supply of more affordable housing for lower income people because you have a distortion affecting the housing construction sector; and all housing, for whatever purpose, in the scenario that I have outlined—whether it is for public housing even—has to compete for skilled labour with those sectors that are building housing for other sectors, including the investor housing sector.

Senator LUDLAM—The long-run increase in house prices is appreciating at about nine per cent a year. The last time a body—I think, apart from the review that you undertook—looked at the combined total of capital gains tax exemptions, land tax exemptions and negative gearing, it was about \$50 billion a year. The Commonwealth spends about \$1 billion a year on housing affordability initiatives, which virtually did not exist under the previous government. I feel as though there is something very difficult to reconcile. As far as your review is concerned, what is the state of your thinking about how to untangle these split incentives?

Dr Henry—There is quite a lot of material in the review on this topic. Broadly, that is on land tax and the way that land tax operates. There are two principal issues associated with land tax that are relevant to the question that you have raised. The first is that land tax obviously has numerous exemptions. So the own home is exempt from land tax, primary production land is exempt from land tax and so on. But the land that is subject to land tax, putting aside commercial real estate, is rental property. But in respect of rental property, there is a substantial threshold that is available on an individual basis in most jurisdictions—in all jurisdictions, I think—but any owner of rental property has to aggregate all of their land and just has access to one threshold.

An interesting consequence of that is that, internationally, the proportion of rental housing owned by individuals is higher in Australia than anywhere else in the world. It is an obvious consequence of the aggregation of land holdings and the application of a single threshold per individual or per taxable entity. The states are pretty well aware of this, but there is an obvious case there for considering a reform of land tax for that reason.

As far as the other aspects are concerned, in the review we presented a case for having a more equal taxation of various forms of saving. An individual can save, obviously, by putting their money in a bank account. They can save in superannuation, as we discussed earlier. They can also save by buying shares or by investing in rental property, as we have discussed. We argue that there was a case for providing preferential tax treatment for saving, and that case is probably nowhere stronger than in long-term saving, post-retirement saving—that is, superannuation. So that is a clear case, we thought, for having concessional taxation for saving.

With respect to the other categories of saving, the various categories, we thought there was also a case for having preferential tax treatment of saving as against, say, labour income; but there was an equally strong case for flattening out the taxation treatment as between those various forms of saving. So we propose in the review a rule which says that a percentage—less than 100 per cent—of income from saving, whatever the form of saving is, be included in taxable income; that is, there be, essentially, a uniform discount across the various forms.

In respect of income from rental housing, what this would mean, for example—and I think from memory it was a 60 per cent inclusion rule—is that 60 per cent of rental income would be included as taxable income, but on the other hand you would only be allowed 60 per cent of your deductions, and that includes interest deductions. So for those who are engaged in negative gearing—that is where, by definition, the interest deduction exceeds the rental income—instead of getting deduction for the full amount of the excess, they would get a deduction for 60 per cent of the amount of the excess. That would go some way to addressing the tax distortion that you have referred to.

There are ways of flattening out the tax treatment of saving to address the distortions that you are referring to, or at least partially address the distortions you are referring to but which overall do not reduce the concessional nature of the tax treatment of saving. Indeed, it would be possible to construct these things in a way where it was actually revenue negative—that there was an enhanced incentive for saving overall but a more—I

hesitate to use the word 'neutral' but this is how we talk about it internally—neutral taxation regime for saving.

Senator LUDLAM—What about tax incentives available for properties that are kept vacant—speculative vacancies?

Dr Henry—I think the two instruments that are available there for governments are capital gains tax and land tax, really. Capital gains tax and land tax are the two obvious instruments that are available.

Senator LUDLAM—I will place my last question on notice. Could you just tell us what specific resources, either FT or work units, within Treasury or the tax office are currently working on housing affordability and where those folk are located?

Dr Henry—Sure. I will take that question on notice.

Senator LUDLAM—Thank you. Thank you, Chair.

Senator BUSHBY—I have just one final question on the excess superannuation contributions. How much money has been raised from that change? It may be Revenue that can give me that answer or the ATO.

Mr D'Ascenzo—Mr Olesen might address that question.

Mr Olesen—As the commissioner mentioned in an earlier answer, we have raised about 15,000 assessments for excess contributions tax. I think collections are in the order of \$100 million to date. I do not have the precise figure here.

Senator BUSHBY—Is that consistent with the projections of the amount that was going to be raised by this change of revenue?

Mr Olesen—I would have to take that on notice.

Senator BUSHBY—Is anybody in Revenue able to answer that? I recall that we had a hearing into the changes through this committee some years ago and there were objections at that time.

Senator Sherry—I think it was under the former government when this provision was introduced. But I do not recall us—

Senator BUSHBY—The former Labor government?

Senator Sherry—No, the former Liberal government—the penalties for the excess.

Senator BUSHBY—I am sorry, when you changed the cap.

Senator Sherry—I am sorry, I thought you were referring to—

Senator BUSHBY—That is what has led to a lot of the errors in terms of advice and people's decision making, the lack of it—

Senator Sherry—Well, let's not—

Senator BUSHBY—and that was actually canvassed in the hearing that we held into that change.

Senator Sherry—That is not true, Senator. If you look at the—

Senator BUSHBY—The commissioner nodded when I said that.

Senator Sherry—If you look at the number of people. First, this penalty was introduced by the previous government. Second, if you look at the 2007-08 financial year, when the previous Liberal government was in power for at least a part, there were a significant number of individuals who were affected by this tax. They are the facts.

Senator BUSHBY—Absolutely. But the cap was lifted, I think, in the last year of the coalition government. The amount that you could actually put in the concession was lifted, and then 12 months later it was reduced by the Labor government. What I am concerned about, and what I have always been concerned about during the process when we looked at the change, is the potential for people to get caught between the cracks. The decision on where you set the concession is a matter of policy for government, and we may like it or we may not. But what I was concerned about was people suffering consequences for not getting it right, because things change. It goes up, it goes down. It is about making sure that people have the opportunity to do the right thing and not suffer consequences unreasonably. My questions to the ATO today and in previous estimates have been designed to get to that point and to understand how we can deal with that to make sure that people are not losing out on retirement savings that they should and would otherwise have had because they made an inadvertent error or their adviser made an inadvertent error.

Mr Olesen—Senator, it might help if I explain a lot of the work that we have done around excess contributions. Tax to date has been in relation to the 2007-08 year. We are finalising those cases in the current period and moving on to the 2008-09 year cases. It will not be until the next financial year that we get onto the 2009-10 cases. So in terms of that three-year picture that you are seeking, it will just take a little while before we get through that body of work. We will have a rough sense now of the overall likely numbers that may be impacted, but in terms of actual assessments that we raise, that work will take place over the next six to 12 months.

Senator BUSHBY—I might leave this topic and move on to something else, and we will have a look at that picture as we go. The reason I ask about the commissioner's discretion is that no doubt there are people who are flagrantly making decisions without checking the law. There are others, I think, who fall through the cracks and, through no fault of their own, find themselves in a position where they might be paying up to 93c in the dollar.

Turning to adverse decisions, I note that in the *Australian Financial Review* on 16 February this year there was a report that the Inspector-General of Taxation will be investigating your order to small businesses and high-wealth taxpayers in addition to a review of larger business entities. I also note that the ATO has received criticism for being too aggressive in its approach and/or failing to take into account key documents and arguments. For example, there is the Denlay case in the 2010 Queensland Appeal Court and the more recent AATA case *Re James and Anor v FCT*. I also see there was a new case that you lost yesterday with Luxottica. I have not had a chance to read that to see if there were any adverse comments in it, but presumably there might be. What were the costs to the ATO of the *Re James* and another case and the Denlay case?

Mr D'Ascenzo—We have actually won the Denlay case.

Senator BUSHBY—Did you have any costs?

Mr D'Ascenzo—We would have had costs.

Senator BUSHBY—If you won did you receive a costs order? There are adverse comments in there about some of your approaches. That is really what I am going to.

Mr D'Ascenzo—Well, we ended up winning the case.

Senator BUSHBY—The court was critical in that case of the ATO for taking steps in bankruptcy against a taxpayer who was in the process of lodging an objection to an assessment. That is a correct statement?

Mr D'Ascenzo—I think the general question was whether or not we should be seeking recovery of debt in relation to an arrangement which we think might be fraudulent. The court said they needed to expend their money on legal defences first.

Senator BUSHBY—My primary focus of these questions is not so much the cost. I did ask that, but it was more of an aside. I am mostly interested in how you are using the powers of investigation when you undertake investigations when you actually take matters to court. In terms of the comments in the Denlay court case and also the comments in *Re James* and another—

Mr D'Ascenzo—Which one is the other case, Senator?

Senator BUSHBY—It is the AATA 26 *Re James* and another v FCT.

Mr D'Ascenzo—I am not sure of that one.

Senator BUSHBY—In that one, the tribunal was critical of the ATO's stance on a number of issues. I can read those out to you. As to purchases and admissions, the AAT noted on several occasions that the purchasers of the business had admitted at various times and in various documents that they remained indebted to the taxpayer. Contrary to the commissioner's argument that the taxpayer had failed to produce evidence of existence of the amount owing to them, and given that you are not familiar with this case, I might put some of these questions on notice for you. We will probably get a better response.

Mr D'Ascenzo—I am happy to do that.

Senator BUSHBY—Basically, I am interested in the decision-making process that leads to some of the processes that you take that have attracted adverse comment.

Mr D'Ascenzo—We have a public process which is contained in a range of our public documents as to how we go about the process of litigation. Litigation is a process that involves not only ourselves but usually external solicitors, depending on the case that we have. Sometimes we do it in-house if it is a routine matter in terms of solicitorial role. We have a range of call-over processes within the organisation to make sure that the

evidence is sound. We have a host of checks and balances in those processes to make it such that we meet the model litigant requirements. Indeed, if you look at the Attorney-General's reports on our performance, given that we have probably one of the highest levels of litigation in the Commonwealth, we do very well given the number of cases we deal with.

Senator BUSHBY—As I say, I will put some of these questions on notice. One of the questions that follows on from that, in my mind, is: what are the criteria that the ATO uses to rank, from high to low, the tax risk assessment into which certain business taxpayers should fall?

Mr D'Ascenzo—Again, it depends on what area of mischief might well be at the heart of risk assessment. Certainly, the size of the issue is an area. What you look at in a risk matrix are the consequences and the likelihood, and you graph that. If you have very high consequences, that puts you at one level of that risk matrix. If the likelihood of that occurring is high, that is our high risk, and then you work your way in accordingly.

Senator BUSHBY—But presumably it is more complex than that. Does it take into account things like the cooperation of taxpayers in willingly providing information or volunteering to extend statutory periods beyond which the ATO cannot act against them, or is it impacted by whether the taxpayers initiated litigation against a tax assessment? Do those sorts of things feed into individual risk assessments?

Mr D'Ascenzo—That goes to the process of examination audit or litigation. In terms of our original risk framework, it is more a question of consequences and likelihood. The consequences do not have to be just to the individual taxpayer; there could be consequences to the integrity of the tax system, the integrity of the super system. Where there is a principle that may have a wide application, that is a risk. A risk is that perhaps the law is not operating as it should. So it is more complicated, as you mentioned. But that is how we first start off working out what areas we put the focus, because all administrations have a scarcity of resources and have to make choices about where you best put your resources to get the best environmental outcome. The best environmental outcome for us is an environment where we have made it as easy as possible for people to voluntarily comply and that there are actually high levels of willing participation in both the tax and superannuation systems.

Senator BUSHBY—Which branch in the ATO is responsible for ensuring that you act as a model litigant?

Mr D'Ascenzo—We have a litigation area in the ATO.

Senator BUSHBY—What procedures are in place to ensure that model litigant rules are followed?

Mr D'Ascenzo—As I explained, we have a range of checks and balances. Ms Granger could give you some more details. We have to report to the Attorney-General on the model litigant claims. They are actually included in the report I send and sign off to the Attorney-General in terms of our performance in that area. We make sure that is reported in our annual report. Over time, I am not seeing any systemic concern over and above the odd case that, for different reasons, can attract criticism, sometimes against us and many times against the taxpayers.

Senator BUSHBY—To change the subject slightly, I note in an appeal court decision in the Supreme Court of Tasmania, Saxby against the Crown, a conviction was confirmed against a taxpayer who made a false representation in an objection to a tax assessment. Without going into the merits or otherwise of the case, which has been decided by due process, I was wondering how often the ATO has prosecuted taxpayers for making false statements in an objection to a tax assessment.

Mr D'Ascenzo—I can take that on notice. We are working with the Commonwealth Director of Public Prosecutions with a view to working with his officers to facilitate the ATO through the auspices of the DPP in prosecuting more cases civilly through the powers that are in our Taxation Administration Act, in order to lessen the burden on the DPP, who we reserve for the more serious, complex cases.

Mr Quigley—I can respond with those figures, if you like, or else we can provide them to you separately.

Senator BUSHBY—Okay. I will put some questions on notice about this because I need to wind up and give some time to Senator Cormann. Thank you.

Senator CORMANN—I have a few quick questions for the ATO. How is your performance going in terms of turnaround for tax refunds for business entities and wage and salary earners? There were some problems there in recent times. How is that tracking?

Mr Butler—As I mentioned earlier in the hearing when I answered a question from Senator Xenophon, in July we had some delays in processing returns, but since then returns have gone through very smoothly.

Senator CORMANN—Can you put some figures around that, on notice, perhaps?

Mr Butler—We have recently completed our 10-millionth individual tax return in the new system since 1 July this year. The actual number is on the website.

Senator CORMANN—I will not dwell too much on this because we only have a little bit of time left. Today, the minister, Senator Nick Sherry, and I have had a bit of a debate about people inadvertently breaching their concession and non-concession contribution caps. I know that Senator Bushby has asked some questions about this. Indeed, Senator Bushby put a question on notice on this issue last year and I put a related question on notice this year, but you have different answers in relation to your capacity to provide statistics on how often you use your section 264 powers. In response to Senator Bushby you essentially said it could not be done and in response to me you said you would be able to do it by around March 2011. What drove the change? What happened?

Mr D'Ascenzo—I am not aware of those differences.

Senator CORMANN—And there was sort of a blank refusal initially.

Mr D'Ascenzo—I think there was a request for the use of access without notice, and that came out of an Ombudsman report. The Ombudsman asked us to make that more public, and we have done that through our annual report.

Mr Quigley—Senator, if I might clarify: the reason we do not keep and we cannot provide figures on every time that we use our access and information powers is because they are used on an everyday basis. The auditors are out there every day. They have their authorities which they provide and they get normal access. I can give you figures on the number of times that we have—

Senator CORMANN—Can we do that on notice, because I do want to spend the last two minutes with Dr Henry. The chair has advised us that this is the area for corporate matters in the Revenue Group. Dr Henry, given that this is your last attendance at Senate estimates, can you share with us whether you are leaving on a high or whether you are leaving on a low?

Dr Henry—After this morning's questions, I would have to say that I am leaving on a high, Senator.

Senator CORMANN—So we can take credit for that?

Senator Sherry—We can all take credit for that.

Senator CORMANN—I will not let you off the hook that easily, Dr Henry. Given that you have put a lot of work into a very comprehensive tax review, out of which the government only picked the proposal for a multibillion dollar new tax and then botched your proposal and introduced something completely different, more complex, less fair, not replacing state and territory royalties but creating a top-up tax, not talking it through with state and territory governments and of course now not having a tax summit to consider your recommendations, at least not in the time frame that was promised, is that a disappointment to you?

Dr Henry—I remain very optimistic with respect to the implementation of many recommendations of the report—very optimistic.

Senator CORMANN—Over the long term it might take a different government to achieve some of them.

Dr Henry—That will obviously be out of my hands.

Senator CORMANN—Thank you, Dr Henry.

CHAIR—Thank you, Dr Henry, and thank you to the revenue section of Treasury. We will resume after the break with the Australian Bureau of Statistics.

Proceedings suspended from 1.29 pm to 2.33 pm

Australian Bureau of Statistics

CHAIR—Thank you to the ABS for coming this afternoon. Are there any opening statements?

Mr Sutton—As senators would be well aware, the ABS is conducting the next census of population and housing this year on 9 August. This is the largest peacetime logistical exercise conducted in Australia, and the results from the census are obviously critically important for many nationally important purposes. We are very appreciative of the longstanding support that has been shown by parliament and the Australian community more broadly, and we look forward to this support continuing in 2011. I am also pleased to report that preparation for the census is going very well and we are confident that we will conduct a very high-quality census in 2011. I would like to thank the Australian people in advance for their assistance in this coming year.

Without that cooperation our task would be impossible. We are in the middle of a recruitment phase currently and we hope to provide employment opportunities to some 43,000 Australians. I would also like to reassure the committee that while the devastating floods and cyclones of recent times have had some impact on ABS operations we are working to minimise any adverse statistical impacts while remaining sensitive to the circumstances of the data providers affected in those parts of Australia. Thank you.

CHAIR—Thank you, Mr Sutton. Policy providers and politicians look forward to the updated information provided by the census. We value the assistance that kind of data gives us, so thank you very much.

Senator CORMANN—I just have a couple of quick questions. How often do you issue your inflation report?

Mr Sutton—This is our CPI?

Senator CORMANN—Yes.

Mr Sutton—It is a quarterly series.

Senator CORMANN—Has there been any proposition to move to a monthly report?

Mr Sutton—There has certainly been interest by users in the past across a range of areas to move to a monthly CPI, but that has always been subject to funding being available.

Senator CORMANN—What sort of funding are we talking about? Has anyone costed that as a proposition?

Mr Davies—We have. We recently had a very extensive review of the CPI with extensive community, academic, government and private sector input, and in fact the demand for a monthly CPI was articulated very strongly. We recognise the validity of that demand, so we have investigated the logistics of doing it and we have come up with some figures. I do not have the figures here with me now but I could certainly supply them to you.

Senator CORMANN—Do you think we might be able to get them before three o'clock? The RBA obviously has called for it in their submission to the CPI inquiry. As I understand it we are one of the few equivalent economies in the world that does not have a monthly CPI report. Is that right?

Mr Davies—Yes, that is correct. We are probably the only industrialised country that does not—

Senator CORMANN—The only industrialised country that does not have monthly report—so if you could provide us with the costing of that I would be very grateful. Now, have you had a recent look at the implications of introducing financial services charges such as interest movements into the CPI, and was that a mistake?

Mr Davies—There was a long list of issues that we visited during the CPI review. This was in fact probably one of the most complex issues we looked at because it deals with the price of a service that is charged for indirectly. When you deal with a bank—you will know the big debate between the explicit charges and implicit charges which are included in increased interest rates you pay or decreased interest rates you receive. On the basis on which we do our CPI in Australia there is absolutely no question that the services received from banks and paid for indirectly are a part of the basket consumed by households which should be included, and that we should be measuring the prices of those services—so that is beyond debate. We included them some years ago. Some people were uncomfortable with the methodology but it did reasonably well for some years. In recent years with high levels of volatility, particularly during the global financial crisis with big movements in interest rates and bank margins, it has moved in a somewhat volatile manner and some of the users have been uncomfortable with it. They have not been able to replicate it in forecasting and there have been some issues around implementation—not the concept that it should be in there but the actual implementation. So what we are doing is taking that out of the CPI and continuing to publish it as an experimental series with the hope of putting it back in. It simply has proved an extremely complex exercise, and we felt that the best move was to remove it and publish it as an ongoing experimental series but with a clear objective of reintroducing it.

Senator CORMANN—Of reintroducing it at a particular trigger time or once you are satisfied—

Mr Davies—We and the users—and I think there is a round of discussion with government users such as RBA, Treasury, other government departments and bank economists. The banks supply the data, so they are quite aware of what should be happening. So the bank economists need to have confidence in what is being done. We have some work to do on that front.

Senator CORMANN—What is the degree of your involvement in supplying APRA with superannuation fund return data?

Mr Davies—APRA collect the data themselves and we in fact access the same data as APRA. The way it works is that APRA, the Reserve Bank of Australia and the Australian Bureau of Statistics have a tripartite agreement whereby APRA is the primary collection agency for a wide range of financial information, which includes the superannuation information.

Senator CORMANN—There has been a lot of concern expressed about the reliability of APRA's superannuation fund return data. From your point of view, is the way it currently happens the best set-up?

Mr Davies—It is a very well-defined and well-functioning set-up. There are some very professional people involved and it works very well. We get a good, complete, coherent dataset which we use extensively. I am aware that both APRA and the Reserve Bank use it extensively.

Senator CORMANN—Has APRA ever approached you for support in terms of the way they manage their data collection and the methodology they use?

Mr Davies—Yes, we do work with APRA. It is a tripartite agreement. As we are the specialist agency in collecting data, we share information with them and discuss methodologies, form design and what is collected.

Senator CORMANN—But you are not aware of criticisms from super funds industry associations and media commentators about the lack of quality?

Mr Davies—No, I am not aware of that.

Senator CORMANN—So, if you are not aware of it, you cannot help APRA address the problems, I guess, in terms of methodology and the way it is all done?

Mr Davies—There are standard statistical methodologies. There are editing methodologies. We work with APRA on a whole range of them across the whole collection of financial data.

Senator CORMANN—Now that I have raised the issue, you might want to reflect on it and we might have an opportunity to explore it at the next estimates. Thank you.

Senator LUDLAM—I want to ask you about a particular indicator in the last couple of censuses—that is, your indicator of vacant properties. I am wondering if you can tell us, if it is not too unfair to land this on you without notice, how you put your estimates together of residential property vacancies in the census.

Mr Sutton—I might pass this to Peter Harper.

Mr Harper—I will give you a general answer and, if you want some more information, the head of the census, Paul Lowe, would be happy to talk to you. It is actually a census of population and housing, so we do not just measure the people in Australia; we measure the housing stock in Australia at the time of the census. Because we enumerate every dwelling occupied or unoccupied at census night, we can provide information on the extent of unoccupied dwellings as at census night.

Mr Lowe—As Peter said, the collectors, when they are going out and enumerating their workload, will try to ascertain whether a property is occupied or not occupied on census night. It is at a particular point in time—on 9 August this year, for example. It does not mean they are necessarily vacant; what it does say is that the collector believes that property was unoccupied on census night.

Senator LUDLAM—Nobody home is very different to properties that are vacant.

Mr Lowe—That is correct.

Senator LUDLAM—Is it possible to extrapolate at all from the unoccupied properties—if nobody answered when you knocked on the door—to get an estimate of vacancies of residential property? I am a bit concerned that that indicator might be being used interchangeably.

Mr Lowe—In my view, I do not think that the census data will give you an indication of vacant dwellings under that definition. All we can produce is unoccupied dwellings on census night.

Senator LUDLAM—So who do I ask to find out about residential vacancies if not the ABS?

Mr Harper—I am not aware of any statistics that the ABS collect on vacancies of that nature.

Senator LUDLAM—Would that not be an interesting thing? I realise that we are not going to make it in time for the 2011 census, but, for example, in China I understand they use traffic through utilities—water and electricity—to establish whether a particular premises has an occupant or not. Is that something that we might

consider here in Australia or is there any other way that you can offer so that we might be able to gauge the difference or distinction between vacancy and just a house that did not seem to be occupied on the night?

CHAIR—You are asking a policy question about whether we should or should not—

Senator LUDLAM—That is fair enough. How would you do so?

Mr Harper—I think we would first have to establish the reason why somebody wanted that information and, based on their particular need, identify what the best way of collecting it would be. But we would also have to consider that in terms of all the other demands that we have on the organisation for collecting statistics in areas where we are currently not collecting them. My personal view is that I do not think that the census would be an appropriate way to do that. You cannot ask a vacant dwelling or an unoccupied dwelling whether it is vacant or not. I do not know the efficacy of other techniques. We would need to look at that in order to be able to answer that question.

Senator LUDLAM—Thank you. I think the chair is correct in that it is a policy question. Can I just grab the minister's attention for a split second. Can I put it to you, Minister, recognising that we have probably missed the boat for the 2011 census, that we do not appear to have an accurate idea at any given time of the degree of residential vacancy in Australian communities—that is, places where people could be living and, for whatever the reason might be, there is no-one there at the moment. Is this something that the government would consider might be a very handy indicator for us to have?

Senator Sherry—I do not know. I suppose it would be useful. You always have to weigh up the costs involved in collecting it and the challenges that have been mentioned. You might be able to do something in cooperation with local government because of their property based systems. I am happy to raise it with the Assistant Treasurer and see if something can be done.

Senator LUDLAM—I am raising it for non-trivial reasons. The last two census outcomes on unoccupied dwellings on the night of the census averages around seven per cent or eight per cent in the big metro areas. That is a reasonably constant figure from 2000 to 2006. We know there are structural issues in our tax system that actually provide perverse incentives for landlords to keep properties vacant to squeeze supply. So I think we do have quite legitimate public policy reasons for wanting to know what the actual vacancy rate is.

Senator Sherry—I accept that you are not wanting to be trivial. As to the reasons you have identified, there may be other issues, so I am happy to raise it with the Assistant Treasurer.

Senator LUDLAM—Thank you very much.

Senator PRATT—You might have covered this in your introductory remarks. I am sorry that I was not here at that point in time. I note that your annual report talks about and acknowledges some of the work program that was able to be reinstated as a result of an increase in funding after cuts in 2008-09. I wanted to ask what the general nature of those programs that were reinstated was.

Mr Harper—I can talk about some of the things that were reinstated. One of the things we did at the time was reduce the sample size in the monthly population survey, which produces labour force estimates. We have reinstated that sample. We also discontinued the survey of job vacancies, and that was reinstated. We also made some timing changes to the survey of employment earnings and hours and we reversed those as a consequence of the reinstatement of funds. We had made some changes to our industry collections which we were able to reverse as a result of that.

Mr Davies—I think the only one to add is retail trade. That was considered particularly important over the last couple of years with the crisis and the government stimulus aimed at households, so we have reinstated part of that.

Mr Harper—At the time we made those reinstatements to our work program we put a statement up on our website which I think is still there. We could either take that on notice or give it to you.

Senator PRATT—I can find it myself. I appreciate your drawing that to my attention. I just have one other question, which is about the Northern Australia enumeration strategy for the census. I am interested to know how you will demonstrate improvements, how you are going to benchmark improvements in that and the nature of the strategy that you are implementing to make sure that it is done properly. I do know that collecting census data for remote Aboriginal communities in particular is very different to how you might do it for suburban communities, for example. I would also like to ask in addition to those questions how you step down to communities that have quite a lot of transient Aboriginal populations but do not fit within the identified regions that you are implementing this strategy for—places like Geraldton?

Mr Sutton—I might pass this over to Peter, who has got responsibility for the census.

Mr Harper—The ultimate indication of the success of the Northern Australia strategy will be a reduction in the level of undercount in the 2011 census compared to the 2006 census, particularly the Indigenous undercount. While obviously not all the Indigenous people in Australia live in Northern Australia, we do know that it is a difficult part of the country to enumerate, for a variety of reasons. We were fortunate that the government a few budgets ago gave us some additional funds for the Northern Australia strategy, particularly the focus on Indigenous enumeration, and that has allowed us to put in place a range of different collection techniques and, importantly, enabled us to have resources that we can swing into action quickly in areas where things might not go as well as we had planned. Having that surge capacity is a critical element of it, as well as the other steps we are taking. We have also significantly increased the range of engagement activities with Indigenous communities, and communities more broadly, in Northern Australia. But in that contact with Indigenous communities we have not just drawn a line across the map and called that Northern Australia; that is operating right across the country. We are already seeing the benefits of that in terms of the levels of engagement and support that we have got for the 2011 census. Mr Lowe can provide you with more details on the strategies and deal with your specific question about the communities outside northern Australia.

Mr Lowe—It is really about deploying additional resources into the field in remote areas and regional and urban areas. It is providing greater assistance, especially to people in regional areas, to complete their census forms—Indigenous householders. We are deploying over 500 staff across the country to help Indigenous households complete the census form through personal interviews rather than self-enumeration. As Mr Harper said, over the last 12 months we have been doing a lot of engagement work with Indigenous communities right across the nation. What is particularly pleasing to me is that I have seen a change in that the Indigenous communities are now taking ownership of the census in their community. They are actually advising us on the best procedures and methodology to enumerate their particular communities and get a great result. As far as the transient population goes, one of the biggest changes from 2006 to 2011 is that it took us, in some places in the country, nearly three months to enumerate the Indigenous population in remote areas. With the additional resources, that enumeration period will come down to four weeks, so that will overcome a lot of the challenges we saw with the mobile population, and I believe we will get a far better outcome in 2011 we did in 2006.

Senator PRATT—What about regional towns that also have a mobile population but are not in Northern Australia?

Mr Lowe—The strategies we are adopting in northern Australia—the Indigenous enumeration strategies—we are actually applying right across the country, even in places in New South Wales, South Australia and Western Australia.

Senator PRATT—That is terrific.

Senator RYAN—I want to turn to the data you collect on victims of crime. I understand you currently only collect data against individuals and households.

Mr Sutton—That is correct.

Senator RYAN—Have you considered collection of data around business victims of crime, whether that be white-collar crime or shoplifting? I am not aware of whether that has been done in the past.

Mr Sutton—I would have to come back to you on that. I am not sure how much work we have done on the business side of things. It is something we would be able to come back to you on and give you an idea—

Mr Harper—I am not aware of anything.

Mr Sutton—I am not aware of anything but rather than say we do not have something on it I would rather have a look and come back to you.

Senator RYAN—That would be great. And if you did have something I would appreciate a direction to it, because that way I can chase it up.

Mr Sutton—Sure.

Senator RYAN—Do you know whether the ABS has access to data from the states regarding crimes like shoplifting?

Mr Sutton—Yes we do. The state police provide us with information on crime statistics.

Senator RYAN—If it would be easy to collate that data with a new category of, say, crimes against business to add to the catalogue that has household crime and other crime, I would appreciate a reason as to

why there might have been a decision to not do so—whether it is cost, data integrity issues or anything like that—so I can come back to you in May.

Mr Sutton—Absolutely, Senator. We will come back to you on notice with some information around that whole area.

Senator RYAN—Thank you.

Mr Sutton—Just for Senator Cormann's information—he asked about a cost and asked whether he could have it by three o'clock. I think we can achieve that. The monthly CPI would cost an additional \$15 million per annum. This would provide the same quality data as the existing quarterly collection. This would be based on about 80,000 price items collected per month, compared with about 100,000 items for the quarterly CPI.

Senator CORMANN—Thank you very much.

CHAIR—Thank you to the ABS.

[2.59 pm]

Australian Competition and Consumer Commission

CHAIR—I welcome the Australian Competition and Consumer Commission. Mr Samuel, do you have an opening statement?

Mr Samuel—No, thank you. We will move straight to questions.

Senator RYAN—Good afternoon, Mr Samuel. I just wanted to trace a couple of individual issues to see if the ACCC is anywhere on these. I will turn to the issue around the voluntary administration of the REDgroup—the booksellers group. I assume that you are aware of the media reports and the apparent instruction to gift cardholders about gift cards only effectively being redeemable by spending twice the value. So I assume it is that, if you spend a dollar, you get a dollar off your gift card. Are you aware of those?

Mr Samuel—Yes, we are.

Senator RYAN—Has the ACCC looked at that issue? Have you been in receipt of complaints on it?

Mr Samuel—We have looked at it briefly. Obviously, there were a number of phone calls made to our Infocentre last Friday. But, of course, this is a matter for the Australian Securities and Investments Commission because it relates to effectively a financial service, so it is part of the carve-out that occurred as a result of the Wallis inquiry.

Senator RYAN—So it is not something that the ACCC has anything to do with because of that carve-out?

Mr Samuel—That is correct.

Senator RYAN—Another issue I wanted to look at was the joint marketing of natural gas from the North West Shelf in Western Australia. I understand that the ACCC has acknowledged that the price of natural gas has increased sharply in Western Australia—or has increased—and that it is higher in the eastern states, although that is not the most important point, but that you do not consider that that is the result of the joint marketing arrangements.

Mr Samuel—That is correct, yes. The issue of the joint marketing arrangements, of course, was the subject of very detailed consideration as part of an authorisation application by the parties to the North West Shelf development. There has been a lot of material that has been produced on that and it is sitting on the public record in terms of the authorisation adjudications.

Senator RYAN—Are you aware of the recent comments attributed to the Woodside energy chief, Mr Don Voelte, in the *Financial Review*, where he said, 'I couldn't care less if we were forced to market separately. In fact, I think we should and I think prices would go down.'

Mr Samuel—I am certainly aware of the report of his reported comments. Equally, of course, there has been a media release that has been issued since by Woodside that suggests that Mr Voelte has no recollection of having made those comments. So we have a bit of a debate going on as to whether or not he made the comments.

Senator RYAN—What you do when you are in such a situation?

Mr Samuel—Keeping in mind that Woodside was one of the applicants for the authorisation, what we do is make inquiries, as in fact we did, to senior people at Woodside to assess the veracity of the reports in the *Financial Review*. Woodside put out a statement, as I have just indicated, that suggested that the reports were not in accordance with Mr Voelte's recollections. In the event that one of the applicants—for example,

Woodside—had changed its position in line with the reported comments attributed to Mr Voelte then, of course, we would consider those factors in perhaps reassessing the authorisation. But that would appear not to be the case in terms of the advice we have had from Woodside.

Senator RYAN—You are currently in legal action in the Federal Court with a couple of Sydney restaurants for breaching your inclusive pricing laws. That is ongoing?

Mr Samuel—Yes, in fact they are your inclusive pricing laws, but they are the ones that we administer.

Senator RYAN—I am sorry.

Mr Samuel—That is right—yes, we are. I am just not sure of what the status of those actions is at the present time. Mr Gregson, perhaps, can help.

Mr Gregson—We took a number of matters to court involving cafes or restaurants and the 53C legislation. The vast majority of those have actually concluded. Indeed, I believe all of them have. There was one that was close to being resolved. I am just a bit out of date, but I suspect that one is also now off the books.

Senator RYAN—Are you not taking action against anyone else? Is that because you are not aware of them or the complaints had not been made?

Mr Gregson—The ACCC has taken a number of actions in relation to complaints and concerns we have about compliance with 53C in this sector. Our actions range from warnings and education through to infringement notices that we have issued. The matters that have proceeded to court are the instances where we have issued infringement notices and the parties have not paid those infringement notices. So we continue to look at the complaints or information that comes to our attention and endeavour to deal with those with a view to compliance.

Senator RYAN—Does the ACCC have a view on whether or not the Productivity Commission's recommendation should be followed to provide a carve-out for the catering or restaurant industry?

Mr Samuel—It is a matter for government, Senator—it is a matter of policy.

Senator RYAN—Can I turn quickly to fuel related issues. I thought I would do some other things before we turned to fuel. I understand that the Fuel Consultative Committee had its inaugural meeting in April last year. Do you have handy or can you take on notice the organisations or people that still take a place in those meetings?

Mr Samuel—Mr Pearson, do you have that detail?

Mr Pearson—No, we will take that on notice.

Senator RYAN—Is there a financial appropriation provided for this or has this come out of the ACCC's—

Mr Pearson—It comes out of our budget. When individuals attend, I think all we do is provide coffee, some sandwiches and the room, so it is not the most expensive.

Senator RYAN—Is it possible to also provide me with an up-to-date list of who is on the committee and any changes that have taken place in the membership of that committee since 30 April?

Mr Pearson—That is no problem at all. We actually went to senior people and asked the most senior people from the representative petrol companies and from organisations such as the convenience store association, so they have all been attending. I just do not have the exact names with me right now.

Senator RYAN—Can you also provide me with how many times it has met? Also, are there minutes or outcomes of the meeting that are publicly available? If so, are they produced by the ACCC?

Mr Pearson—There are some internal discussions, but one of the things that we attempted to do in bringing these people together was to try to get some discussion between basically supply and demand lobbyists, or the lobby groups representing groups, and ourselves. I would have to take that on notice. At this point, they are not public at this stage.

Mr Cassidy—In our annual report each year, we publish the details of each of our consultative committees, of which the fuel committee is one. Without going through every meeting and saying this is what was discussed here and this is what was discussed there, we give an outline of the issues that came up during the course of the meetings of that particular committee during the last year.

Senator RYAN—I want to turn to a couple of small business related issues specifically. In relation to what you call small-business related investigations or complaints from small business, does the commission have benchmarks in place with respect to time frames for completing such investigations?

Mr Samuel—I think it is fair to say that in respect of all investigations we have some benchmarks. I cannot give you the specifics of them, but suffice it to say that, where we can see damage being done, it is well recognised that it is appropriate to try to step in at the earliest possible opportunity to stop the damage being done, otherwise you can get to the extraordinary situation where you are conducting a detailed investigation over a period of two years and meanwhile the small business has gone out of business.

Senator RYAN—I appreciate that they are not in a form, but are those benchmarks something that you could take on notice and provide to the committee?

Mr Samuel—As I think I indicated in my opening response, it is not that they are benchmarks that can be described in specific quantitative terms, but they are qualitative benchmarks in the sense that there is a clear sensitivity and recognition that the failure to take immediate action, including interlocutory proceedings, can potentially lead to a very thorough investigation but a thorough investigation that is after the horse has bolted and it is too late to have any real impact.

Senator RYAN—Do you collect internal data on small business related investigations categorised by small business, effectively, and then the time taken for some sort of action or resolution? Is that possible with the data you collect?

Mr Gregson—Our database collects a number of different bits of information that would help us to identify small business issues. Of course, it is not always possible at the time you take a complaint to identify whether it is going to be small-business related, so they are not precise. We also do obviously find ways of identifying franchise matters or those matters that may involve unconscionable conduct in relation to the dealings of large business with small business. So we do have information that is available there and that assists us in determining the types of areas that we are going to focus our attention on in this sphere.

Senator RYAN—You have read my mind, because I wanted to ask you a quick question about franchising related to that. Has the commission received any formal complaints from mediators under the Franchising Code of Conduct regarding possible breaches of the dispute resolution processes?

Mr Gregson—I actually think this may have been an issue that was raised at a recent Senate estimates and we may have provided that answer on notice.

Senator RYAN—It could have been before my time in this portfolio. My apologies. If it has been, I am happy to be referred to it rather than ask you to restate it now.

Mr Gregson—It may be useful for us to refer to that to ensure that the answers are helpful and consistent.

Mr Ridgway—The ACCC does have some contact with individuals within the mediation community from time to time and we have had some feedback in relation to individual mediator perceptions about the processes they have undertaken. I do not have an immediate sense of a particular complaint related to the process or a particular matter at hand.

Senator RYAN—Could I ask you to take on notice whether you have received any complaints in relation to breaches of the dispute resolution process under the various codes in operation. I would be happy for you to take that on notice.

Mr Ridgway—Yes.

Senator RYAN—With respect to unconscionable conduct—I understand this question has been asked previously and I am seeking an update on it—can you indicate or take on notice how many cases the ACCC has commenced in relation to unconscionable conduct since we last appeared before estimates. If there is a more convenient reporting period I would be happy with that.

Mr Cassidy—I think the answer to that is one.

Senator RYAN—That makes it easy—easy to find, too. Can you also indicate whether you have commenced any predatory conduct related cases since the last estimates or, again, a similar reporting period?

Mr Gregson—We have not commenced any predatory pricing cases since last estimates.

Senator RYAN—I might have another colleague or two who might want to talk about this next issue, and there is a Senate inquiry on at the moment. Is the ACCC making a submission to the inquiry into the pricing of milk? I do not know the formal name of the inquiry.

CHAIR—The dairy inquiry.

Senator RYAN—Does the ACCC plan to make—

Mr Samuel—No, we are not in the process of making a submission.

Senator RYAN—Are you undertaking any activity with respect to that issue—what I would call the \$2 price of milk issue—at the moment?

Mr Samuel—Yes, but obviously it is not appropriate for us to be commenting in detail, other than to say that to the extent that there may or may not be any potential breaches of the Trade Practices Act they are matters that we are examining. I do not want to say too much about this but I am not sure that there are matters that fall within the jurisdiction of the ACCC that would address some of the issues of concern that are being raised in relation to this matter as we read about it in the public press.

Senator RYAN—Sure. I appreciate the need to curtail your comments given what is going on at the moment. The final issue I want to raise—again following an issue from last estimates—is with respect to what has been referred to as the telco scam—or we might want to call it an alleged telco scam. How many complaints have you received up to now from small businesses caught up in this issue?

Mr Gregson—I do not have those precise figures but it is fair to say that we are aware of a large number of small businesses that have either complained to the ACCC or come to our attention through private litigation, lobby groups or indeed referrals through members of parliament. Those numbers are certainly not insignificant.

Senator RYAN—By ‘large’ and ‘not insignificant’, are we talking about a number closer to one with three zeroes, four zeroes or five zeroes behind it?

Mr Gregson—Perhaps we will take that on notice but, to try to give you an idea, it is certainly well above the 10s.

Senator RYAN—Sure. Since this was last raised has the ACCC commenced any further action? I understand you took some action in 2008 on this issue. Has any further action been commenced?

Mr Gregson—Those proceedings that were commenced in 2008 against 28 respondents continue. The hearing has been set down for March next year.

Senator RYAN—March 2012?

Mr Gregson—Correct. That is timetabling that is set by the court. We continue to go through the processes of that matter.

Senator RYAN—So it would be fair to say that sometimes—referring to the need for urgency that you referred to, Mr Samuel—the courts may be part of the time factors to be taken into account rather than the ACCC. It seems like a relatively long period from 2008 to a hearing in 2012, even by my knowledge of the court system.

Mr Samuel—That is the nature of the court process. It is totally outside our control.

Senator RYAN—I appreciate that.

Mr Gregson—Beyond that matter, the ACCC is obviously turning its mind to other ways in which it can address the concerns that have been raised in this space.

Senator RYAN—In a previous answer to a question, you outlined that you have been involved in ongoing discussions with a number of financial institutions about their positions on the pursuit of the completion of the relevant finance concerns. Are those discussions ongoing or have there been outcomes?

Mr Samuel—It is fair to say that discussions are ongoing, although there have been some outcomes. That does not give you much of a satisfactory answer. I think we need to understand that given the nature of the court process, which Mr Gregson has already outlined, and given some of the limitations on the ability or power of the ACCC to commence its own actions as distinct from being an intervener in private actions by being able to invoke the provisions of section 73 of the Competition and Consumer Act—I was going to say the Trade Practices Act; I presume it is the same section but I will stand corrected on that—

Senator RYAN—We are all waiting for our reprint, too.

Mr Samuel—There is a very good iPad app, actually, that will show you the conversion from one section to another.

Senator RYAN—There is?

Mr Samuel—Unfortunately I have not got it in front of me at the present time. There is that element of intervention in respect of private actions under section 73 and then there is the process of some interaction—at

a reasonably high level, I would have to say—with some of the major financiers. But in the event it will probably take the completion of successful court action—either the 2008 action, which as Mr Gregson has indicated will not be heard until 2012, or intervention in privately instituted proceedings where the ACCC may intervene—to bring about some outcomes and some adjudication in respect of the application of section 73. I doubt whether until that has actually occurred we will be able to get some serious outcomes with some of the more recalcitrant of those in the financial—

Senator RYAN—Are you serious—is there actually an iPad app that does that?

Mr Samuel—Does the convert?

Senator RYAN—Yes.

Mr Samuel—Yes. ACLC, it is, if you have a look—and you can use it for your iPhone as well.

Senator RYAN—That will actually make life a lot easier for some of us.

Mr Samuel—I tell you, for the chairman of the organisation it is a great facility.

Senator RYAN—Did the ACCC develop that?

Mr Samuel—No, it was developed by a proprietary group—by Thomson Reuters, I think.

Senator RYAN—Well, there you go. It will be the highest selling item on the iTunes store soon, I imagine.

Mr Samuel—That might be the most useful information you get from this whole hearing, Senator.

Senator RYAN—Can you tell us how many small businesses you have assisted with private proceedings in this regard? Is that something you can get data on? If you do not have it handy, I understand.

Mr Gregson—In terms of assisting them, we have had contact with a number of businesses and we have turned our minds to whether those proceedings are a vehicle for our intervention. I have to say that given that the ACCC is not in control of those proceedings in any sense it is at times a bit of a moving feast as to the ones that may be the most suitable for possible intervention. But we have had contact with a number of businesses, either because they have approached us or because we have approached them to seek details of their cases.

Senator RYAN—Sure. Again, I understand that the criteria for intervention would be, I imagine, less of a moving feast than the cases you are intervening in; that would depend partly on their status, on how they were going. What sort of criteria do you use for that?

Mr Gregson—The ACCC does actually publish guidelines that set out the general types of matters that we take into account as to whether we should intervene. They generally boil down to whether they are in the public interest, whether they are better suited to private action and whether there are core principles that we should be involved in as the regulator. And we are certainly interested in these matters given that, as we say, we accept the seriousness and the nature of the concerns raised. The key issue for us, though, is finding the right vehicle—and that has been a moving feast.

Senator RYAN—That is why I was wondering. I know that the principles are broad so that people have a sense of trying to apply them through their own circumstances. Do have sort of a subset of principles that are developed in response to an issue about which you have had very many complaints—as you have in this instance?

Mr Gregson—We very much look at the specifics—

Senator RYAN—If they are the sorts of things you cannot release, I am quite happy for you to say so too.

Mr Gregson—There are certainly no guidelines, Senator, but we look at the particular matter and determine whether that is a good vehicle. We have a look at this stage it is up to in the proceedings and whether the issues that we are interested in are at the forefront before the court in that matter or whether they are ancillary. They are the types of things that we would have regard to.

Mr Samuel—I think it is fair to say that we are interested to find an avenue to get an outcome in the court process that will make it much easier for us then to tackle some of the more difficult or recalcitrant of the financiers that we have been endeavouring to deal with over the last 12 months to bring about a successful outcome in this area.

Senator MILNE—I just want to ask a question in the light of the concerns that are going on currently in the dairy industry and that have been going on for some time—in particular, around the Competition and Consumer Act and the adequacy of anti price discrimination and whether in fact that is captured adequately post the Boral case. Given that the milk companies have admitted that whole milk, either home brand or

branded—this is just whole milk products, not low-fat milk products—is the same whether it is in a home brand packet or a branded package, can you tell me whether it is price discrimination when different prices are charged for the same product in different packaging?

Mr Samuel—No, it is not. But when you talk about price discrimination and then you refer to Boral, I think we need to clarify. The price discrimination, as you describe it, provisions of the Trade Practices Act were repealed back in 1995 or thereabouts as a result of the Hilmer competition policy report. There is nothing to prevent retailers from selling products that might look similar or might be of a similar content at different prices. Of course, we are aware, as I am sure that you are, that the difference in price between generic branded or home branded products and the branded product are very much related to some of the marketing elements of the branded product.

When you refer to Boral, of course, we are referring much more to issues of predatory pricing and misuse of market power. I think that, where reference is made to the ACCC in more recent times in relation to the dairy industry issues and the pricing of milk, that reference is being made with particular focus on whether or not the major retailers and other retailers in this area are engaging in predatory pricing. I think, as I indicated in an earlier question asked by Senator Ryan, it is probably not appropriate for us to comment on those matters in this arena in the sense that we do not comment upon matters that we may or may not be currently investigating.

I think it is perhaps also appropriate to note that, as I think our grocery inquiry indicated—and there is a significant chapter on the whole dairy and milk processing chain—there are several steps in the processing chain, from the dairy farm right through to the supermarket shelves. It is perhaps just worth reflecting back on that chapter in the grocery inquiry as to the various elements of that chain that can impact upon the price of milk at the retail level and equally on the price of milk that the farmer receives at the farm gate.

Senator MILNE—That is precisely the concern—that this is becoming more and more of a make-or-break issue for the farmers because the farm gate price is being driven lower and lower, to unsustainable levels, and being sold below the cost of production for them. Is the Competition and Consumer Act adequate to deal with the issues that are being faced by the farmers at the moment when it comes to issues like predatory pricing and anti price discrimination? Do we have an adequate act?

Mr Samuel—When it comes to issues of predatory pricing, of course, we have two provisions of section 46, including the now infamous Birdsville amendment. I would have to say to you that that amendment on any analysis, subject to ultimate testing in the courts, goes a long way to covering issues of potential predatory pricing. But there are a number of aspects of that have to be dealt with, including whether or not products are being sold below cost for a sustained period and then with the relevant purpose—the relevant purpose being to do damage to or destroy a competitor in one or more or other markets. So there are issues involving that, but we do need to remember that between the retailer and the farmer are processors. It may well be that the issue is not so much the retail price of milk that is being charged to the consumer that may be the centre of the potential problem for the dairy farmer; it may well be that the relationship between the dairy farmer and the processor is the issue.

Some of the focus of more recent times on Coles, Woolworths, the IGA group, ALDI and the like may be—and I have to emphasise the word ‘may’—misplaced and misdirected, and it may well be that it is the relationship between the farmer and the processor that becomes a relevant factor. In that context—and we are getting into the dairy inquiry, which I think is in about two weeks time—I just note a couple of reports in the last couple of days where Coles has indicated that, with respect to its Western Australian processors—that is, Fonterra—it is, as from 23 February, increasing the price per litre by five cents. There was a report by John Durie in this morning’s *Australian* that suggested—and I have to rely on the report—that Fonterra was indicating that that extra five cents that Coles will pay Fonterra will be retained by Fonterra; it will not be passed through to the farmer. That is not a matter that we can necessarily influence. That is a matter of the relationship between the dairy farmer and Fonterra. They are the sorts of issues that may well come out in analysis under the dairy inquiry.

Senator MILNE—I might ask you about the adequacy of the legislation again in that inquiry.

Mr Samuel—I think I have indicated that the legislation in the context of predatory pricing we think—

Senator MILNE—Is adequate?

Mr Samuel—is very thorough indeed.

Mr Cassidy—It is probably worth mentioning that, following the Boral High Court case, this committee had an inquiry that focused a lot on section 46. It is fair to say that each of the changes that we were advocating to section 46 in that inquiry has subsequently been made. It was done in a couple of tranches, but each of the changes we recommended at the time has been made to section 46.

Mr Samuel—We have had one successful outcome in respect of section 46 in the Cabcharge case. It was adjudicated on by the Federal Court last year with a very successful outcome in terms of both the court interpretation of section 46 and at the same time the penalties imposed.

Senator EGGLESTON—Can I make a comment on the Western Australian dairy situation. There are only 160 dairy farmers left in the south of Western Australia, so this is really quite a critical matter for them. That industry's future is very much under a question mark, I think. What I would like to ask you about is the definition of 'flood insurance'. I had a major insurance company come to see me in Perth last week that had been concerned with the Queensland flood situation. They said that, in 2008, you declined to issue an authorisation on a definition of flood insurance. As I understand now, the head of the Commonwealth Bank and the minister—Minister Shorten of the Federal government—are concerned with developing a definition of flood insurance. Would you like to advise the committee whether or not the reservations you held in 2008 are still pertinent or do you think that you can be persuaded to accept a definition as being acceptable?

Mr Samuel—It depends on what the definition is. The 2008 authorisation decision was made on the basis of three or four specific matters. The first was that the definition that was proposed by the Insurance Council introduced a range of new concepts which we, ASIC, the Insurance Brokers Association and the consumer groups believed would cause more confusion than it would provide certainty. It introduced new legal concepts and it was not, in our view or in the view of the other bodies that I have mentioned, including ASIC, the insurance brokers and the consumer groups, going to lead to certainty.

The second element of it was that the flood definition that was proposed by the Insurance Council was intended to be entirely voluntary and capable of amendment. So it was hardly a standard definition. It was a definition that was being proposed which was capable of variation by each and every insurance company as they saw fit, either by adding exclusions or amending or doing as they saw fit. So it was hardly a standard definition.

The third element that we were concerned about was that there was not, in our view, a significant proposal by the Insurance Council or the insurers to market the impact of the definition, other than to provide a link to some page on the Insurance Council's website that might have explained what the definition was about. We did not think that was going to be an adequate means of providing some increased certainty to consumers in terms of flood definition.

Then there was another element of it, which was that—and we need to consider this equally today—you can have all the standard definitions you like but, if the standard definition is being used as a means of defining where cover will be excluded rather than included, it does not actually achieve much other than to provide some certainty as to when cover will be excluded. There was no indication as to how it might be used. In fact, the suggestion was that with some insurers it might well be used as a means of excluding cover under a standard definition of flood as distinct from including cover.

So, if something was put to us today it would need to address those issues. It would need to address the issue of consumer information, of providing a definition that was clear and not going to lead to greater uncertainty and new legal concepts, and of providing a definition that could not be varied, at least by any process of diminishing the extent of the definition—it might well be varied by providing enhancements by various insurance companies in terms of additional cover beyond that of the standard definition. And then, fundamentally, if we were considering the public benefit associated with the standard definition, we might want to look at a set of circumstances, or a code of conduct in a sense, that basically said insured persons, consumers, will need to have drawn to their attention in the clearest possible terms what the impact of this definition is in respect of their individual policy. It may well be a front-page cover sheet that says, 'You are covered for flood—and 'flood' for this purpose means the following ...' It may even go far as saying 'You, the insured, acknowledge that you have read this and you understand it'.

It is that sort of thing. If we want a degree of certainty then it needs to show a level of public benefit that would offset any anticompetitive detriments flowing from it. I would have to say to you that, if the same proposal were put up as was put up in 2008, I would be surprised if we did not have the same objections, along with ASIC, the insurance brokers and the consumer groups.

Senator EGGLESTON—That is a very interesting answer. I am told that about a third of Australia's hazard insurance relates to flood claims. Obviously, there is a problem in the sense that it seems very much that if people do not have insurance the government may well come along and compensate them anyway for their losses, and probably a broader based insurance scheme would encourage more people to take out insurance rather than assuming they will be helped out by the government, either state or federal, after some problem occurs. But there is clearly also very much a difference between the amounts of research various insurance companies put into what is offered to the public. The particular company that was talking to me does detailed studies of the levels of previous floods in various areas and specifically relates an insurance to an address rather than a broader basis. Will you be seeking to be involved with the Insurance Council and the government in coming up with a definition which you might be able to provide authorisation for?

Mr Samuel—We are very much in a receiving/reactive role. It is entirely a matter for government as to whether they wish the ACCC to be involved, and of course it is for the Insurance Council to approach us for authorisation of a standard definition if they reach the position of having agreed one amongst their various members. All I can indicate is that we reached a decision in 2008 but the reasons for that decision were very clear and they would be, I would have thought, matters that the Insurance Council would want to take into consideration in determining whether they were going to submit a new proposal to the ACCC. Keep in mind that the ACCC, I repeat, was not Robinson Crusoe on this—it took into account significant submissions that were made by ASIC, which has primary responsibility for the insurance industry; the Insurance Brokers Association, which would have a fair bit to do with both consumers and insurance companies; and a number of consumer groups. So we will wait with interest as to whether we are approached by the Insurance Council and to see what they propose.

Senator EGGLESTON—It is in the public good to have this sort of insurance, you would agree. It is a glaring deficiency, I think, in the kind of coverage and security that the community have. I would hope that the views you expressed in 2008 are taken into consideration both by the government and by the ICA. Thank you.

Senator XENOPHON—Mr Samuel, further to Senator Eggleston's line of questioning, would the problem with flood insurance contracts be solved if insurance contracts came within the purview of unfair contracts legislation?

Mr Samuel—I do not think we have given consideration to that. It is of course a matter of policy for government, so it would not be appropriate for us to comment, but I would have to say to you I do not think we have given consideration to that. You must remember from my response to the last question from Senator Eggleston that we are very much in a reactive position—that is, we have no role to play in this area unless we are approached for an authorisation of a standard definition. In that event, we then consider whether there are sufficient public benefits flowing from the arrangements relating to the standard definition to offset any anticompetitive detriments. That is the authorisation test. But the provisions of the Insurance Act and the administration of that, which of course is primarily undertaken by ASIC, are matters of policy that are outside our jurisdiction.

Senator XENOPHON—We will be having the dairy inquiry soon, but there are some matters that I think are pertinent to ask about now. We have seen the Coles ads with 'Down, down; prices are down'—I do not know whether it is Status Quo or Deep Purple. I do not know whether anyone could help me as to which song it was borrowed from. Senator Sherry knows.

Senator Sherry—I know the song but I cannot remember the name of it. It is a great song.

Senator XENOPHON—Status Quo or Deep Purple—it is one of the two.

Senator Sherry—It is very effective, actually.

Mr Samuel—You could get that on your iPad as well if you had iTunes.

Senator Sherry—I could listen to the ad, unfortunately.

Senator XENOPHON—I can play it for you, Minister. Mr Samuel, you made reference to predatory pricing and I think you said 'the infamous Birdsville amendment'.

Mr Samuel—That was for the benefit of Senator Joyce, who is not here at the moment.

Senator XENOPHON—He is not here, but I am sure he is here in spirit. And Professor Zumbo is probably here in spirit as well.

Senator Sherry—I notice you are being provocative even when he is not here.

Senator CAMERON—He might be in a river somewhere with that Toyota.

Senator XENOPHON—I do not think this is helping me or Mr Samuel! Are there any cases being looked at in the context of the Birdsville amendment with respect to any breaches of that amendment?

Mr Samuel—The answer is yes. Actually, you have caught me from left field because it is normally Senator Joyce who asks these questions. But yes, there are—

Senator XENOPHON—He is channelling through me right now.

Mr Samuel—The issue of predatory pricing is constantly on our radar screen. Mr Gregson could give you the exact numbers, but there are matters that are being examined at the moment that relate to the issue of predatory pricing.

Senator XENOPHON—Can I have those notice? I do not have much time and I want to ask about some broader issues in relation to the Coles ad—‘Down, down; prices are down’. I think the ad goes on to say ‘and they are staying down’. I think that rings a bell. When someone advertises in those terms, saying ‘prices are down and they are staying down’, that obviously does not mean from here till eternity, but there must be a reasonable time frame, must there not? You cannot just push prices down for a week or two. If you make a promise to consumers, what does ‘they are staying down’ mean?

Mr Samuel—As best I can recall, those ads—and I am not a watcher of ads generally; fast-forward works very well on the recording—indicate that the pricing that is being applied to these milk products will not be on a ‘specials’ basis but will be for some significant or sustained period. That would appear to be the case. At this point of time, we have not seen them out for long enough to be able to determine whether or not they are going to be cut short. But I think there are some representatives of Coles at the back here that you might want to ask. They can give you the answer.

Senator XENOPHON—We will be able to ask them during the inquiry, I think. They are not part of the estimates process.

Senator Sherry—And they are not part of the ACCC.

Senator XENOPHON—Is it not unreasonable for the ACCC to ask, ‘You have made these representations; what do you say is the time frame in which you will have these prices down’?

Mr Samuel—No, I think it would be more reasonable for us to ask, if they were cut short at a particular point of time, whether or not the reference to them staying down was misleading and deceptive.

Senator XENOPHON—But isn’t it a twin-edged sword though? The conundrum is that, if those prices are kept down for a considerable period and there is evidence that milk is being sold below cost, that then brings in issues of predatory pricing and the Birdsville amendment, doesn’t it?

Mr Samuel—Absolutely, but that is why I have indicated that they use the words that, if the prices stay down for a reasonably long period of time, one of the tests of the Birdsville amendment—that is, sustained period—may well be satisfied. But there are several other tests that need to be satisfied, including substantial share of the market, sale below relevant cost and having a predatory purpose.

Senator XENOPHON—But, if Coles were to say, ‘Look, we say that this is going to be for at least the next six months’, wouldn’t that be evidence of potential predatory pricing if you can show that the milk was being sold below cost?

Mr Samuel—It would certainly be an indication of an intention to sell a particular price for a sustained period. Then we would have to take into account the other tests relating to predatory pricing which I have just outlined—substantial market share, selling below relevant cost and having the predatory purpose in the three paragraphs, (a), (b) and (c), of section 46(1AA). I should say that we are well aware of those issues, we are well sensitive to those issues and I think some answers I gave before to—

Senator XENOPHON—Senator Milne. I know. But this is a variation on that. Would you be concerned if advertised specials at Coles were not real discounts—in other words, there was evidence that prices were either jacked up before a sale to give the impression of a sale or, alternatively, other prices in the shopping basket went up? So, in other words, the margins on milk may be down, but the margins on others would be increased.

Mr Samuel—Let me deal with those two separate issues there. The first issue you raised is that it is not a genuine discount because the price had been jacked up and then discounted. That is what we call was-is selling and marketing. As you would be aware, because we have talked about this previously in Senate estimates

hearings, we have taken a number of cases on where retailers of products have sold products with an apparent discount when in fact it has not been a real discount at all. Either the products were never sold at the previous price or else they had been jacked up to give the appearance of a discount. The separate question you have asked, though, is a different question altogether—

Senator XENOPHON—Absolutely, it is.

Mr Samuel—and that is discounting one product and then, as you are suggesting, raising the price of other products to compensate. That is a far more complex issue and I am not sure there are any provisions of the Trade Practices Act or the Competition and Consumer Act that I would be aware of that would deal with that particular scenario that you have described as the second part of your question.

Mr Cassidy—It would depend a bit on what the representation was. If the representation just related to the particular goods in question and then the prices of other goods went up to offset that then it probably does not run foul of the act. If the representation was a more general one then maybe there is an issue. It would depend on what the particular representation was.

Senator XENOPHON—But does the ACCC have power to ask about the margins on other goods where the margins have been increased on other goods, for instance?

Mr Samuel—No, because, as Mr Cassidy has indicated, if the representation is that the price of product — say, milk—will be reduced and will stay down and that is the totality of the representation then the fact that prices of other products might have been increased would not be within the scope or ambit of the CCA—the Competition and Consumer Act—and would not be the subject of inquiry by the ACCC.

Senator XENOPHON—Even if it means that, in the average shopping basket, people may not be any better off, for instance?

Mr Samuel—But if the representation is about product A—milk—and it is not about the total price of the shopping basket then there has been no representation made as to the price of the shopping basket.

Senator XENOPHON—So it is all in the representations, basically?

Mr Samuel—That is correct.

Senator XENOPHON—Just on airport car parks, your recent report found, I think, that JFK and Heathrow are cheap as chips compared to Sydney and Melbourne airports. They might not be earning monopoly rents from aeronautical services. What actions can you take or are we stuck with a deal that was done to privatise the airports—and Senator Sherry had nothing to do with that, I should add.

Senator Sherry—I did, actually.

Senator XENOPHON—Did you? You were a culprit?

Senator Sherry—That is another story. It was a long time ago. I will tell you privately one day.

Senator XENOPHON—Okay.

Senator Sherry—I would also point out that the car parking at Devonport airport is a dollar forever. So there is great value at Devonport airport. I know it is not a favourite—

Senator XENOPHON—That is a reason to visit, Senator Sherry.

Senator Sherry—It is one of the reasons for living in the great state of Tasmania.

Senator CAMERON—It is a bit of a long walk to the Sydney international terminal, though!

Senator Sherry—And a swim.

Mr Samuel—I trust that the reference to it being a dollar forever is not an indication that it will be a sale below cost for a sustained period. But, in answer to your question, Senator: we have been given, since the privatisation period, which was about 2002, the task of monitoring the airport in terms of both the aeronautical service charges, their other charges and then I think, from about two years ago or thereabouts, the airport car parking charges. At the same time, we monitor the quality of service provided for those aspects of the airports that are run by the airports themselves as distinct from the terminals that are run particularly by Qantas, which runs its own terminals. There is nothing else that we can do in that context than provide our annual report, which is what we do. What happens after that is a matter for government. You would be aware, of course, that this is now a matter that is being reviewed by the Productivity Commission. I think they are due to report on this whole issue some time towards the latter part of this year.

Senator XENOPHON—But, when you hear stories of people trying to offer alternative parking and the valet type parking arrangements down the road, and they put up barriers so that you cannot park and all sorts of things like that, isn't that something that the ACCC could look at because it is there? Many would say that it is there to block competition.

Mr Samuel—I think we can look at it, but I am not sure that we have any power under the law to do anything about that. That is the nature of the way that the airports are structured. In many respects, it is the nature of what occurs where you have a monopoly position. We have opined on that in our successive airport monitoring reports. There is not a lot that we can do.

Senator XENOPHON—So consumers will keep getting gouged for those sorts of services.

Mr Samuel—I would not like to use those expressions, but what we have indicated—

Senator XENOPHON—Ripped off?

Mr Samuel—is that there is a suggestion and there would be clear indications that monopoly rents are being charged and that monopoly type outcomes in terms of quality of service are occurring, particularly with respect to Sydney airport.

Senator XENOPHON—But you cannot do anything about it under the current law?

Mr Samuel—There is not a thing we can do. This is a matter, I think, to be addressed to the Productivity Commission in terms of its current review of airport regulation.

Senator PRATT—At September estimates I asked the ACCC about an investigation of breast imaging technology that marketers purported detects breast cancer—a claim for which, as I understand it, there is very little scientific evidence. You advised that you were taking it seriously and were in the early stages of looking at the issue. I would like to know where the ACCC's inquiries on that issue may be up to.

Mr Gregson—I think it was with me that you had the exchange at the last Senate estimates. We remain committed to looking at those issues as a priority. As you are aware, we have, in my view, a very sound position that we do not comment on matters that may or may not be under investigation. I would rather not touch on the specifics of each particular trader. We continue to identify representations made in the marketplace. We continue to talk with those stakeholders that you may be talking to in terms of concerns raised. Indeed, we have approached some traders in relation to those matters. We have also seen an evolution of the representations that are made in the marketplace by some traders. That is obviously something we are tracking to see through. These are complex medical issues as well and some of the representations are not black and white. So it is not always possible to form an immediate view about what we can do about them. But they continue to be a high priority and we have a team of investigators looking at those.

Senator CORMANN—Referring to the information released through FOI on internal Treasury analysis in relation to banking matters—this relates to powers of the ACCC—are aware of what the references to the ACCC were in that advice?

Mr Samuel—I am not sure. I think it would be helpful if you would just supply it.

Senator CORMANN—It sets out those powers you have in three broad categories: general research powers, independent investigative powers and the ministerially directed prices surveillance powers. My questions are in that context. Are you undertaking any investigations at present of financial institutions in Australia for suspected breaches of part IV of the Trade Practices Act? I am not asking you to name anyone; I am just asking whether you are currently conducting any investigations.

Mr Samuel—Senator, I do not think we can give any details of any matters that we may or may not be investigating in relation to this area. That is not to imply that we are and not to imply that we are not; it is just that it is not appropriate for us to give any details on those issues. You would be aware—and our records would indicate—that one or two matters currently before the courts relate to part IV matters concerning one or other of the major trading banks, but beyond that I really cannot comment any more.

Senator CORMANN—Do you have a ministerial direction at present to conduct any prices surveillance on Australian financial institutions?

Mr Samuel—No.

Senator CORMANN—Are you doing any general research into Australian financial institutions?

Mr Samuel—We have undertaken some significant general research as an appendage to the work that we have had to do in relation to prospective mergers of financial institutions in Australia and, as a result, we have

gathered together a reasonable database of knowledge on the whole issue of competition in the banking market and in the financial market, and particularly what has occurred over the past two or three years.

Senator CORMANN—There is a Treasury document setting out these options. Are they the only powers the ACCC has in that space? Is that an accurate reflection or is there something missing?

Mr Samuel—I think that about summarises it, Senator. But of course in relation to the banking and financial institutions market we do not have specific powers or responsibilities; they rather rest with the other three organisations: ASIC, APRA and the Reserve Bank. Our primary role in this area has tended to be in relation to mergers in more recent times. In the past, it was in dealing with the payments system and the like—although that is primarily now handled by the Reserve Bank.

Senator WILLIAMS—Mr Samuel, do you have an application before you in regard to the Australian Wheat Board, in relation to CBH and Cargill?

Mr Pearson—Senator, we have had contact with AWB concerning the port undertakings. I am not sure whether that is what you are referring to.

Mr Grimwade—In addition, we are looking at a proposed acquisition by Cargill of AWB's commodity business.

Senator WILLIAMS—Is there also a proposal from CBH?

Mr Chadwick—There is an exclusive dealing notification that CBH lodged in 2008 relating to the transport and storage of grain, which we are currently reviewing. The commission issued a draft notice late last year indicating its intention to revoke that notification.

Senator WILLIAMS—So you could say that both Cargill and CBH are pursuing taking over AWB?

Mr Chadwick—No, sorry; the notification is purely about the way CBH operates its transport and storage. It does not relate to any other companies.

Senator WILLIAMS—Okay. Mr Samuel, I do not know whether you are the right man or the right agency to answer this. I believe there is a company called Veda that used to be the CRAA—credit ratings. If you applied for a loan or a credit card or anything, the bank or finance institution would contact the CRAA and get a reference on you. If you did not pay your phone bill or your power bill you would get black marks. Are you familiar with what I am referring to?

Mr Samuel—No, I am not but I suspect that that is because this would fall within the jurisdiction of the Australian Securities and Investments Commission rather than the ACCC.

Senator WILLIAMS—I actually did run it past them at one stage and they did not think so. It might be something for APRA. Minister, would you be able to give me any guidance there?

Senator Sherry—I would have thought, like Mr Samuel, it was ASIC, not APRA, because I would not have thought it was a prudentially regulated—

Senator WILLIAMS—I have been informed that there is no watchdog, no-one overlooking that industry at all—and if they make mistakes, so what. I have a close friend who applied for a credit card many years ago and it was wrongly reported that this person had not paid a \$120 account. And now I am getting information that they are going to not only track whether you pay accounts or have blacklistings but also at what time you pay your accounts and how big the accounts are. There is talk now, I know, in the finance world about getting more information. I am just concerned that we do not have any watchdog over that industry whatsoever—that they are just a free dog, basically.

Mr Samuel—I am not sure that there is no watchdog, Senator, but I would have to say to you that since the carve-out of financial services from the ACCC's jurisdiction which followed on from the Wallis inquiry—I stand to be corrected but I think you will find this—that issue is entirely within the jurisdiction of ASIC.

Senator WILLIAMS—I will put a question on notice to Mr D'Aloisio at ASIC and see if he can help me.

Senator Sherry—Why don't I take the question on notice for the minister and the parliamentary secretary?

Senator WILLIAMS—That would be good, Minister.

Senator Sherry—We will get some advice on this matter as to who oversees the area. It is an interesting point, Senator.

Senator WILLIAMS—That would be great. If there is a court case, I think the situation is that when the media say ‘Senator Sherry said this’ and it is wrong, the blame goes back to Senator Sherry and not to the media. There is an ‘out’ there whereby the media cannot be sued or whatever or held accountable—

Senator Sherry—Somewhat like a credit rating agency.

Senator WILLIAMS—Yes. If the CRAA or Veda come under the same criterion as the media, I am just concerned that there is no oversight whatsoever of that industry. It is a big industry and a growing industry. I believe that with many loan applications, whether they be for credit cards or home loans or whatever, the computer does so much of the work these days and may be getting wrong information from these credit information people. If they have got it wrong, who is saying to them ‘Why have you got it wrong and what are you going to do about correcting it?’ That is my concern.

I will move on to something you would be familiar with, Mr Samuel: fuel prices. I know of one independent fuel station, for example, that might be paying a terminal gate price of \$1.30—just guessing figures—while the big dealers down the road, Coles and Woolworths, are selling at \$1.26, below his terminal gate price, and then he has to freight it from Newcastle to his service station. What do you do about that when the big end of town are selling at 4c or 5c less than the small player pays as the terminal gate price?

Mr Samuel—We are getting into the area of predatory pricing again. Suffice to say that we are well aware of and well sensitive to some of the issues that are raised there. But I would have to say to you that at this point in time, despite many investigations into this area, we have not yet been able to establish that there is any evidence of predatory pricing involved. We must remember that the terminal gate price paid by retailer A is not necessarily an indication of predatory pricing by retailer B, who can sell below that terminal gate price, because it may well be that retailer B is acquiring its fuel at a lower price—and predatory pricing involves selling below its own relevant costs, not selling below the relevant costs of some other party.

Senator WILLIAMS—Or there may be kickbacks later. I know that probably 10 years ago rural outlets might have been selling Roundup, for example, for \$105 a 20-litre drum and paying \$100 for it but at the end of the year Monsanto would give them a kickback according to how many drums they actually sold. Perhaps that exists in the fuel industry as well.

Mr Samuel—Those issues would not have escaped our attention, Senator; that is all I can say.

Senator WILLIAMS—Truth in pricing is perhaps required.

Senator McGAURAN—I just want to pick up on an issue that Senator Williams just raised, because it has come to mind. A critical issue to the final, total deregulation of the wheat market was port access, as you well know, particularly for the Australian Wheat Board because, as we know, there are port monopolies held by two or three companies whose names escape me—CBH was one, definitely. Therefore, the legislation and the acceptance by the parliament of deregulation of wheat, except in the National Party, was on the grounds of access to ports and fair trade—in particular, I come back again to the Australian Wheat Board—and ship placements and all of those sorts of things. Are we able to get a quick overview of the status of the access to ports for companies such as AWB? I know that the groups were meant to submit to you their plans, for want of a better word—

Mr Samuel—Their undertakings.

Senator McGAURAN—It has been some time now. It should all be locked away and fair trade should be operating.

Mr Pearson—We actually have three major undertakings. We went through an initial consultation. We are now going back to the market and we have commenced discussions with the operators of the terminals and some discussion with the market. We will be getting additional information from the market for the next round of undertakings. The initial ones were time limited. At this stage, we are probably looking at 12 months, perhaps, of market inquiries for all three undertakings, although they will be done as separate processes.

Senator McGAURAN—It is certainly a long and dragged-out affair, which may not be your fault. Even so, with getting these final undertakings, isn’t there a status report on how it is all operating now? Have you had complaints from AWB that, while this long talk session and planning are going on, they are being blocked at the ports or not?

Mr Pearson—No, we have not. The initial undertaking assessment was actually cut short. We cut short and cut out what we would normally do for a full-blown undertaking because of the fact that this was an industry that was deregulating. There were questions about the extent that we needed to do a full-blown undertaking

inquiry. So it was actually cut short. We took into account what we saw as the major issues to do with discrimination, access, ports, stems and so on. We have had some complaints. We have investigated, and many of those are purely technical or they are commercial issues. At this stage, without actually going into it, we have actually had a couple of marketers who have complained about certain aspects of port stems. There is nothing that we have seen at this stage that would require additional work, although I think in South Australia some information went up on the website which concerned some issues there with information that was put out to the market, which they then corrected. So, at this stage, I think our view is that it is working well. It would be interesting to see what happens with the market concerns now. We have not seen any evidence of blocking at this stage. Nobody has brought us any. I am more than happy for people to bring that to us.

Senator McGAURAN—That is very encouraging.

Mr Samuel—Suffice it to say that, as the undertakings are being reviewed in the ensuing months, any of these issues that may be causing concern will come to light.

Senator McGAURAN—Thank you.

CHAIR—I thank the ACCC for coming along this afternoon.

[4.05]

Australian Prudential Regulation Authority

CHAIR—I welcome APRA. Thank you for coming in. Dr Laker, do you have an opening statement to make?

Dr Laker—My opening remarks today focus on two matters that have been receiving close attention from APRA since our last appearance. The first of these matters is the impact of the recent spate of natural disasters in Australia—including the floods in Queensland and Victoria, tropical Cyclone Yasi and the Perth bushfires—on the general insurance and deposit-taking industries regulated by APRA. To this catalogue of disasters we must now add the devastating earthquake in Christchurch, New Zealand. The largest and most immediate impact of the natural disasters in Australia, not surprisingly, has been felt by the general insurance industry. Based on data received directly from a number of general insurers and from the Insurance Council of Australia, the gross insured claims from these events for the industry are likely to be in the order of \$A3 billion. These are, to be clear, initial estimates and it will be some time before the true quantum of insured claims is known. Of this total, \$1.5 billion relates to the Brisbane flooding and a little above \$700 million to the earlier flooding into Toowoomba and elsewhere in Queensland. Initial estimates of insured claims arising from tropical Cyclone Yasi are a little above \$500 million, with an additional amount of up to \$200 million from the Victorian floods and up to \$50 million from the Perth bushfires. Of course, actual losses sustained by the Australian community from these events have been much larger, but not all of the losses are covered by insurance.

APRA has specific prudential requirements for general insurers in regard to capital and reinsurance that are designed to ensure that they are able to handle the costs of catastrophes, single or multiple. As a consequence, only a portion of the gross incurred losses will need to be met from the direct resources of APRA-regulated general insurers, because each insurer has itself insured against the risk of these events via its own reinsurance programs. These programs, which are typically placed with large international reinsurance companies, allow for the claims to be shared beyond Australian shores.

What is unusual in this particular episode is the number of large adverse events that have occurred in such a relatively short period. This has two broad effects. It has a substantial effect on the capital of insurers providing cover against these events and it requires reinstatement and/or additional reinsurance arrangements to be put in place expeditiously. Given the unusual circumstances, APRA has established a small team of specialist staff devoted full-time to establishing the scale of the insured claims from these events and to assessing the impact of these claims on individual general insurers and on the industry as a whole. We want to satisfy ourselves that each APRA-regulated general insurer has the financial capacity, now and in future, to meet our capital requirements and, ultimately, policyholder claims. As such, we have examined general insurers one by one, assessing the extent to which each will be the subject of claims relating to these events, the strength of its financial position and the coverage provided by its reinsurance arrangements. Our objective has been to identify promptly any general insurers that might be challenged to meet our capital requirements and to work with them on any necessary remedial action.

Some large general insurers have already indicated publicly that they expect most of the losses will be borne by their reinsurance programs. Some smaller general insurers, where the relative loss has been larger,

have already sought and received additional capital from their foreign parents to cover potential losses that may still arise as the claims develop and all late notifications are received. Overall, APRA does not expect that any general insurer it regulates will have difficulty continuing to operate in the face of the potential losses from these recent disasters. We are confident of the capacity of the general insurance industry in Australia to meet all of its claims and obligations.

We do expect, however, that a number of general insurers will incur additional costs to reinstate reinsurance cover that has been eroded and, if required, to buy additional reinsurance cover for the remainder of the year. In some cases the cost of the reinsurance cover being sought could be greater than the net claims incurred from the catastrophes themselves. To help inform our assessments we are seeking updated capital plans and financial forecasts from each affected general insurer. In addition we have been applying a stress test that assumes a further major catastrophe event before the end of the financial year at least as large as those to date and we have been testing the potential impact on the financial position of each general insurer.

The Christchurch earthquake has unfortunately provided a real-world stress test. The earthquake will involve further claims on the general insurance industry in Australia but at this very early stage it is difficult to put any quantum on these claims. Gross incurred claims may prove to be larger, again, than the claims from the recent natural disasters in Australia. But initial feedback from the general insurers affected by the earthquake is that their net claims will not be substantial. Again, the bulk of the claims will be borne by their reinsurers. We are monitoring developments in Christchurch very closely and have been in contact with the Reserve Bank of New Zealand, which has supervisory responsibility for the general insurance industry in New Zealand.

The resilience of our general insurance industry is at least in part reflective of the benefits of APRA's robust prudential regime, and in particular the strength and risk based capital requirements introduced in 2002. These capital requirements are currently being revisited as part of a comprehensive review of capital standards for general insurance and life insurance. One of the aims of this review is to make the capital standards more sensitive to the risk profile of each insurer.

The impact of the natural disasters on authorised deposit-taking institutions, ADIs, with activities and/or credit exposures in the affected areas is likely to be considerably less than the impact on the general insurance industry. Initially the impact was an operational one. A number of ADIs in flood affected areas experienced significant disruptions and many were forced to close branches for a period of days. APRA was in ongoing contact with the relevant ADIs as to the status of their operations, as of course was the Reserve Bank of Australia. Cash distribution was temporarily disrupted. Some ATMs were unavailable. But overall the industry's disaster coordination protocols worked well to ensure reasonable continuity of banking services. This no doubt owes something to the considerable attention APRA and the ADI industry have paid to business continuity and disaster recovery capabilities in the last few years.

The impact of the disasters on ADIs' loan books and on profitability is too recent to assess. The major banks and regional ADIs have a substantial amount of lending exposure in the affected regions, both to businesses and to households. We are closely monitoring the potential impacts on credit quality and are receiving regular reports from ADIs on the status of loans to affected borrowers. However, natural disasters are unfortunately nothing new for ADIs and they have policies for dealing with borrowers and other customers who have experienced hardship as a result. Some ADIs have already indicated that they have taken the prudent step of establishing provisions for potential loan losses, and APRA will be monitoring those loss estimates over coming months. Historical experience is that natural disasters do not have long-term impacts on credit quality overall, as the initial property damage and short-term income loss from the disaster itself is mitigated by economic activity from the rebuilding process, together with insurance and any government assistance. Broadly speaking, we expect that the impact of the recent spate of disasters on the affected ADIs will be readily manageable.

The second matter on which I would quickly like to bring the committee up to date concerns the global reforms to bank capital adequacy and liquidity being driven by the Basel Committee on Banking Supervision. Just before we met in October the Basel committee had announced broad agreement on the calibration and transition arrangements for the capital reforms, and the formal rules text was released in December with no surprises. As I advised the committee in October, APRA does not expect that the tougher global capital regime will have significant implications for ADIs in Australia, which remained well capitalised throughout the global financial crisis. We are now preparing a consultation paper on how the capital reforms will be implemented in Australia.

Also in December the Basel committee released the formal rules text for a new global liquidity framework that seeks to promote stronger liquidity buffers and more stable sources of funding for banking institutions. The centrepiece of this framework is a new global liquidity standard—the so-called liquidity coverage ratio, or LCR, requirement—that aims to ensure that banking institutions have sufficient high-quality liquid assets to survive an acute stress scenario.

The committee will recall that this new requirement posed problems for Australia, since the volume of high-quality liquid assets, particularly government securities, needed to meet the requirement is simply not available here. I am pleased to advise the committee that a sensible solution to this so-called Australian problem has been found that does not compromise the intent of the global liquidity reforms. That solution, agreed between the RBA and APRA, allows an ADI to establish a committed secured liquidity facility with the RBA sufficient in size to cover any shortfall between the ADI's holdings of high-quality liquid assets and the LCR requirement. That facility will count, then, towards the LCR requirement. The approach will be applicable only to the larger ADIs, around 40 in number.

This solution is not in any sense a concession to ADIs in Australia. In return for the committed facility the RBA will charge a market based commitment fee. This fee is intended to leave participating ADIs with broadly the same set of incentives to prudently manage their liquidity as their counterparts in jurisdictions where there is an ample supply of high-quality liquid assets in their domestic currency. These ADIs will need to demonstrate to APRA that they have taken all reasonable steps towards meeting their LCR requirements through their own balance sheet management before relying on the RBA facility.

We are now preparing a consultation paper on how the liquidity reforms will be implemented in Australia. There are substantial lead times before the capital and liquidity reforms come into effect, allowing the opportunity, if needed, for extensive discussions with industry and other interested parties. The RBA will be consulting separately on the liquidity facility but, as always, APRA and the RBA are closely coordinating their joint work in this area.

CHAIR—Thank you. In respect of liquid assets and ADIs, there has been some publicity recently that one or two of the credit rating agencies are looking at the major banks in terms of doing a review. The reported reason was that there was an undue reliance on wholesale markets as a source of capital. I know that credit rating is not a particular interest of yours but I wonder whether you have any comment on that view.

Dr Laker—I have no comment on what one of the rating agencies is doing. The end result may be that the ratings will then align with those of one of the other rating agencies. They have simply signalled that they are sensitive to the extent to which the large Australian players borrow in offshore wholesale markets and they are sensitive to the fragility of those markets over the last two or three years, which has been continuing. I have no comment to add as to why they are undertaking that assessment at the moment.

CHAIR—But the current structure of the banking industry does not create any prudential problems from your point of view?

Dr Laker—Not as such. I think we have always said that when a bank borrows in offshore markets there is a discipline that comes from being exposed to investors in those markets, and it means the rating it holds is a very valuable part of its ability to raise funds. So it has provided a discipline on our major institutions that they do need maintain credit ratings as high as they have.

Senator CAMERON—Who can help me with ASIC regulatory guide 69?

Senator Sherry—Did you say ASIC?

Senator CAMERON—Sorry, it is ASIC. You have some relationship with that, haven't you?

Dr Laker—I am even not sure what the topic is.

Senator CAMERON—I have correspondence here from a constituent, Mr Henry di Suvero, who has written to APRA asking them to investigate the Sandhurst Trustees. Is anyone aware of that?

Mr Jones—Yes.

Senator CAMERON—So I have got it right? It is just that there has been a transposition from ASIC to APRA in one of the notes that I have here. You are aware of that?

Mr Jones—I am aware of complaints that we get from constituents, yes.

Senator CAMERON—I am asking you about Mr di Suvero.

Mr Jones—I could not speak specifically about his particular case.

Senator CAMERON—Okay. Sandhurst Trustees is a subsidiary of Bendigo Bank—is that correct? Are you aware of that?

Mr Chapman—Yes. I can confirm that they are.

Senator CAMERON—If an investor has a problem with their trustees, who deals with that? Is it ASIC or APRA?

Mr Jones—It would depend upon the circumstances. It may well be that their first course of action would be the Superannuation Complaints Tribunal. That would be another possibility. It would depend on the nature of the issue.

Mr Chapman—Can I add to that. A trustee company could be doing three types of business. They could be doing traditional trustee business, banks and things like that, in which case it would probably be a state issue. They could be doing superannuation, in which case, as Mr Jones said, it could be a Superannuation Complaints Tribunal issue—it depends what the issue of the complaint is. It could be a managed investment, in which case it would be ASIC.

Senator CAMERON—This is, I think, basically a managed investment.

Mr Chapman—In that case, it would be an ASIC issue.

Senator CAMERON—But, Mr Jones, you have seen the correspondence on this? Is it an APRA matter or an ASIC matter?

Mr Jones—I have seen some correspondence regarding issues with regard to Sandhurst. At first sight they did not appear to be an APRA matter, but I cannot say with certainty that we are talking about the same matter. I cannot say that I recall the name of the constituent.

Senator CAMERON—Mr Di Suvero wrote to Ms Kathleen Maxwell.

Mr Jones—Yes she is in APRA.

Senator CAMERON—She is a senior manager of the APRA secretariat—is that correct?

Mr Jones—That would be the likely person you would write to—correct.

Senator CAMERON—In terms of the problem that has been raised, the allegations are of negligence and waste against Sandhurst and the receiver.

Mr Jones—Against a superannuation trustee?

Senator CAMERON—Against Sandhurst Trustees.

Mr Jones—Perhaps it might be easier if we took the question on notice and then we can look at the specifics. It would be very difficult to give you a sound response on a particular criticism or complaint at this stage.

Senator CAMERON—If you have that correspondence, can you keep me advised as to how that is moving through the bureaucracy within your organisation?

Mr Jones—I would assume so, assuming that the initial correspondent gave us permission to do so.

Senator CAMERON—I am sure I can get that permission. The first thing I would need to know is whether this is regulated under ASIC or APRA. The person has written to you and there are some 1,100 debenture holders in a company called LKM Capital. Are you aware of LKM Capital? The allegation that has been made in the correspondence is that Sandhurst Trustees—I am just trying to figure out whether this is your area or not, because it is complex and I accept that—failed to advise debenture holders of changed circumstances and, because of that failure, people continued to make investments not based on the material facts that were available.

CHAIR—I think that, since we are short of time, if we could get APRA to take this on notice and—

Senator CAMERON—But I am sure they can answer that question as to whether—

Mr Jones—The way you have briefly described that, at first sight it sounds like a disclosure issue. I would be very wary about going much further than that. If it is primarily a disclosure issue with regard to information to a debenture holder, it sounds like it would be an ASIC issue. But I am not trying to pass the buck.

Senator CAMERON—Why don't we do this, because it is a very complex issue: why don't I forward the correspondence that I have to you and then you will be in a position next time to tell me, or hopefully before we meet again, whether I should be looking at ASIC or APRA to try to deal with this issue.

Mr Jones—Yes, we can do that.

Senator CORMANN—What is APRA's view of the current trend of a series of megamergers between various superannuation funds, from a prudential point of view?

Mr Jones—There has been a lot of talk for quite a number of years that mergers between superannuation funds are inevitable. Super funds believe that there are substantial economies of scale with regard to investments and with regard to costs. We have seen over recent years the number of superannuation trustees continuing to decline. In the period, say, post superannuation licensing from 2004 to 2006, there was something like a 70 per cent reduction in the number of superannuation trustees. So this is a process that has been occurring for a number of years.

Senator CORMANN—I hear what you are saying in terms of economies of scale and that would seem to be the intuitive view on it all. But I am intrigued by an article in the *Australian* earlier this week which says, INDUSTRY superannuation funds are getting bigger, but the benefits of scale are few and far between due to a combination of growing pains and more diverse and costly investment choices.

Further in the article it says:

Membership fees since 2004 have increased by 12 basis points, to 15 basis points last year.

Trustee and other costs have nearly tripled over the period to 11 basis points, and at 69 basis points the fee for the basic default option is well above the 50 basis points recoded five years ago, although it is below the peak of 78 basis points in 2009.

It does not seem that these mergers and these economies of scale are really being passed through to members, does it?

Mr Jones—It is probably too early to tell for mergers that have taken place in the past few years. The mergers that you are talking about, particularly the ones you described as megamergers, are ones that are occurring right now. But the statistics that we publish in terms of superannuation rates of return give a measure of performance of various types of funds, fund sizes and so on. It does not suggest that large funds are inherently inefficient. In fact, by global standards, many of our superannuation funds would be described as reasonably small.

Senator CORMANN—Is it something that you are monitoring from a prudential point of view—how these mergers are—

Mr Jones—We publish quarterly performance statistics on superannuation funds.

Senator CORMANN—I will have some questions about those performance statistics in a moment, as you might expect. But, from your point of view, those statistics are showing that there are efficiencies flowing through?

Mr Jones—Our statistics are showing that many of the larger firms are performing better than some of the smaller firms. The dilemma with the statistics, of course, is that we are measuring rates of return. Our statistics are not collecting a lot of information at the cost level. We have had a lot of discussion for many years about the nature of our statistical collections with regard to costs.

Senator CORMANN—Sure. Is it likely that we will end up in a similar situation as in the banking system, where we have the big four or the big five super funds and then a few smaller ones on the edge?

Mr Jones—It is interesting. The ACCC, which I used to be part of, would have described it as quite competitive in terms of market structure relative to many other parts. The fact that we still have hundreds of superannuation funds would suggest to some people at least that it is a reasonably competitive market. There are a whole of lot of other issues, of course, so I would not venture to say whether the market is hugely competitive.

Senator CORMANN—For example in relation to the selection of the five superannuation funds under Modern Awards—but I will not ask you about that.

Mr Jones—Yes, that is really not our area. I can see a lot of further consolidation, and I think what we will see over the next decade is a substantial degree of consolidation from where we are now.

Senator CORMANN—Irrespective of the debates about issues around your data collection, if there was a trend in the context of market consolidation of increasing fees and increasing trustee and other costs, you would be able to pick that up? Even if it might not be entirely accurate, you would be able to assess the trend?

Mr Jones—We look at those types of things as a matter of course. When we do our analysis of trustee behaviour we look at what the trustees are doing and we ask trustees all sorts of questions about how they are doing that type of activity.

Senator CORMANN—As I am conscious of time, I will quickly move on to another issue. What is your interest in the corporate governance arrangements of superannuation funds?

Mr Jones—We are highly interested in them.

Senator CORMANN—Sorry, let me be more specific. In the context of the Cooper review recommendations that there should be independent directors and that there should be a process whereby directors wanting to sit on more than one board must attest to APRA that at the time of appointment there is no reasonably foreseeable conflict of interest, what is your view on those specific recommendations?

Mr Jones—A view on the recommendations from Cooper?

Senator CORMANN—The recommendations that I have just mentioned—the one around the requirement for independent directors and the requirement to have a specific process involving APRA around testing that there is no reasonably foreseeable conflict of interest if somebody wants to sit as a director on more than one superannuation board.

Mr Jones—We have looked at these types of issues and we look carefully at the issues of conflicts of interest in various types of funds regarding cross-directorships and also regarding related party transactions coming from different types of funds and so on. With regard to the recommendations from Cooper, given that the government has already made its view clear on which recommendations are being accepted or not, I do not really think it is up to APRA to give a view on what a committee recommended that the government did not accept.

Senator CORMANN—Let me ask the question a different way. If there are conflicts of interest with directors sitting on multiple boards—conflicts of interest that are reasonably foreseeable—what can you do to prevent someone in that circumstance being a director on multiple boards?

Mr Jones—We actually do not have formal powers in the sense of being able to say ‘You are banned from appearing on more than one board’. We do not have that power.

Senator CORMANN—But if there was a requirement that somebody had to go through a process with APRA before they could sit on multiple boards then you would have a power to monitor and ensure that there was not conflict of interest in these circumstances?

Mr Jones—It is also possible to do so after the fact by looking at the nature of the conflict of interest policy. Various boards, for example, have conflict of interest policies. We would expect that not just in superannuation funds but also in all sorts of other boards.

Senator CORMANN—But to do so after the fact you would have to be aware of the facts, and who knows how many conflicted transactions take place that you are not aware of and never will be aware of.

Mr Jones—You would hope that the minutes of the trustee board would indicate that trustees, in the same way as company directors, would indicate whether they had conflict of interest in a particular matter and either absent themselves from that discussion or do something else.

Senator CORMANN—You would certainly hope that, but there is no check and balance in the corporate governance system as it is currently structured to minimise that risk?

Mr Jones—We would expect all of our trustees to have conflict of interest policies. That is one of the things we would look at.

Senator CORMANN—Does ARIA have a conflict of interest policy?

Mr Jones—I would imagine so. I cannot say that I have personally seen it.

Senator CORMANN—I have been looking and I have not been able to find one. I would be interested on notice whether you are aware of a conflict of interest policy for trustees on the ARIA board of trustees.

I will quickly ask you a few questions on statistics. What work are you doing to improve the quality of the statistics that you are collecting? The ABS has told us that they are part of a tripartite arrangement with you and somebody else.

Mr Jones—We collect the statistics and we also provide some of those statistics to the ABS and to the Reserve Bank. We have high levels of confidence in the quality of our statistics in terms of superannuation

fund performance. Where we have always believed that there have been weaknesses is in our collection of costs, because historically information on costs has been less relevant to APRA for prudential purposes than information on returns. Prior to the Cooper enquiry we had in fact begun consultation with industry to expand our collection, and that would focus more on costs. We put that on hold while the Cooper inquiry was being undertaken. The Cooper inquiry came out with certain recommendations. We are now moving towards a new statistical collection and we hope that that new statistical collection will commence from 1 July 2012. We have had consultation with industry and we are working to an expanded set of statistics.

Senator CORMANN—So when somebody says that APRA's tables offer meaningless performance data and cannot serve as a meaningful tool you would not agree with that?

Mr Jones—Absolutely not; I would not agree with that at all. We are the official agency that has the official statistics; we are publishing now five-year and seven-year performance statistics with the objective of showing the performance of trustees over the long period. In our view the reliance by certain parts of industry on quarterly performance statistics is inappropriate and we strongly support the view that, superannuation being a long-term investment, the focus should be on longer term performance.

Senator CORMANN—Sure. The assertion that ignoring the huge variances in investment strategies and objectives held by funds—you do not think that that distorts the way you collect and report performance data?

Mr Jones—We believe that we can improve performance data by in fact collecting information about the investment option, and that is something that we will do. We have—

Senator CORMANN—That you will do?

Mr Jones—Yes and we have long believed that in the future—we have said this on a number of occasions—we can improve the statistics by going to more disaggregated statistics. Certain parts of the industry were in fact quite agreeable to do this some time ago. Other parts said that they were not able to provide the information. This goes back a number of years—

Senator CORMANN—When do you think that will happen? Which parts of the industry are cooperating with this and which parts of the industry are reluctant to cooperate?

Mr Jones—It often depends on the structure of the statistical collections within the funds. For example, those funds that have a very small number of investment options may find it considerably easier to provide the information than those which have a very large number of investment options.

Senator CORMANN—But usually those with a large number of investment options have more of an interest to have it spread out and disaggregated, don't they, rather than averaged out?

Mr Jones—Not necessarily, because the fact that it is an average means that many of the—if you have 100 investment options and your average performance is fairly poor then a very large number of your investment options must be performing poorly.

Senator CORMANN—Thank you, Mr Jones.

Senator BUSHBY—Thank you for your opening statement about the insurance and how you are approaching it. That answered a lot of the questions I would have had otherwise. There is a lot of talk about insurance providers being required to provide cover even if the policies they have written do not actually provide cover in certain circumstances. Is that sort of issue—the issue of the extent to which the policies that are written provide cover—relevant to your prudential calculations and how you look at it? And if there was a whole-scale pressure or requirement for insurance companies to pay out on things that they had not calculated when they did their underwriting, or—

Mr Laughlin—The quick answer to your question is no, that is not an issue. The initial point you make is not an issue. It is not a prudential issue, in other words; it is an issue for market conduct, so it is an ASIC issue or an issue between the company and the policyholders.

Senator BUSHBY—So, to the extent that you do your prudential calculations, you do not actually assess the degree to which, in an event like this, the coverage would extend?

Mr Laughlin—No. If we are talking about ex gratia payments then that is an issue of interest to us.

Senator BUSHBY—That is really in a way what I am talking about—ex gratia payments.

Mr Laughlin—Ex gratia payments are an interest to us, but the degree of those payments so far has been pretty modest and they have also come, in some cases, from parent companies, not from the insurers.

Senator BUSHBY—I am not saying that there is any suggestion of this, but if there was government pressure or a requirement that ex gratia payments had to be made in certain circumstances, that would be something that you would need to have a pretty good look at?

Mr Laughlin—We would be extremely interested in that and would resist any such imposition, because it would create problems, potentially.

Senator BUSHBY—Yes, it mucks up your calculations in terms of where appropriate solvency levels are and so on.

Mr Laughlin—In simple terms, the insurers set their premiums and their reserves based on a set of assumptions, which is based on the contract.

Senator BUSHBY—Yes. That is sort of what I was getting at, but you say it much better than I do. In terms of the RBA LCR deal that has been worked out, you say they will be charged a fee, after they have exhausted all of their other options, for parking money with the RBA, effectively?

Dr Laker—I would not say it is ‘parking money’. It is a secured and committed facility which would guarantee them access to the RBA for that amount if they needed it at any point.

Senator BUSHBY—It is not like they would go and buy government bonds and there would be a transfer of money from them to the government in return for the bonds, which they would normally use for those—

Dr Laker—If they were holding—

Senator BUSHBY—They would buy a secured facility and pay a fee for a guarantee against that liquidity. Is that how it works?

Dr Laker—If a bank or an ADI were to hold a government security in its own name, that would be counted against the LCR requirements.

Senator BUSHBY—That is right. But to hold that, though, they would have to buy it?

Dr Laker—Yes, they would have to buy it in the marketplace.

Senator BUSHBY—And they would have to pay a certain amount of money.

Dr Laker—They would buy it in the marketplace. They will hold other assets which do not strictly meet the Basel requirements by which the Reserve Bank would be prepared to accept as collateral for the Reserve Bank providing the facility. So, after we look at the extent to which they have stretched the maturity of their liabilities and what they are holding in the way of liquid assets, and we are satisfied that they have made every effort to be prudent in managing their liabilities and their duration, that institution could go to the RBA and the gap could be covered by the facility as long as they have the collateral for the amount of that facility.

Senator BUSHBY—You probably would not use these terms, but it is effectively a guarantee against assets that the RBA and you recognise that that institution holds?

Dr Laker—It is committed by the Reserve Bank, so for the duration of the contract between the Reserve Bank and the ADI, the Reserve Bank will provide funds on demand against that collateral.

Senator BUSHBY—Given the problem essentially in Australia that there are not enough high-quality assets to buy—

Dr Laker—I always put ‘problem’ in inverted commas—it is actually a very good situation to be in.

Senator BUSHBY—Some around the table would suggest that the country is doing its best to solve that problem. But the issue is that there are not enough high-quality government bonds in Australia to be able to meet the liquidity requirements. But, if there was, the banks would have to put the money that they hold over to the Commonwealth in return for the assets. Why wouldn’t the RBA actually accept that money and hold it instead of the government bonds, in which case there may be other benefits? I am just trying to work that through.

Dr Laker—The banks could place money, if they wanted to, on deposit with the RBA and I think that would count as a high-quality, level 1 asset anyway. They would have a choice between that option and buying government paper.

Mr Littrell—Can I follow up on that. In the work developing the RBA facility between us and the RBA, we did essentially look at whether the banks should just hold a big RBA cheque account. There are a number of technical problems with that which would make it preferable for banks to hold a spread of other securities instead of just having one big cheque account. If you want to ask the question on notice, we can explain that.

Senator BUSHBY—I would be interested in that—strangely, yes, I would be.

Mr Littrell—Put it on notice and we will—

Senator BUSHBY—If you will accept that on notice.

Senator Sherry—Yes.

CHAIR—I thank APRA for coming in today. We are grateful for your advice, once again. We will adjourn until 5.00, when we will have Treasury back, and the Macroeconomic Group.

Proceedings suspended from 4.45 pm to 5.02 pm

Macroeconomic Group

CHAIR—I welcome back the Treasury. We have with us outcome 1, the Macroeconomic Group. Are there any opening statements from the minister or Dr Gruen?

Senator Wong—No.

Dr Gruen—I have an opening statement. Dr Henry will be joining us—he is just a couple of minutes late. We have copies of my opening statement for others who wish to read it as we go. The floods in Queensland, New South Wales, Victoria and Tasmania and Cyclone Yasi have had a material impact on Australia's near-term economic outlook. These opening remarks seek to explain Treasury's current estimates of the impact of these natural disasters on both economic growth and consumer prices. Based on the latest available information, Treasury estimates that the combined impact of the floods and Cyclone Yasi will be to reduce real GDP growth by around half a percentage point in 2010-11, with the resumption of economic activity and reconstruction expected to add about a quarter of a percentage point to real GDP growth in 2011-12. The largest negative impact should be recorded in the March quarter of 2011, which could leave overall growth in that quarter flat or possibly slightly negative. While it is too early to assess accurately the impact of Cyclone Carlos, initial reports suggest that the disruption to economic activity is small relative to those from the other extreme weather events.

To estimate the impact of the floods and the cyclone on real GDP, Treasury relied on the production side of the national accounts, with the primary information source being industry estimates of lost production. Where these were not available, Treasury estimated these production losses on the basis of reports of the geographic extent, duration and severity of flooding and cyclonic activity. Turning to coal and other non-rural commodity exports, the greatest estimated impact on real GDP is as a consequence of the interruption to Queensland coal production and exports caused by the floods. The direct impact of heavy rains from December on coal production is estimated at 19 million tonnes, valued at \$4.8 billion at pre-flood prices, with Cyclone Yasi causing an additional 200 million loss of non-commodity exports. The impact on coal export earnings will be less than this because of the related increase in global coal prices.

Most Australian coal is sold on contract. Nonetheless, it is illustrative to look at recent movements in the spot market, where prices for thermal coal rose nine per cent in January and, for metallurgical coal, 38 per cent. While spot prices for both types of coal have since moderated, they remain above pre-flood levels. The main coal freight lines affected by the floods were the Blackwater and West Moreton lines, together transporting around one-third of Queensland coal exports to port. The Blackwater line was out of operation for about three weeks and continues to operate below full capacity, while the smaller West Moreton line remains closed. We understand that neither rail line will be fully operational for some months.

A key uncertainty is when the coal mines in the flood affected regions will return to full production, with some mines still inundated with water. Recent information, though, suggests that most of the major coal mines in the area will return to full production before the start of the June quarter. While the main areas of destruction caused by Cyclone Yasi were north of Queensland's main coal-mining region, it nevertheless caused the closure of the Dalrymple Bay, Hay Point and Abbot Point coal terminals for about three days. The cyclone also temporarily halted transportation of base metals and metal ores, including from the Mount Isa region.

Turning to agriculture, Treasury's estimate for lost agricultural production from the floods is \$1.2 billion, with the additional production loss due to Cyclone Yasi estimated to be around half a billion. These estimates are broadly consistent with those produced by ABARE, state treasuries and industry organisations. The January floods mainly affected cotton, vegetable and fruit production, accounting for about 45 per cent of the flood related losses. Other crops adversely affected by the floods include sugar and grains. Cyclone Yasi had a significant impact on tropical fruit production and has caused additional destruction of Queensland sugar cane,

with 87 per cent of Australia's banana supply and approximately one-third of Australia's sugar crop produced in the region crossed by the cyclone.

Lost value added in the tourism industry is estimated to be around 400 million, with around three-quarters of this due to flooding and the rest due to the cyclone. This estimate represents the direct loss of tourism business in the affected regions and therefore does not capture the impact of any diversion of travel to other parts of Australia or overseas. Turning to reconstruction, the secondary impacts of the floods and Cyclone Yasi are expected to add to GDP as assets destroyed by the disasters are replaced. The estimated addition to demand includes the replacement of around 1,000 homes, with a further 6,000 requiring some sort of refit and lesser repairs required to another 37,000, although some of this repair work does not add to GDP because of the treatment of home repairs in the national accounts.

The bulk of reconstruction spending, though, will be on replacement and repair of publicly owned assets such as roads and bridges. For the floods, the Commonwealth Government's contribution to the recovery effort is estimated at 5.6 billion, of which more than two-thirds relates to the restoration of public infrastructure. The Queensland government has also released preliminary estimates suggesting that the additional restoration and recovery costs from Cyclone Yasi could be in the order of 800 million. With the economy approaching full employment, it is likely that the increase in economic activity associated with reconstruction and repair will be partly offset by a reduction in other building. The pressure created by reconstruction spending on the real economy will also be reduced by the Commonwealth Government's decision to introduce a flood levy and finance a substantial part of its contribution to the rebuilding of public infrastructure through expenditure cuts and the deferral of infrastructure spending.

Turning finally to consumer prices, the floods and Cyclone Yasi are expected to add around half a percentage point or maybe a little more to the consumer price index in the March quarter of 2011. This spike in consumer prices is expected to unwind over future quarters as the supply of fresh produce recovers. To estimate the impact on consumer prices, Treasury analysed the effects of comparable flood and cyclone events with similar impacts on the agricultural regions affected using the current expenditure weights of the CPI. Based on this analysis and recent observed price movements, fruit and vegetable prices are expected to increase significantly in the March quarter, with a broad range of crops affected, including bananas, eggplants, capsicums, beans, grapes and potatoes.

Although the floods and Cyclone Yasi will have significant effects on real economic activity and consumer prices in the short term, they have not materially altered Australia's economic outlook beyond the next couple of quarters. With the terms of trade at record highs, the outlook continues to be underpinned by strong business investment intentions, particularly in the resource sector. The floods and cyclone had very little impact on the large projects currently under way and have not altered our expectations for projects that are now under consideration. Indeed, the second of the four large LNG projects planned for Gladstone received a final decision for \$US16 billion investment in the same week that the floods were peaking in other parts of Queensland. I am sure that committee members will have many questions and we are happy to take them.

Senator CORMANN—That was a very important opening statement. I will go to the issue of superannuation and retirement savings. I was intrigued by an FOI request that has been released—an information briefing on national savings, which essentially shows that the recommended changes to superannuation tax in the Henry tax review would increase retirement incomes and national savings by more than increasing the superannuation guarantee. That is right, isn't it?

Dr Henry—Sorry, Senator, I do not have that document in front of me.

Mr McDonald—I was the decision maker on that FOI request. I believe that the information you refer to is in one or two charts.

Senator CORMANN—Yes.

Mr McDonald—Those same charts were in the—what was the review called?

Dr Henry—Australia's Future Tax System Review.

Mr McDonald—Australia's Future Tax System Review.

Senator CORMANN—It was not memorable enough for you remember the title—you just remember the short title: the Henry tax review.

Mr McDonald—I would prefer not to call it the Henry review when sitting next to him, Senator. Those documents—both of the projections but also of how they compare with different alternatives—were in the

Future Tax System Review report and were subsequently released under FOI as helping to give context to the rest of the document that was released.

Senator CORMANN—Dr Henry, what would be the impact, particularly on low- and middle-income earners, of increasing the superannuation guarantee?

Dr Henry—It depends where the incidence of the increase in the superannuation guarantee falls, of course—whether it is reflected in lower wage increases for the employees that you are talking about, whatever their income, or whether it is absorbed by the employers, who are required to make higher superannuation payments. The answer to that question of course depends upon a whole range of factors, not least of which is the tightness of the labour market and the extent to which businesses can have workers absorb the burden of increased superannuation in the form of lower wages or slower wages growth, or perhaps conditions in the labour market are sufficiently tight that businesses would have to themselves absorb the increase in superannuation. So it really depends upon economic conditions. Secondly—and I should make this point—of course many businesses already provide superannuation coverage in excess of the statutory nine per cent minimum. In those cases there should be no impact. In the cases where superannuation contributions are presently less than 12 per cent, as the guarantee is phased up to 12 per cent the extent to which that guarantee comes through in the form of a slower rate of wages growth or is absorbed by businesses is a matter that depends upon the state of the economy and in fact depends upon the state of individual businesses.

Senator CORMANN—Sure, but Minister Shorten has actually made the assertion that it will come from lower wages or slower wage growth, which I think is an assertion that you have made in the past as well.

Dr Henry—You may be right there, Senator, but I think that what I would have said in the past is that historical experience would suggest that. The work I am aware of that has looked at the way in which the superannuation guarantee, the first nine per cent, was absorbed economically suggests that it was mainly in the form of slower growth in wages.

Senator CORMANN—Your report says:

Although employers are required to make superannuation guarantee contributions, employees bear the cost of these contributions through lower wage growth. This means the increase in the employee's retirement income is achieved by reducing their standard of living before retirement.

The effect of this reduction in a person's standard of living before retirement is likely to fall most heavily on low- to middle- income earners who are unlikely to be in a position to offset the increase in the superannuation guarantee by reducing their other savings.

Have you changed your view compared to that statement that you made in your review?

Dr Henry—If it is in the review I stand by it.

Senator CORMANN—It is good to know that you stand by it. It obviously has implications, though, for where we go in terms of policy options moving forward when it comes to retirement savings, so—

Dr Henry—Sure. But the point here is that the intention of the superannuation guarantee is to compel people to save, obviously enough. So it is a form of compulsory saving, obviously enough. One way of doing that is obviously to put the proposition to workers that instead of having a wage increase they have some money put into a superannuation fund in the form of saving for them. Indeed, when the superannuation guarantee was first introduced it was introduced explicitly on that basis: as a wage trade-off.

Senator CORMANN—If something is directed by government through compulsion that way, though, I think everybody would agree there ought to be a line in the sand somewhere. The question then becomes where the line in the sand is. You say that you stand by things that are in your review. In your review you said:

The superannuation guarantee rate should remain at 9 per cent.

Dr Henry—We looked at two options in the report and on balance favoured an alternative option but we did not discount completely the case for an increase in the superannuation guarantee. We recognised that there was a case for lifting retirement savings. Increasing the superannuation guarantee is one way of doing that, and we examined that case. But we examined an alternative which would change the tax structure quite significantly and which would have different impacts, different distributional consequences, and on balance we favoured the alternative approach. But I do not recall us rejecting outright proposals to increase the superannuation guarantee.

Senator CORMANN—You did not reject it outright if recommending that it remain at nine per cent is not rejecting it outright.

Dr Henry—We had an alternative recommendation. We looked at two options. One was increasing the superannuation guarantee; the other one was keeping it at nine per cent and instead doing something else to change the taxation arrangements.

Senator CORMANN—When you talk about the heavy impact on low- to middle-income earners, they are not one homogenous group either. You have families that face cost of living pressures around having kids and mortgages and then you have the post-children and post-mortgage stage of life, where people have more discretionary income; perhaps they have a better capacity to make additional savings and they are probably more focused on their retirement needs. Isn't there a case to have a more differentiated look at increasing retirement savings?

Dr Henry—The alternative approach would be to have the same approach in respect of retirement savings but to take account of the things that you have just referred to through other payments, whether it be family tax benefit payments or rent assistance or whatever.

Senator CORMANN—Is it efficient to do it that way?

Dr Henry—I think it would be more efficient to do it that way than to seek to tailor a superannuation guarantee according to somebody's circumstances.

Senator CORMANN—But, of course, in a way that is what the more generous concessional contribution caps under the previous government were designed to do—they were designed to attract additional voluntary contributions at a stage of people's lives when they could better afford it and when they were probably more focused on their retirement needs. The decision to halve those concessional contribution caps probably made it harder for people in that bracket to contribute.

Dr Henry—Well, harder for people on high incomes. Those caps were a very high proportion of average income. So, for people on average to lower incomes, the size of those caps, I would suggest, was not really a binding constraint. I think the reduction in those caps for people on average and lower incomes would not amount to a binding constraint either. I think the issue is—and I think I am agreeing with you here—that the financial capacity of individuals to save depends on a whole range of factors like where they are in their life cycle. I agree with you on that—that is true. But it also depends upon their income.

Senator CORMANN—Yes, sure.

Dr Henry—And it does not achieve much to have a very high cap if people do not have enough income to be able to make those sorts of savings.

Senator CORMANN—Sure, but the fact that the concessional caps actually cover both the compulsory component and any additional voluntary component, though, makes it quite restrictive in terms of what you can put into super under concessional arrangements at a time of your life when you are more focused on it.

Dr Henry—It does for some people. For people on average or lower incomes, I do not think it is restrictive. The cap is necessarily quite a high proportion of the income of somebody on a middle or lower income.

Senator CORMANN—Sure, but, for people on lower and middle incomes who are in the circumstances of family and mortgage and facing increasing cost of living pressures and mortgage repayments—which is non-deductible debt—if we accept the minister's assertion that the increase in the super guarantee will be funded through lower wages or slower wages growth then the question has to be asked: why should those low- to middle-income families in those circumstances not be able to use their money to deal with increases in cost of living pressures and pay off their mortgage faster? From a savings point of view, paying off your mortgage faster in that circumstance would be at least as good an investment, if not a better investment in terms of your whole life financial plan, as boosting the super guarantee by a further three per cent.

Dr Henry—I am not sure about that—it depends.

Senator CORMANN—It depends, sure. But—

Dr Henry—It is actually tax-free superannuation benefits from age 60. That makes quite a difference to those calculations on the tax-effectiveness of superannuation as an investment as against paying off your mortgage. But even so—

Senator CORMANN—It is non-deductible debt and so whatever you get is pretty good for safe return.

Dr Henry—I understand that. But actually—

Senator CORMANN—It is a safer return than super fund returns, potentially.

Dr Henry—I am sorry?

Senator CORMANN—I think that paying off your mortgage faster and paying off non-deductible debt is a very certain return for you as a young family compared to putting money into super in the current circumstances.

Dr Henry—I would not want to—

Senator CORMANN—I do not want to overstate the point.

Dr Henry—I would not want to be providing that sort of financial advice to people.

Senator CORMANN—I understand that.

Senator CAMERON—You were probably told about that in the US as well.

Senator CORMANN—But you understand the concept.

Dr Henry—I do understand the concept, certainly. The issues that you are raising are issues that I recall being raised many years ago, before the superannuation guarantee was legislated—precisely the same issues. There was quite significant public debate about the superannuation guarantee at the time for all of the reasons that you are raising now. I think the debate has been had, really.

Senator CAMERON—You can always go backwards in politics.

Senator CORMANN—The point here is that obviously there is bipartisan support for the concept of the super guarantee at the level of nine per cent. The question is whether we should take it further. Surely every time you decide as a government to mandate people's income in a particular way, taking voluntary decisions away from people, you have to go through debate again. I am not surprised that we are going through some of the debates again, because somewhere there has to be a limit to how much of people's own money that government decides where it has to go. You, in your report, said that the line in the sand should be nine per cent. You made a very astute observation, I thought, which was that if people thought they needed more money in retirement, it is always open to them—and I am paraphrasing—to save more. Do you remember making that observation?

Dr Henry—Sure, although for low-income people, of course, that is not likely.

Senator CORMANN—But for low-income people, you also made the observation that taking more of their pre-retirement take-home pay away from them in order to fund the three per cent increase in the super guarantee will have a more serious impact on their standard of living than on the standard of living of people in other financial circumstances.

Dr Henry—Yes, but it would increase superannuation savings. That is what saving does, of course—it reduces your standard of living now in order to achieve a higher standard of living later. That is what saving is all about. When the superannuation guarantee was eventually legislated by the Australian parliament more than 20 years ago, there was intense debate about whether it made sense to compel people to save for their retirement. Eventually it was legislated and eventually there was a consensus that formed around this notion. I might say that it is a feature of the Australian retirement income system that is remarked upon globally. It has been favourably reviewed by researchers and policymakers globally.

Senator CORMANN—That is interesting. I have a final question on this. I was intrigued to see the minister out there asking the superannuation industry to come on board with the proposal to increase the superannuation guarantee. Would you expect the superannuation industry to be against or in favour of increasing the super guarantee?

Dr Henry—In my experience, the superannuation industry has always been strongly in favour of the superannuation guarantee.

Senator CORMANN—And do you think that is surprising?

Dr Henry—It has not surprised me.

Senator CORMANN—Why do you think they are so much in favour of it?

Dr Henry—It is their business.

Senator CORMANN—And it gives them a significant increase in their funds under management and significant additional reliable cash flow, courtesy of government. Also, of course, they do not have to work hard to attract additional payments from their members into superannuation funds. Is that a fair observation?

CHAIR—This is not really Dr Henry's area.

Dr Henry—I do not know if it is appropriate for me to comment.

Senator CORMANN—Fair enough. I might leave it there.

Senator CAMERON—Dr Henry, on superannuation, I think what we have just witnessed is one of the problems in Australian politics, and that is short-termism. I can go back to 1981, when I worked for the Electricity Commission of New South Wales—

Senator CORMANN—I was still in primary school.

Senator CAMERON—You were in primary school, that is right; that is the problem. You see, in 1981 I had superannuation through the Electricity Commission, but there was no vesting, so when I left my job \$16,000 that had been in my account went back to the Electricity Commission.

Senator Wong—You are still annoyed about that, Senator, aren't you?

Senator CAMERON—I am really annoyed, because that is a lot of money with compound interest. But that was the reality for working people, and I was one of the lucky ones: I had superannuation. I had superannuation but it was all taken back from me except for my own contributions. We have come a long way on superannuation. The point I want to make is that we did have these debates back in 1981 when the six per cent came in—I think it was three per cent, wasn't it, first up—

Dr Henry—It was three per cent.

Senator CAMERON—Three per cent—and then we moved on. It seems to me that some have not moved on. Can you outline to me what the longer-term benefits of increasing superannuation are for both the economy and individuals?

Dr Henry—I will not go through the whole sermon, if you like. But there is almost 100 per cent of gross domestic product now invested in superannuation assets, which by global standards is of course enormous. Those assets represent future retirement income streams for people who would otherwise in most cases have to rely entirely on the age pension. When the superannuation system, and before the superannuation guarantee it was mainly occupational superannuation initiatives—when that policy program was initiated there was recognition that to some extent superannuation would displace age pension, but only to some extent. More importantly, superannuation would over time lead to an increase in retirement incomes for all employees—that was the objective. Notwithstanding some market setbacks which have eroded earning on the odd occasion, that has also been the experience. That is, the experience has been one of increased retirement incomes.

The superannuation guarantee was legislated because there was an acceptance that individuals left to their own devices under-provide for their retirement. The same point is being made today—that nine per cent is not sufficient—that nine per cent would mean for most people that they would make inadequate provision for their own retirement. Of course in making a judgment of that sort you have to make an assessment of what is an adequate retirement income. That is very much a personal thing, no doubt, but those who write in this area—and they are not all representatives of the industry—tend to the view that nine per cent is probably not adequate with present taxation arrangements. This was the proposition that we were confronted with in the tax review.

As I was saying, we looked at two ways of lifting the level of retirement incomes. We looked at an increase in the superannuation guarantee. And the other option we looked at was to hold the superannuation guarantee at nine per cent but change the taxation arrangements in a way that would actually increase retirement incomes by effectively increasing taxation but with the revenue going into the superannuation fund. It is rather difficult to explain but that is a shorthand version of it. So that was the motivation for our work in the tax review. It was building on a long period of policy change that has been about, in the main, expanding retirement incomes for employees—not just employees, but there is no doubt that that has been the primary focus.

There are two other advantages for the economy in a macro sense. One is that compulsory superannuation savings presumably add something to national saving on an annual basis. There will be some leakage, if you like, in the sense that not all compulsory saving will show up as additional saving. To some extent it might be saving that was going to occur anyway but in a different form. There will be some leakage. But on the numbers that we have done over the years we are confident that the superannuation guarantee has made a very substantial contribution to the rate of national saving.

The other thing is that it has built a pool of private financial assets. One of the consequences of that was demonstrated in the global financial crisis, actually—and I think we have discussed this previously. It was something that I guess we had thought might happen if Australia were to be hit with an external capital shock.

But while we saw it as a possibility, after the global financial crisis it was demonstrated quite graphically. It is that when some Australian businesses—not all, obviously—were denied access to global capital markets in the middle of the global financial crisis they turned to Australia's superannuation funds to provide equity. Many who have written about this period, both in Australia and internationally, have remarked on the strong support that the Australian superannuation pool of assets provided to the Australian corporate sector and how very differently things might have turned out had we not had that strong, large pool of domestic assets.

CHAIR—Thank you very much, Dr Henry.

Dr Henry—A pleasure.

CHAIR—We will return to general questions.

Senator BUSHBY—Looking at your opening statement, Dr Gruen, I see you note that the effect of Cyclone Yasi will be to reduce real GDP growth by around half a per cent and that the resumption of economic activity will add about a quarter of a per cent the following year, 2011-12, but that in the March quarter of 2011 it will have the largest negative impact and could actually lead to GDP being flat that quarter or even negative. How much had you predicted GDP would rise in that quarter, prior to Yasi occurring?

Dr Gruen—I am not sure that we put those numbers into the public domain. We can take that on notice, but I do not think we give out our quarterly profile of estimates of GDP growth. That is a longstanding tradition.

Senator BUSHBY—Is it? Okay. Looking at it the other way—and I am not deliberately doing that—what I am really interested in is the impact you think Yasi will have in that quarter. How bad does it get in that most severe quarter in terms of reducing economic activity?

Dr Gruen—If you are after quantitative estimates, I think the Reserve Bank has actually put out some quantitative estimates by quarter. They are looking at the same information that we are, so I think it is fair to say that ours are not going to be very different from theirs. Without signing up exactly to their numbers, they are not going to be very different. The other point that is worth making is that the Bureau of Statistics, unavoidably, is going to have a difficult time estimating output in the March quarter simply because of the disruption making it difficult to collect data.

Senator BUSHBY—Yes, from the collection point of view.

Dr Gruen—Exactly.

Senator BUSHBY—I understand that. On those aggregate estimates of the impact of both the disaster itself and the recovery, you go into further analysis of some of the broader impacts that you think will happen. They represent a summary of what you talk about later in your report.

Dr Gruen—Yes.

Senator BUSHBY—So the impact on agriculture and coal—

Dr Gruen—You might think that, to read this, growth goes down by one-half and then goes back up by only one-quarter. But the point is that our estimate is that, once you have left behind the flood and then the reconstruction, the level of GDP ought to be pretty much unaffected. It is simply that the reconstruction is spread out over more than a single year.

Senator BUSHBY—And presumably as well the economic impact of the flood itself actually stops certain economic activity, whereas the investment in rebuilding is a direct investment in infrastructure, which of itself will generate economic activity at a later date.

Dr Gruen—Yes, but—

Senator BUSHBY—So it is not a direct correlation. The cost of Yasi is not just measured in the damage to the infrastructure that you have to repair. It is actually economic activity that is limited as a result.

Dr Gruen—Indeed. And it has broader implications, because it changes people's assessment of what it costs to ensure risks. Beyond GDP, there are broader economic implications.

Senator BUSHBY—The reason I was asking about the rest of the report being built into those figures—and before I read that I was wondering about the same question—is that the \$400 million cost to tourism does not account for substitute activities elsewhere in Australia. People might say, 'I won't go to Queensland, so I will go to Tasmania', or South Australia or something like that.

Dr Gruen—Indeed.

Senator BUSHBY—So not accounting for that could slightly—in a very small way, no doubt—distort those assessments that you have on the front page?

Dr Gruen—Indeed, it is likely to reduce them—that is the net impact. Presumably, if the spending is somewhere else, it will reduce the net impact.

Senator BUSHBY—And the overall GDP is a nationwide thing.

Dr Gruen—Yes. But it is obviously also something that we would be hard pressed to come up with a number on, even after the event.

Senator BUSHBY—I understand that. I am not being critical.

Dr Gruen—I understand that. You are just fleshing it out.

Senator BUSHBY—I am just trying to work out what this all means. In terms of agriculture—and I do not know the answer to this—you note later on that a lot of agricultural products will go up in price and that is presumably a supply-and-demand issue. If people are paying more for bananas in unaffected areas, doesn't that mean that they then go off and have more money to spend, to go on holidays and buy new fridges and washing machines? Does that in some way offset, by increased activity because of the higher prices that then go through that community—

Dr Gruen—The price has gone up, but it is a transfer from the buyer to the seller. To the extent that you eat the same number of bananas, the buyer has less—

Senator BUSHBY—The buyer has fewer bananas, but the money still gets spent and goes into the economy?

Dr Gruen—The buyer has less money and the seller has more. We can get sophisticated here about which of them has a higher marginal propensity to consume. That might have an aggregate effect. But, if they have the same propensity consume, it will be a wash, although it will have regional implications.

Senator BUSHBY—It certainly has regional implications. What I am trying to understand is this: if you go to a supermarket and you have \$100 to spend, you still spend that \$100 but you substitute what you would have bought, either by paying more for the same goods or by buying alternative goods.

Dr Gruen—Yes, that is true.

Senator BUSHBY—You are still spending your \$100.

Dr Gruen—True.

Senator BUSHBY—The people who grow the bananas but cannot sell them because they have all blown over do not get that money, but other growers around the country might.

Dr Gruen—Indeed.

Senator BUSHBY—Would that offset some of the agricultural impacts that you are talking about there?

Dr Gruen—If you are thinking about real output, to the extent that some production has been destroyed—

Senator BUSHBY—Real output? I am talking about GDP.

Dr Gruen—That is real output. So, to the extent that some production has been destroyed, you have lost that.

Senator BUSHBY—Okay.

Dr Gruen—To a considerable extent, the way that accounts are put together, and to the extent that it is a price change, the Bureau of Statistics attempts to abstract from that in working out how much output has been produced.

Senator BUSHBY—That is all of the questions I have on that. I will not go into this in great detail, but I have a couple of questions on the stimulus package. Are you able to tell me how much of that remains unspent?

Dr Gruen—I am sorry?

Senator BUSHBY—The stimulus package. It is probably a fiscal question to some extent, but, in terms of the impact on the macro—

Dr Gruen—That is a fiscal question, I think.

Senator Wong—That is for the Fiscal Group.

Senator CORMANN—Just on that same issue, though, from a macroeconomic point of view, how are fiscal policy and monetary policy interacting at the moment in terms of macroeconomic impact?

Dr Gruen—As you would be aware, the latest figures are that MYEFO estimates the underlying cash balance for this year to be a deficit of three per cent of GDP and an underlying cash balance for next year of 0.8 per cent of GDP, if I have my numbers correct. They are on the front page of this, so I will just check. Yes, that is correct. So the underlying cash balance for this year is a deficit of three per cent of GDP and next year it is a deficit of 0.8 per cent of GDP. So you are talking about a tightening of fiscal policy of a bit over two per cent of GDP. That is a substantial tightening of fiscal policy between this year and next year. Fiscal policy is currently—and has been for a while—detracting from growth in the aggregate economy. Monetary policy is mildly contractionary, as the bank has made it clear that interest rates that borrowers face—not the cash rate—are a little bit above their longer-term averages.

Senator CORMANN—Mildly contractionary? I guess if you compare the circumstances of Australia to the circumstances in the US and the UK, in the US and the UK you have record low official cash rates, quantitative easing or printing money, strong fiscal stimulus—

Dr Gruen—Not in the UK, but in the US.

Senator CORMANN—In the US, sorry. There was a reasonable fiscal stimulus in the UK—

Dr Gruen—Going back there was, but in the UK—

Senator CORMANN—Of course, now there is a good government that is trying to put the books back under control, but in Australia our fiscal and monetary policies are still going in opposite directions, aren't they?

Dr Gruen—No, they are going in the same direction.

Senator CORMANN—On what basis? Your stimulus—

Dr Gruen—They are both contractionary for growth.

Senator BUSHBY—That is because the level of stimulus spending is lower this year than it was in previous years?

Dr Gruen—Indeed.

Senator CORMANN—But it is still more than normal trends.

Senator BUSHBY—We have had this discussion before. If you stop all stimulus spending at the moment—

Dr Gruen—It would be even more contractionary.

Senator BUSHBY—That is right, which indicates that the extent to which you are spending will have a positive influence on GDP.

Dr Gruen—The level of GDP.

Senator CORMANN—It is higher than if it had stayed on trend, taking the fiscal stimulus spending out of the equation.

Senator Wong—Where does the global financial crisis figure in all of this discussion? If you could have the unemployment rates of the two countries you outlined—

Senator CORMANN—You are assuming that the Reserve Bank would not have continued to make a monetary policy response, if that was required, to stimulate the economy much more efficiently than you can through debt.

Senator Wong—Fiscal policy has no role in trying to deal with a situation like the country and the globe faced a couple of years ago?

Senator CAMERON—All these economic geniuses in the Liberal Party.

Senator BUSHBY—Nobody, I believe, ever argued against the need for some fiscal intervention.

Senator Wong—Senator Cormann came pretty close. I think he basically said to me then that we should just have dealt with it through leaving it to the Reserve Bank. That is what he basically said.

Senator CORMANN—That is not what I said. You know that we supported the first stimulus, but we did not support the wasteful spending and mismanagement of the second well-overblown stimulus, which is still working its way through the economy even though spending is not going to be—

Senator BUSHBY—Even though a lot of our economy is at capacity or nearing capacity.

Senator CORMANN—And that is why our interest rates—

Senator Wong—You referenced the United States and the United Kingdom and I would refer you to the unemployment rates in those two countries.

Senator BUSHBY—Didn't the United States also have a stimulus package of comparative size relative to their economy?

Dr Gruen—The interesting thing in the United States was that there was a big federal stimulus, but the state and local governments were contracting their spending. So, in aggregate, when you take all levels of government, the US did not have a particularly big stimulus. It was quite small by the standards of the OECD.

Senator BUSHBY—So, Dr Gruen, are you saying that is the primary reason that the United States has done so much worse despite having that stimulus package—that it was the size of it compared to Australia—or are there other factors that contributed to that outcome?

Dr Gruen—Sorry—I did not say anything about the primary reason.

Senator BUSHBY—That is what I was asking. I mean, you did note that that was a difference.

Dr Gruen—If you are asking me why the US has had such a difficult period then the answer is that there are a lot of reasons.

Senator BUSHBY—Absolutely.

Dr Gruen—No question. The primary reason why the US has had such a difficult time is that it was the epicentre of the financial crisis.

Senator CORMANN—And they had a more difficult starting position, too, didn't they?

CHAIR—Senator Cormann, you keep interrupting. I think it would be good if we let Dr Gruen answer the question.

Dr Gruen—The primary reason is that they had an enormous shock which put their economy into freefall for a while. That was multidimensional—it was not just a financial crisis; it was also a huge housing bust and various other things. I think we are aware of all of those things. But it is the case that the fiscal response, if you take all levels of government into account, was relatively moderate. And I think it is the case that they would have done better had they had a more substantial fiscal response in 2009 and 2010. I think that is right because they did as much as they could on monetary policy, bringing interest rates down to effectively zero.

Senator BUSHBY—They could not go any further on monetary policy.

Dr Gruen—At least—

Senator BUSHBY—We did have more room to move on monetary policy.

Dr Gruen—And as the governor has pointed out, that is a double-edged sword.

Senator BUSHBY—It was a double-edged sword for fiscal policy as well though.

Dr Gruen—To respond to the point you make, there are also dangers in having extremely low interest rates, because they make profitable things which will not be profitable in the longer run, and that can lead to trouble. That is the comment he made, and—

Senator BUSHBY—But did the level that we actually get to qualify for what you would call extremely low interest rates?

Dr Gruen—Well, Australia's historical experience is that we have had higher cash rates than the US. Three per cent was the lowest we had got to, certainly in the low-inflation era, by quite a bit. So they were very low interest rates by Australia's standards. I do not know the last time the cash rate was three per cent but it would probably have to be the 1950s or the 1960s.

Senator CORMANN—How long has the cash rate been a quarter of a per cent in the US—three years?

Dr Gruen—Since December 2008, I believe.

Senator CORMANN—So, what, it is 2½ years?

Dr Gruen—However long that is—2009-10; yes, a bit over two years.

Senator CORMANN—That is a fairly long time to have an interest rate at a quarter of a per cent.

Dr Gruen—It is.

Senator CORMANN—Whereas in Australia over a 12- or 13-month period between 2009 and October 2010 or whatever we have had seven successive increases up from three per cent—when over there not only are they keeping it at a quarter per cent—

Senator CAMERON—Oh, Chair, come on.

Dr Gruen—It is true. Those are the facts.

Senator CORMANN—The point is that if you read between the lines of the very diplomatic language of the Governor of the Reserve Bank then part of it, of course, is that in the context of fiscal policy he was putting the brakes on while the government was still putting on the accelerator.

Dr Gruen—Senator, our assessment is that fiscal policy turned contractionary early in 2010—contractionary for growth, which I think is the right way to look at it—and monetary policy turned contractionary after that. So I think fiscal policy was contractionary before monetary policy was. That is not a criticism; that is just my assessment of how these things have played out. Broadly speaking, they have been acting in the same direction most of the time.

Senator BUSHBY—But once again it comes back to what we interpret. When you say that it was contractionary, technically speaking in economics-speak you are correct and nobody can argue against that. But it is contractionary in the sense that the fiscal policy is putting less into the economy than it was the previous year, when you had put an awful lot in to try to be excessively expansionary.

Dr Gruen—Those are your words, not mine. I would simply make the point that fiscal policy is currently, and has been for a while, detracting from the growth in the economy.

Senator BUSHBY—Because essentially the stimulus package is winding down and there is not as much coming into the economy from the stimulus package as there once was.

Dr Gruen—There is more than one way to look at the stance of fiscal policy. But at least in the first instance looking at how the underlying cash balance is changing is a reasonable way of looking at the stance of fiscal policy, and the underlying cash balance is improving at one of its fastest rates in a very long time.

Senator CORMANN—It has not from the budget to MYEFO. The underlying cash—

CHAIR—Sorry, Senator Cormann, I am sure Dr Gruen's economic knowledge is worth two of you but it is very difficult—

Senator CORMANN—We have been doing this all day—follow-up questions. That is not unusual.

CHAIR—No, sorry. Senator Bushby is following a line of questioning and I think he should stick with it.

Senator BUSHBY—I am not upset that Senator Cormann is adding at times, and I think he has some very good questions, but I do have some things to ask. Dr Gruen, I have asked you a couple of times about the chart on page 2-23 of Budget Paper No. 1. We were talking about what happened in the United States. You had that graph showing the impact on various countries that had stimulus packages.

Dr Gruen—Yes.

Senator BUSHBY—You made the point, I think this estimates and the estimates before, that it is not overly useful—that it was just an interesting thing to graph and show. Nonetheless it created an impression at the time that was quite politically useful for the government. Last estimates I asked you whether you were going to continue mapping the impact on those countries as their stimulus packages became contractionary and as they started having to address their government debt. Just as it was interesting as a snapshot at that time to see that those nations that employed a stimulus package did quite well, according to your graph—which did have some issues that were pointed out in terms of some countries that were missed off, but you have addressed that since—it would be interesting to see how that plays out over time in terms of how each of those countries deals with the contractionary phase as that winds down and also then how they deal with how they funded their stimulus packages.

Dr Gruen—We have not done this but the IMF has done some very careful work on what the implications are for economic growth of fiscal contractions. I can refer you to that work but—

Senator BUSHBY—Does it also look at how those countries have had to deal with how they financed the stimulus packages?

Dr Gruen—It looks at whether you get a different effect depending on the stock of debt as a share of GDP that you start with. So for highly indebted countries it gives somewhat different results than for countries that are not highly indebted.

Senator BUSHBY—And that is obviously very important for future planning in terms of how you would advise governments to deal with future shocks.

Dr Gruen—It is very important for a range of countries; that is right. But it does come to the conclusion that cutting the fiscal deficit is in almost all circumstances contractionary for growth.

Senator BUSHBY—Could you provide that on notice?

Dr Gruen—That paper?

Senator BUSHBY—Yes, or any analysis of that that you might have done.

Dr Gruen—That paper is actually a chapter from the *World economic outlook*.

Senator BUSHBY—If you could provide a reference to it on notice, then, that would be good.

Dr Gruen—We can.

Senator BUSHBY—Thank you. When was the last reassessment of the structural budget position undertaken?

Dr Gruen—The last reassessment is the one we talked about last time.

Senator BUSHBY—So nothing has changed since then?

Dr Gruen—Nothing has changed.

Senator BUSHBY—That is fine. Nothing has changed in terms of the current estimate of the structural deficit?

Dr Gruen—We have not updated that work.

Senator BUSHBY—When is that likely to happen?

Dr Gruen—I think the answer is: probably intermittently. I think we made the point we made in the *Roundup* article that this is one input into thinking about fiscal sustainability but that it is an estimate that is highly sensitive to—

Senator BUSHBY—To the terms of trade.

Dr Gruen—the level of terms of trade that you assume to be the long-run level of the terms of trade. We were reasonably conservative—in other words, we assumed a level of the terms of trade that is a long way below where we currently are. If you assumed a level of the terms of trade that was a bit higher than that then the structural estimates improved quite considerably. So there is no one answer to this and different institutions come up with different measures of the structural balance. We thought it was a contribution to give this. But, as I said, in the current economic circumstances, where a lot of people are having a conversation about where the terms of trade are going, that has lots of implications for the structure of the Australian economy.

Senator BUSHBY—You said you are making a contribution by putting that out there. What contribution does putting information out about the structural deficit have, given that it is—

Dr Gruen—Given that it is quite sensitive?

Senator BUSHBY—Yes.

Dr Gruen—It is something that people look at and that the OECD and IMF calculate for different countries. The OECD made the point that, for commodity-exporting countries, it is not enough to simply control for where you are in the economic cycle; you have to take a stand on what level of the terms of trade is consistent with the long run. Having made that contribution, which I agree with from an intellectual point of view, I think they would be the first to agree that it is extremely difficult to make strong statements about what the appropriate long-run level of the terms of trade is.

Senator BUSHBY—What are the current predictions on the terms of trade? Do you have any assessments of that at the moment?

Dr Gruen—As you would be aware, we do a couple of years of forecasts and then, after that, we have projections. For a long time, we have assumed in our projections that the high level of the terms of trade would not be sustained and that they would come down gradually over time.

Senator BUSHBY—Dr Henry did mention that earlier.

Dr Gruen—Yes. We have been making that assumption since 2005.

Senator BUSHBY—Presumably you are updating that all of the time—

Dr Gruen—We are.

Senator BUSHBY—in light of the reality of events that you actually observe.

Dr Gruen—Indeed, we do. Every time we update our economic numbers, we update that.

Senator BUSHBY—And it has been increasing?

Dr Gruen—Spot prices for some of the key commodities have been rising.

Senator BUSHBY—You note that, I think, in your report.

Dr Gruen—For coal in particular, yes.

Senator BUSHBY—What does Treasury see as the current inflationary risks and where are we at on labour market capacity?

Dr Gruen—The unemployment rate is five. As you would be aware, in *Intergenerational reports*, ever since we have produced them, we have made the assumption that a sustainable rate of unemployment is five. But I guess it is also true that it is impossible to be precise about an estimate of the sustainable rate of unemployment. We think that it may well be that the unemployment rate can be sustained below five. But the last time that the unemployment rate went down as far as four, we saw a gradual build-up of inflationary pressure. So we have been characterising the current environment as one where we are approaching full employment and we are deliberately no more precise than that, simply because we think it would be misleading to be more precise than that. But I think it is fair to say that spare capacity is less than it was, as the unemployment rate has come down.

Senator BUSHBY—Less than it was when?

Dr Gruen—When the unemployment rate peaked at 5.8 in the middle of 2009.

Senator BUSHBY—Okay.

Dr Gruen—But it is coming down gradually.

Senator BUSHBY—It is gradually coming down, but the trend is still down?

Dr Gruen—Yes, that is our assessment, although, of course, the floods and all of that are going to—

Senator BUSHBY—That was going to be my next question. What impact have the floods and cyclones had? Presumably that would be a bit of easing.

Dr Gruen—You would imagine that most employers would not be laying people off if they are expecting that something temporary has happened. I think our assessment is that it is not going to have a big impact on unemployment.

Senator BUSHBY—Is there potential particularly for the down time as a result of those natural incidents to contribute to the drift of financial and human capital from some of those industries in those areas to places where there is greater demand, particularly in the—

Dr Gruen—It is possible. It is giving people an opportunity to look in the paper for alternative employment.

Senator BUSHBY—Absolutely.

Dr Gruen—Or on the internet.

Senator BUSHBY—And knowing that there are higher demands elsewhere caused particularly by the activity in the mining sector in the west, that may well cause a drift of capital in both financial and human terms?

Dr Gruen—Yes.

Senator BUSHBY—That leads to my next question. What impact is the income boost from the terms of trade having on our supply capacity at the moment? We talked about where it is at, but the terms of trade are continuing to get higher. That is putting more income in and boosting the income of the nation.

Dr Gruen—It is.

Senator BUSHBY—What impact is that having on our ability to continue to supply?

Dr Gruen—It is true that, as the terms of trade go up and more income accrues to the domestic economy, more income accrues to overseas as well because of the significant foreign ownership of mining companies. But it also accrues to Australia. Part of that spreads through the economy via a higher exchange rate, which improves people's purchasing power to purchase imports cheaper. That is one mechanism which transfers that income from its original source to broadly through the economy.

Senator BUSHBY—But that has consequences for the economy?

Dr Gruen—It does.

Senator BUSHBY—That is, once again, on the allocation of human and financial capital and where that goes to?

Dr Gruen—Indeed.

Senator BUSHBY—And that can have longer term consequences?

Dr Gruen—Indeed.

Senator BUSHBY—Is that something that the Macroeconomic Group is looking at and advising government on?

Dr Gruen—In detail.

Senator BUSHBY—Are there any proposals that you have put to the government on that? I am not asking what they are, but have you discussed potential proposals for how that can be addressed with the Treasurer?

Dr Gruen—Proposals for how to—

Senator BUSHBY—For how to address the issues that arise from the movement of human and financial capital as a result of the exchange rate rises and in terms of terms of trade differences. Have you been discussing proposals or made any proposals?

Dr Gruen—We certainly have conversations with the Treasurer and the Treasurer's office about what is happening. That is in detail. If that leads to things, we respond to requests.

Senator Wong—Senator Bushby, you may or may not listen to what the Treasurer says or what the Prime Minister says, but I would have thought that what you have alluded to—the particular circumstances we find ourselves in historically, the economic consequences of that and essentially the structural change in our economy that has been driven by them—has really been the context of most of the government's policy considerations for some time. A small example might be the decision to defer \$1 billion of infrastructure as part of the floods package. That was deliberately taken or consciously taken recognising the sorts of capacity constraints that the economy is facing.

Senator BUSHBY—Well, you can tell that—

Senator Wong—We can have an argument about whether you agree with that or not. I was not actually trying to enter into that. I am just making the point that what you have described—the phenomenon or the circumstances that the nation faces—is the policy context of the government's economic thinking.

Senator BUSHBY—Thank you for your input, Minister, on that. I have one final question. Mr Gruen, you mentioned that, in looking forward, you assume the terms of trade actually deteriorate.

Dr Gruen—Come down, yes.

Senator BUSHBY—And that is a prudent, normal practice that you would do. Does that have an impact in terms of underestimating the overall change in the mix of the economy that will result from movements of human and financial capital?

Dr Gruen—To be precise, over the forecast horizon, we do our very best to forecast what we think will happen with terms of trade. Beyond that, we have what we call projections, which go out some way. But we are not making macroeconomic statements about how the structure of the economy is changing out there. If we were to do so—if we were to engage on that issue—we would not do it using these projections; we would do it with some sort of model that actually tried to look—

Senator BUSHBY—Look at the various scenarios.

Dr Gruen—That is right.

Senator BUSHBY—I assumed that was probably the answer. I just wanted to check. Thank you.

CHAIR—Are you aware of the way the Reserve Bank calculates terms of trade?

Dr Gruen—The ABS is the institution that publishes the terms of trade. We and the RBA both use ABS data. So we do not calculate it; they do. The terms of trade is the ratio of the price of our exports to the price of our imports, and it is one of the things that come out in the national accounts every quarter.

Senator EGGLESTON—You were talking about nations that had had stimulus packages. One of the largest in the world was China. We are now very entwined—interdependent, in fact—with China economically. Would you like to tell us a bit about how successful the Chinese economic stimulus package was and what is currently happening there in terms of the maintenance of that package and the growth of their economy apart from the minerals industry?

Dr Gruen—The Chinese instituted a very substantial stimulus package which was both fiscal and monetary. China is still in many ways a command economy. There are obviously benefits in having a market based economy, and I think we all understand what they are, but in a circumstance where you are trying to get spending to occur very quickly there are some benefits in having a command economy—not that I am recommending it. So the Chinese were able to turn around growth in their economy very rapidly through 2009 and their economy grew quite robustly in 2009, whereas at the end of 2008 many people were fearing that the Chinese would not grow very strongly. You saw that both in the amount of spending they did, which was across a wide range of things, and in the credit growth in the Chinese economy, which accelerated extremely sharply in 2009.

I think the situation—and I am happy to have others give you more detail—is that they are now in a world where they are experiencing quite a lot of signs of the economy running too hot. They have had quite a lot of asset price inflation and property price inflation, and their consumer price inflation has been getting faster. Much of it is food but, even outside of food, their consumer prices have been rising. They are taking steps to rein that in with a tightening in monetary policy, and we all hope that they are successful in engineering what we call a soft landing so that the Chinese economy slows somewhat but does not slow down too sharply. I think that gives you a broad summary, at a high level, of what the Chinese have been doing.

Senator EGGLESTON—I was told in 2008, by people who spent quite a lot of time around Shanghai and other places, that there were empty factories and workers were being sent back to western China—

Dr Gruen—In 2008?

Senator EGGLESTON—Yes.

Dr Gruen—In late 2008, with the financial crisis?

Senator EGGLESTON—Yes. A lot of their manufacturing goes to North America and Europe, of course, and I just wondered whether that part of their economy had recovered. I am particularly interested, obviously, in the relationship between our economy and the Chinese economy, which relates to minerals very largely. How has the domestic economy, and the economic welfare of the Chinese people, turned around? Has employment improved, have factories become operative again and are they exporting goods to Europe and North America successfully?

Dr Gruen—In 2010 the Chinese economy grew by 10.3 per cent, so they have been growing rapidly. I do not have the number in front of me but in 2009 I think they grew significantly faster than people had expected earlier in the year. Their exports suffered quite significantly, as you have said, in the crisis. Trade in general fell very substantially in the crisis but that has recovered. So I think it is true that export growth in China has been quite strong over the last 18 months. We could get you the figures if you need them.

Senator EGGLESTON—I would be quite interested.

Dr Gruen—I have just been handed the Chinese growth rate for 2009, which was nine per cent. That is very strong—maybe not by their standards but certainly by the standards of any economy that I look closely at.

Senator EGGLESTON—That is very strong. Are there any questions about how reliable the figures are?

Dr Gruen—The governor yesterday quoted a number which is quite extraordinary. I think it was that Chinese per capita growth over the last decade has been close to 10 per cent. That is quite incredible.

Senator EGGLESTON—Since we are talking about this kind of subject and your responsibility for monitoring other economies which we are involved in, would you like to say something about Chinese investment in mining in Africa and co-investment by Australian and Chinese mining companies in Africa?

Dr Gruen—I certainly cannot give you anything intelligent on that subject. There may be someone here who can talk to you about that; I am not sure. We are not experts on Chinese investment—

Senator EGGLESTON—The point is, of course, that there is significant Chinese and Australian investment in mining in Africa and joint investment by the Chinese and Australians in mining in Africa. What implications would you say that might have in terms of the future of the Australian minerals industry if, just as in the 1970s, the Japanese went to South America, to Brazil, because they were not satisfied that there was certainty of supply from the Pilbara because of the industrial situation there—with respect to my colleague Senator Cameron? Is history repeating itself and is it possible that the mining industry is building a safety net for itself in Africa?

Dr Gruen—I do not want to comment on what the mining industry is doing in Africa but let me make the point that mining as a share of the size of the economy has never been higher than it is currently. The Australian Bureau of Statistics surveys companies on a regular basis. Its latest survey came out this morning, and mining companies' first estimate for the next financial year is that they will spend 55 per cent more in Australia in capital expenditure in the mining industry this year than they estimated. So mining investment in Australia is going up extremely fast, despite the fact that it is already at extraordinarily high levels. So there is no question that the mining industry sees extremely profitable opportunities here.

Senator CAMERON—We should change the name of this from 'additional estimates' to 'a chat with Dr David Gruen'!

Senator EGGLESTON—That is what this segment is always like. Thank you, Dr Gruen.

Senator WILLIAMS—Dr Gruen, I want to ask you about the Reserve Bank's movements on interest rates et cetera. Is the main reason for raising interest rates simply inflation or is it about cost of money as well—for example, the credit shortage encouraging more deposits, perhaps? Is inflation your main reason for raising rates?

Dr Gruen—As you understand, Senator, monetary policy is in the hands of the Reserve Bank. They make their own decisions. As you know, the Secretary to the Treasury is one of the members of the Reserve Bank board. But, for a considerable time, the Reserve Bank has been responsible for monetary policy. The agreement between the government and the Reserve Bank is that the Reserve Bank is to aim for average inflation of two per cent to three per cent on average over a run of years or through the cycle. The Reserve Bank Act also specifies that the Reserve Bank should have concern for the general welfare of the people of Australia and for employment. So the Reserve Bank does not have a single goal of achieving its inflation outcome irrespective of everything else, but it is certainly the case that the inflation outcome is something which, on average, it aims to achieve. So inflation is important in the deliberations of the Reserve Bank for determining interest rates, but they have also, I think on many occasions, made the point that it is not the only thing.

Senator WILLIAMS—I want to take you to another issue about the terms of trade. When I was involved in foreign exchange markets in the late 1980s and early 1990s, each month we would get the balance on current account. That was not only the difference between exports and imports, which gave you the terms of trade, but also net income—

Dr Gruen—No, that is the balance of trade—it is not the terms of trade. They are different.

Senator WILLIAMS—The balance of trade, yes. No doubt there is no question that we are exporting more than we are importing now, which is great. For many years we imported each month far more than we exported. So now we have a positive terms of trade.

Dr Gruen—No, a positive balance of trade.

Senator WILLIAMS—Yes, balance of trade. When it comes to the bottom line of those monthly figures and balance on current account, is that also in the black? I simply have not looked at one literally for years.

Dr Gruen—The current account is now published every quarter rather than every month. The current account is currently running at a deficit of about two per cent of GDP. We can tell you what the latest quarter is, but the deficit is roughly of the order of two per cent.

Senator WILLIAMS—So, despite our huge value of exports superseding imports each month by a couple of billion dollars perhaps on average, we are still running in the red on the balance on current account after a three-month period?

Dr Gruen—Just to give you the number, for the September quarter the current account deficit was 2.3 per cent of GDP but for 25 years it has averaged about 4½ per cent of GDP or around that.

Senator WILLIAMS—Obviously the increase in exports has helped balance that bottom line?

Dr Gruen—It has. But another good way of looking at it is to say that the current account deficit is a measure of the extent to which we tap foreign savings to fund our investment. The other thing that is going on, of course, as a consequence of the big rise in commodity prices is that we are having an enormous investment boom. We are paying for most of that with domestic savings, but not all of it.

Senator WILLIAMS—So is that net income figure in the balance of current account basically the flow of money which would also include interest payments on foreign debt flowing out of the country compared to dividends coming into the country from overseas investments by Australians? It is the balance of the flow of money, basically?

Dr Gruen—That is right.

Senator WILLIAMS—And services around education and things like that?

Dr Gruen—To the extent that they are exports or imports, they get counted. They are there in the trade balance. But the money does not actually have to leave the country. The way the Bureau of Statistics does this is that, if a foreign company makes a profit in Australia and reinvests it—so the money never went overseas—according to the way the accounts are put together, it flows out of the current account and comes back through the capital account. So, to the extent that, let's say, a mining company makes profits which it reinvests here, that actually adds to the current account deficit, despite the fact that no money has flowed overseas.

Senator WILLIAMS—Even though the figure might show that so much money should be going overseas, the payments for these foreign investors in that particular mining company—

Dr Gruen—That is the way the accounts are put together. But the money never left. What happened in that case was that notionally that money goes out via the current account and then it is recorded as foreign investment inflow.

Senator WILLIAMS—Do you see a time in the future when the quarterly balance on the current account will actually become square or go into the black?

Dr Gruen—It is possible.

Senator WILLIAMS—It is a long time since we had it in the black.

Dr Gruen—I think 1972 might have been the last year that we ran a current account surplus. But it is also true that several other countries like us which run big current account deficits are doing so because they have very low national saving and not particularly strong investment. In our case, we have a national saving rate that is around the OECD average, but our investment rate is way above. We are a young country that just happens to be on the doorstep of Asia, which is the fastest growing region in the world and has been for decades. That means that there are vast investment opportunities in this country and we cannot fund them all from our own savings. That is not something to decry. That is okay.

Senator CAMERON—Tell Barnaby that, will you?

Senator WILLIAMS—I am talking to Senator Bushby, not you, Senator Cameron!

Senator PRATT—I am noting a speech of yours, Minister, on 13 October last year—I am sure it will be a question for Dr Gruen, in any case. We have specifically had some discussion of the OECD and IMF today already. But I want to ask about their endorsement of the government's fiscal stimulus, specifically what it was that they saw in Australia's response to the global financial crisis that warranted their endorsement.

Senator Wong—I do not have the speech in front of me, but—

Senator PRATT—The speech did not go into the detail; that is why I am asking the question.

Senator Wong—I may well have been quoting from a range of international commentary about the strength of the Australian stimulus package and the extent to which it was, I think, 'timely, targeted and temporary'. I think that the result—where the economy is now and where the economy did not go, given the sorts of risks that the Australian economy was facing at the time—gives us some confidence about the benefit of the stimulus package. The other point that I have made on a number of occasions, as has the Treasurer, is that, obviously, despite some commentary to the contrary, we are in a very strong fiscal position in terms of when we will come back to surplus and in terms of our net debt position, particularly when compared to the

advanced economies. I am sure Dr Gruen, who is looking at a very interesting OECD publication here, can give you a little more information.

Dr Gruen—This is the *OECD Economic Surveys: Australia, November 2010*. The OECD said, ‘The government also rapidly implemented one of the largest fiscal stimulus packages in the OECD, which contained many timely, targeted and temporary measures to boost consumption and investment.’

Senator PRATT—There you go.

Dr Gruen—It says:

The stimulus package was among the most effective in the OECD and is estimated to have boosted growth by some two percentage points in 2009. The extra aggregate demand helped to avoid a recession as usually defined by at least two consecutive quarters of negative growth. But the fiscal policy reaction also had a pivotal role in boosting overall confidence. The effectiveness of the stimulus was in part a function of its size. Adopting such a large stimulus plan was made easier by the healthy state of public finances, which reflects in part the effectiveness of the fiscal strategy pursued since the mid-1990s which aimed at maintaining a budget balance or a small surplus on average over the cycle’—

Senator CORMANN—Hear! Hear!

Dr Gruen—and:

at keeping the tax burden below its 2007-08 level.

Senator PRATT—Do you endorse the whole statement, Senator Cormann? I am happy to endorse the whole statement!

Dr Gruen—It says:

The effectiveness of the stimulus also stemmed from the speed with which it was introduced.

It goes on, but that was the main message.

Senator PRATT—Thank you for that. That does go to the crux of what I wanted to ask.

Senator Wong—I do not have the figure in front of me, but our net debt peaks in 2011-12 at about 6.4 per cent of GDP, from memory, and I think the G7 economies average is close to 90 per cent of GDP at their peak, which I think is later. So that gives you some indication of the strength of the fiscal position.

Senator PRATT—It certainly does. You referenced aggregate demand in that statement from the OECD. What is the assessment, now that we have come out of that period, of the impact of that aggregate demand on jobs overall?

Dr Gruen—In terms of the effect of the stimulus on jobs?

Senator PRATT—Yes.

Dr Gruen—I think our estimate of the overall effect was that the peak estimate was about 200,000 jobs. We both have that number somewhere deep in our brains. The peak effect was to have employment 200,000 higher than would otherwise have been.

Senator PRATT—That represents a lot of saved dislocation in the economy. What footing are we on now in terms of having avoided the worst impacts of the global financial crisis? How does that influence our settings now into the future? I suppose that, considering the natural disasters that we have just had, to have taken those steps backwards at that time would have placed an even greater burden on the nation now, looking forward to things like disaster recovery.

Dr Gruen—I said this myself in a speech: there are benefits in terms of avoiding skill atrophy and the general dislocation from unemployment, particularly long-term unemployment. There is a lot of evidence that people become generally disaffected with society as a consequence of being long-term unemployed. Not all of those 200,000 would have gone into long-term unemployment. We did not make that estimate. We may have made an estimate. Nevertheless, it is avoiding that sort of dislocation. So I think that is really what one is talking about. I think that is the answer to that question.

Senator PRATT—I understand that you have a unit called the Macro Dynamics Unit.

Dr Gruen—We do.

Senator PRATT—As I understand it, that is the unit that does the assessment of the evolution over time and factors in both policies and exogenous developments that are likely to influence medium-term performance of the economy. Is it something along those lines?

Dr Gruen—It sounds to me like that is what it does, yes.

Senator PRATT—The internet is an amazing thing. In a general sense, what are each of those key factors telling us and the settings about where we are placed in the medium term in relation to the Australian economy? What is the Macro Dynamics Unit saying?

Dr Gruen—The Macro Dynamics Unit says lots of things. The Macro Dynamics Unit is an opportunity for us to have some resources devoted to things other than the day-to-day issues to do with collecting and analysing the data. That unit looks at productivity developments and thinks about that. It also has deeper thinking about the longer-term development of the economy.

Mr McDonald—That unit is in my division. Perhaps just to add to Dr Gruen's observations, I think the broader sense that we see is that the things that will be most important for the health of the Australian economy over the medium term primarily relate to the supply side of the economy and about how efficiently we use the resources that we have in the economy.

Senator PRATT—So labour and skills and all of those key things?

Mr McDonald—All of the resources in the economy—labour, obviously; capital; and natural endowments, including water. But I think the key point of this is that, for much of recent decades, the key task of macroeconomic policy has been to try to reduce the unemployment rate so that the economy was operating at something equivalent to full employment. Having reduced the unemployment rate significantly, a key task is then to try to keep it there. But to sustain growth over the medium term highlights the importance of how efficiently people are able to be employed. That can relate to a whole range of factors—innovation, broadly defined, and productivity within firms, but also the way in which firms employ people and invest. So the efficiency with which we undertake that investment is extremely important. One of the points we put in the analysis that that unit does, which is contained in statement 4 of the budget last year, was about the implications and many of the opportunities—and very positive opportunities—that the boost to the terms of trade and more broadly the re-emergence of the Chinese and Indian economies and others in our region means for the Australian economy. They are very substantial. Dr Gruen gave a speech about that earlier today, so he may expand on those points if he wishes.

Dr Gruen—I will not; I will spare you.

CHAIR—We look forward to it.

Senator CORMANN—Just one follow-up question to something that came up in the discussion with Senator Bushby. You talked about how the underlying cash balance has been improving, and of course it deteriorated for this financial year from the budget to MYEFO from \$40.8 billion to \$41.5 billion. What caused that?

Dr Gruen—There is a chain. One updates the estimates—it is all in MYEFO if you want to know that. But also if you want to know that detail I would take it up with Fiscal Group.

Senator Wong—My recollection of that side of the balance sheet is that the Treasurer spoke about the impact of the exchange rate. I am going back to the MYEFO announcement.

Senator CORMANN—No—

Senator Wong—But we can probably assist you with that in the Fiscal Group.

Senator CORMANN—But this is the area—

Senator Wong—That is one of the factors that might have affected the change in the figures.

Senator CORMANN—Because the assertion was made, I was just intrigued as to—

Dr Gruen—Sorry, which assertion?

Senator CORMANN—The assertion that the position has been improving. When you say 'the underlying cash balance has been improving', what are you referring to?

Dr Gruen—If one is asking the question as to what effect fiscal policy is having on the economy then what one wants to look at is the change from one year to the next in the fiscal balance. Last year the underlying cash balance was 4.3 per cent of GDP and this year it is projected to be 3 per cent of GDP, so that is an improvement of 1.3 per cent and that is a significant fiscal tightening. The fiscal tightening that is projected for next year is even bigger, at 2.2 per cent of GDP.

Senator CORMANN—Thank you for that. Is this the area that I can ask about advice to government and efficient administration of federal financial relations?

Dr Gruen—No. Federal financial relations is fiscal policy.

Senator CORMANN—It says on the program:

Macroeconomic Group ... including by achieving strong, sustainable economic growth, through the provision of advice to government and the efficient administration—

Senator PRATT—They both say the same thing.

Senator CORMANN—So why I can't I ask—

Dr Gruen—Sorry, finish it again.

Senator CORMANN—It says:

... through the provision of advice to government and the efficient administration of federal financial relations.

Dr Gruen—Federal financial relations should be in Fiscal Group.

Senator CORMANN—That means that there is a mistake in our program then. That means I do not have any more questions for you.

Senator CAMERON—Given that we are having this friendly little chat, Dr Gruen, I thought I would just ask this question. You may want to take this on notice. Nicolas Sarkozy commissioned an inquiry into measurement. I think it was chaired by Professor Stiglitz—

Dr Gruen—Sen, Fitoussi and Stiglitz.

Senator CAMERON—Yes. It is about identifying the limits of GDP as a measurement tool and looking at more social measures about wellbeing.

Dr Gruen—It is about a lot of things.

Senator CAMERON—Has Treasury looked at this report, done any analysis of the report and prepared any, I suppose, way forward on this?

Dr Gruen—We have looked at the Stiglitz-Sen-Fitoussi report and we do take an interest in this. You will be pleased to learn that it happens in the Macro Dynamics Unit. But, as you may well be aware, the Treasury has a wellbeing framework and has had one for about a decade, so we take wellbeing seriously. Professor Stiglitz was in Australia last year talking about this issue. He gave a talk at Treasury. I certainly went to one of his lectures on the Stiglitz-Sen-Fitoussi report. So we take that seriously and have a considerable interest in it.

Senator CAMERON—You are not handling it, though—it is the Macro Dynamics Unit?

Dr Gruen—Yes, I am macro. We are handling it.

Senator CAMERON—Are there any papers that you have done or any discussions that you have developed on it?

Dr Gruen—Yes. The Secretary gave a speech about this to the NatStats Conference last year, in 2010. I was on a panel discussing it. I think Professor Stiglitz launched this report in many places, but one of the places he launched it was in Korea in 2009. I was the lead discussant on it and I talked about Treasury's wellbeing framework. So we take a serious interest in it.

Senator CAMERON—I will be interested to watch this and see what developments come out of it in terms of measurement.

CHAIR—I thank the Macroeconomic Group.

Proceedings suspended from 6.42 pm to 8.02 pm

CHAIR—We are continuing with Treasury. We have the Fiscal Group with us.

Senator CORMANN—First up, has Treasury updated its economic modelling on a carbon price since 2008? I see that Ms Quinn is over here, so I am sure she will look forward to sharing that information with us.

Ms Quinn—At this point, Treasury has not updated its analysis of carbon prices on the Australian economy. The last set of economic modelling that was done was done in 2008.

Senator CORMANN—So the decision to introduce a carbon price effective 1 July 2012 was taken in the absence of any fresh modelling about the economic impact of such an initiative?

Senator Wong—Senator, you know the announcement today is in relation to the mechanism. No decision has been made in relation to issues such as price or industry assistance, be that for the electricity sector or the

emissions intensive trade exposed industries and a range of other matters that would normally be considered in the context of the carbon price.

Senator CORMANN—If you had watched *The 7.30 Report* tonight as some of us have, you would have heard the current Minister for Climate Change and Energy Efficiency actually concede that what we are going to get over the next three years from 1 July 2012, if your government is successful with where they want to go, is a carbon tax, which you then want to replace with an emissions trading scheme from 2015. I just note that you are making these sorts of decisions and these sorts of announcements without any economic modelling.

Senator Wong—Hang on. All I am saying is that what has been announced today is the first—and I am not at all trying to minimise it; it is very substantial—part of what are a range of decisions which need to be worked through the multiparty committee. So to make the sorts of comments you are making really does not recognise what Minister Combet said and what the Prime Minister said around the sequence of different design decisions the government will have to make and work through with the multiparty committee. You will recall that the government did undertake what was, I think, the largest economic modelling exercise undertaken, which was led by Ms Quinn and others here tonight and across government in the context of the work done in the previous term.

Senator CORMANN—The largest modelling exercise ever back in 2008 pre Copenhagen and pre a whole range of other events and a modelling exercise that has not been updated before your government made a decision to introduce a carbon tax effective 1 July 2012 and an emissions trading scheme, if possible, effective 2015. Now—

Senator Wong—Senator, I make the point that it would not matter what we did; you would still call it a great big new tax on everything.

Senator CORMANN—It is a carbon tax.

Senator Wong—I am just making the point. So that is what you will do. The debate will not be about anything to do with what is right for Australia's future. It will not be about anything to do with science.

Senator CORMANN—It is entirely about what is right for Australia.

Senator Wong—It will not be about not running away from this important policy issue. It is about your slogan.

Senator CORMANN—It is entirely about what is right for Australia.

Senator Wong—We are making the point that it is entirely disingenuous for you to be calling for additional evidence on this issue when we all know it would make not one iota of difference to your opposition.

Senator CORMANN—Ms Quinn, can you confirm that the modelling that was conducted in 2008 was based on an assumption that the United States would have an emissions trading scheme in place by 2010?

Ms Quinn—In the modelling that was done for *Australia's low pollution future*, released in 2008, there were various different assumptions taken about international action. In one set of assumptions, it was assumed that the United States would take action along with other countries from 2013. In another set of assumptions, it was assumed that the United States would take action in terms of putting a price on carbon in some form from 2010. So there were a range of dates in their modelling. To be clear, it was very clear in the report that we were looking at the impact of carbon pricing. It did not necessarily mean precisely that they had a trading scheme themselves.

Senator CORMANN—Has the United States put a price on carbon in 2010 or are they, indeed, likely to put a price on carbon by 2013?

Ms Quinn—I am not an expert in this particular component of international action. I believe these questions were raised with the Department of Climate Change and Energy Efficiency. I would refer to their answer, which, to paraphrase it, was that some parts within the United States have actually put a price on carbon. Other states are reviewing and moving towards the possibility of putting a price on carbon—in particular California.

Senator CORMANN—Having spoken—

Senator Wong—I will also add to that answer. In addition, obviously—and these are really not matters in Fiscal Group per se; these are probably matters for the Department of Climate Change—

Senator BUSHBY—It is about modelling.

Senator CORMANN—We have been told all day.

Senator Wong—You were not asking questions, Senator Bushby, about modelling. You were asking questions about the carbon.

Senator BUSHBY—I was not.

Senator Wong—You—plural—were asking questions about the carbon price in the United States. So, no, I would not suggest that that is necessarily something that we would reasonably address in Fiscal Group.

Senator CORMANN—But, Minister, I am asking you.

Senator Wong—I have not finished my answer. I was responding to the interruption, so can I finish my answer. I would also make the point, in addition to whatever explicit prices have been put on through state mechanisms, that obviously there are also in many economies, including the United States, what you might term shadow carbon prices by virtue of regulatory changes which have been made. I do not have the officers at the table who can traverse those. This is in fact part of what the Productivity Commission is investigating. I do not know if you were here last night, Senator.

Senator CORMANN—I was.

Senator Wong—I cannot recall. That was not a joke.

Senator CORMANN—It is very sad.

Senator Wong—It actually was not a joke, Senator. I could not recall towards the end of the evening whether or not you were still there.

Senator CORMANN—You were not meant to be here. It was supposed to be Senator Sherry. At least I remember.

Senator Wong—Sorry, but I do not keep in my memory every moment of yours, Senator Cormann.

Senator CORMANN—Very, very serious, Minister.

Senator CAMERON—Is there any room left for questions?

Senator CORMANN—I am sure, Senator Cameron. The reason I am asking questions is that what has happened in the US is because the economic modelling—which, of course, Treasury is responsible for—made a set of assumptions which we now know either have not eventuated or are unlikely to eventuate. Having been in the US in January and having spoken to federal politicians on both sides of politics, I can say that they will all tell you, Minister, that there will not be an emissions trading scheme any time in the near future. In fact, that is what the Secretary of State, Hillary Clinton, said very clearly to a group of young people when she was here on a visit to Australia back in October-November last year. Incidentally, those who assume that China would have an emissions trading scheme by 2015 and India by 2020—

Senator EGGLESTON—All our trading partners.

Ms Quinn—As I mentioned, there were two different schemes for when international action occurred. Under one there was action starting in 2013. Under the other set of assumptions there was a phased entry of countries depending on their level of development. Some countries took action from 2010. Others took action from 2015, 2020 and so on. Once again, what we assumed was that there was a price on carbon in those countries. We assumed that that was done through an emissions trading scheme or a carbon price. But there are other ways of getting prices on carbon in countries. I refer to the shadow price of carbon. The Productivity Commission is looking into this in more detail. But there has been a release of a report by Vivid Economics and the Climate Institute that looked at what the current shadow price of carbon was in the electricity generation sector in key countries. Their report, depending on how you measure the GDP—whether it is at market exchange rates or PPP, purchasing price parity exchange rates—found in evidence that with the current policies in place in the United States at the moment there was a shadow price of \$5.05 and in China a shadow price of \$8.08. So I do not think—

Senator CORMANN—So what is the shadow price in Australia?

Ms Quinn—The shadow price in Australia was \$2.34 in that assessment.

Senator CORMANN—So we now know what the shadow prices are. We also know that you have not actually done any modelling to assess what the impact of a carbon tax would be. The US is not going to have any emissions trading scheme any time soon, even though they might have a shadow price of \$5 or whatever.

Ms Quinn—What is important for assessing the international competitiveness effects and the impacts on GNP and GDP is the price on carbon that is faced by industry in the country.

Senator CORMANN—Sure.

Ms Quinn—The mechanism by which you place that price on carbon has implications. Inefficient measures through regulation typically are found to raise the economic cost of putting a price on carbon versus more efficient market based mechanisms, such as an emissions trading scheme or a carbon tax.

Senator CORMANN—In your economic modelling back in 2008, did you model a scenario where others did not put a price on carbon other than the shadow price that you have just talked about?

Ms Quinn—In the economic modelling that was undertaken for the ALPF report, Treasury did not do a scenario where Australia took actions and others did not. The Garnaut review for climate change did undertake such a scenario and found that the overall economic cost of Australia taking action versus the rest of the world not taking action was not quite so clear-cut. If Australia takes action and the rest of the world does not take action, that does not equate to the presumption, I think, that Australia would do better, because there are different ways of things happening. If the world takes action and Australia takes no action, it is still negative for Australia because we export emission intensive trades.

Senator CORMANN—Has Treasury been instructed by the government to update the 2008 modelling?

Ms Quinn—We have been asked to update our capabilities to undertake economic modelling related to climate change mitigation policies. We have been reviewing all aspects of the modelling undertaken over the period 2007-09—updating the models, updating assumptions as appropriate. As with previous climate change policies exercised with Treasury, we are drawing on the expertise of sector specific experts and external modellers, who have aided us in our assessments. So we have been updating our capabilities and reviewing the economic modelling throughout the last 12 months.

Senator CORMANN—You have been reviewing your capability and updating things. So by when do you think you will have a conclusively updated assessment of the impact of a carbon price with different scenarios?

Ms Quinn—That depends on exactly what we are asked to evaluate and look at. So it is very hard to provide an answer to that question.

Senator CORMANN—But if we go to the government's five per cent carbon reduction target by 2020, which was at the lower end and part of the legislation that was before parliament last time—sort of the starting point—given that we are now in a shorter time frame, you would have to assume that the impost of the carbon price is going to be steeper than what it would have been compared to what you assumed back in 2008.

Ms Quinn—It is very difficult to make those sorts of assessments without doing the updated economic modelling. Many things have changed over the more recent period. It also depends on the mechanisms by which such a target is achieved, the action internationally, and other developments in the Australian economy such as sectoral growth and technology options. So it is difficult to take a piece-by-piece approach in a partial equilibrium analysis and say whether the carbon price will be higher, lower or steeper et cetera.

Senator CORMANN—Remind me again what the benchmark year was for that five per cent reduction by 2020.

Ms Quinn—2000.

Senator CORMANN—So if you are now going to have a shorter period to reduce emissions by five per cent compared to 2000 emission levels, you start later. It stands to reason. Unless you think that emissions have reduced by themselves for other reasons, the effort would have to be steeper. If you aim to reduce emissions by the same amount over a shorter period by imposing a price then surely you will be looking at imposing a higher price.

Ms Quinn—It depends on what else is going on because, if technology costs have changed in such a way that it is easy to achieve a target, if Australia has a trading scheme that allows the imputation of foreign permits, it depends on the foreign permit price which depends on foreign action and technology costs; it depends on a myriad of factors. It is difficult to be precise about making those partial assessments without doing a full update of the economic analysis.

Senator CORMANN—Sure. Is it the intention for the carbon tax revenue and other implications to be included in the 2011-12 budget?

Mr Ray—I probably should have a go at that one. The standard practice would be for a measure to be included in the budget when a decision is taken.

Senator CORMANN—Okay. That is a very good answer. Let me ask in a different way. Do you expect a decision to be taken to the point where it is ready for inclusion in the budget by whenever the budget is expected to come down?

Senator Wong—It is not expected to come down!

Senator CORMANN—You know—we have a date. You can make fun of my linguistic—

Senator Wong—It is usually a day, you know; it is in the diary.

Senator CORMANN—You know that I am a non-English speaking background person, Minister.

Senator Wong—I am hardly the person you could make that charge to.

Senator CORMANN—You can make fun of my linguistic contortions, but I am trying to do the best I can, Minister, to make myself understood.

Senator Wong—My first language was not English, either, Senator.

Senator CORMANN—I think that Mr Ray understood very well what I was asking.

Senator BUSHBY—He was 20 years old before he started speaking English.

Senator Wong—Yes.

Senator BUSHBY—That is impressive. Oh—23? There you go.

Senator CORMANN—Mr Ray?

Mr Ray—I do not know that I can add to my earlier answer.

Senator CORMANN—So essentially you do not know? Today we have had an announcement but you do not know whether it is going to be part of the budget come the middle of May?

Mr Ray—The answer to that question depends on when a decision is taken.

Senator CORMANN—Treasury's 2008 modelling estimated a carbon price of \$26 was necessary in 2005-13 to achieve the government's five per cent carbon reduction target by 2020. Now that there is less time to achieve the five per cent reduction target, does that mean we need a higher carbon price than the \$26 per tonne?

Ms Quinn—I think this is the same question that you just asked, about the shorter period of time.

Senator CORMANN—I am just putting a dollar figure to it now. So \$26 a tonne is what you said in 2008. We have a shorter period of time now. Is it going to be higher than \$26?

Ms Quinn—Once again, it is very difficult to make an assessment without undertaking the economic analysis. There are many things that have changed. There are many things to update. It depends exactly on the mechanism that is put into place. I cannot answer that. The reason why we undertake economic modelling is to be able to put answers to those sorts of questions.

Senator CORMANN—The thing is: you say it depends on international developments, technology and other things but, if anything, since 2008 when you did the last modelling, there have been international developments. We might differ on the degree to which they have become worse. But you have to concede that post Copenhagen and post the decision in the US not to go ahead with the ETS legislation, international developments, if anything, are worse now from an Australian point of view. So if we have a shorter period and if the international developments are more challenging and everything seems to be more difficult in terms of achieving that five per cent emissions reduction, the chances are that we would need a higher price on carbon than \$26 a tonne, wouldn't we?

Ms Quinn—As I said, it is difficult to be precise about the direction of carbon prices or economic costs associated with putting a price on carbon. I would note that I do not think it is an accurate representation to say that international action that is currently on the table through pledges and then reaffirmed in Cancun suggest less action than was undertaken in the modelling in 2008.

Senator CORMANN—But you have not assessed that.

Ms Quinn—We now have more countries that have pledged to take action than we initially anticipated in the 2008 scenarios, and there are differences at the margin between some countries pledging more action and others less action. But, taken as a whole, there are a wide range of assessments that the pledges at Cancun are

broadly consistent with a 550 parts per million stabilisation level for greenhouse gases, which was the stabilisation level that was incorporated into two of the larger scenarios undertaken for the 2008 report.

Senator CORMANN—Can you give us on notice, perhaps, then, the changes that have occurred in terms of the international developments, up and down, when you say that there are countries that are doing more than was expected compared to your modelling and countries that are doing less than you expected compared to your modelling? If it is not too difficult, could you put that in perspective in terms of the proportion of global emissions that those countries represent in terms of the up and down?

Ms Quinn—I can certainly take that on notice. To give you an example, in the economic modelling we undertook, we did not have Brazil taking any action for a significant period of time and yet they have provided a pledge under the international arrangements to date. So there are many examples of countries that we had not taking action until significantly later who have currently taken pledges and are framing action. So I am happy to take that on notice and provide that information.

Senator CORMANN—I have to say, given you assumed back in 2008 that \$26 per tonne would be necessary as a carbon price in 2012-13 to achieve a five per cent carbon reduction by 2020, if anything, my guess would be that it would have to be higher to achieve that same outcome rather than lower. But we will see what comes out of your modelling. I am sure that other colleagues will want to ask about the carbon tax issue. I have some other issues later, so I might just leave it there.

Senator EGGLESTON—I did have some questions on this issue, but I think Senator Cormann has covered the ground quite well. It is quite extraordinary that, given that none of our regional trading partners have engaged in developing emissions trading schemes or imposing carbon taxes, except perhaps for New Zealand, we are going down this pathway, which is beginning with a carbon tax and may go on to an emissions trading scheme. The question arises, as it did at the time, a couple of years ago: who will we trade with if none of our regional trading partners have emissions trading schemes and countries like the United States do not have them?

Ms Quinn—I refer to my earlier answer. Some countries have emissions trading schemes, such as the countries of the European Union and New Zealand. Some are exploring and investigating the options, such as Korea, Japan, regions of the United States and various others. There are various ways to put a price on carbon, including through a carbon tax or an emissions trading scheme, and another way is through regulations. As I have pointed out, the shadow price of carbon in the electricity generation sector has been found in many of our major trading partners, such as Japan, China, South Korea, the UK and the United States, to be an important element in terms of the international comparability of action on climate change. It is also true that there is in existence now a substantial trading scheme in carbon permits. The EU trading scheme exists, and there is the clean development mechanism, the CDM market; you can buy CDM permits on a traded stock market at the moment. So if Australia were to have an emissions trading scheme, barring issues around compliance and quality, we would have access to that CDM market. That is an existing market that is in operation right now. A trading scheme does not necessarily require every individual country in the world to be creating permits. It just requires a body of trade that we can purchase international offsets from.

Senator EGGLESTON—I suppose you have to ask yourself what the net gain is. I went to a renewable energy forum in Beijing in September 2009, and the delegates of China, Japan and Korea said they had no intention of establishing emissions trading schemes. As with Senator Cormann, I was in the United States last year. I spent some time in congress in the capital, and there is no sentiment there to have an emissions trading scheme. So, once again, we seem to be walking down a very lonely road. I am sure New Zealand has an emissions trading scheme. But one of the problems they said they have is that there is no-one to trade with. Indeed, the Europeans have an emissions trading scheme but not a very big one.

Ms Quinn—The only point I would make is that China is taking seriously action on climate change.

Senator EGGLESTON—In renewable energy.

Ms Quinn—Which is action on climate change.

Senator EGGLESTON—Which is what we are doing.

Ms Quinn—They are looking at energy efficiency improvements, renewable energy improvements and a variety of mechanisms. There are regions within China that are looking at trialling and establishing emissions trading schemes. So it is fair to say that right now some of these countries do not have emission trading schemes but are investigating them and seriously exploring the feasibility of them. We have seen a significant growth in the CDM market over time. There is no reason to presume that, if countries stick to the pledges they

have raised, they will not find efficient mechanisms to reduce greenhouse gases. That intrinsically suggests that trading is an option that they would be exploring.

Senator EGGLESTON—When I was in Beijing, the Chinese delegate, who was the chair of their environment committee, said that they would not introduce an emissions trading scheme or a carbon tax because it could harm their economy and make them less competitive. I think that is an issue which has been ignored in this announcement today—the impact on the trading economy.

CHAIR—Senator Eggleston, do you have a question, preferably for the fiscal group rather than—

Senator EGGLESTON—I am getting to a question.

Senator Wong—This is torture!

Senator EGGLESTON—I wonder whether the extra expense of the energy will have a profound effect on the Australian economy. I would like to ask you what modelling has been done on the impact of a carbon tax on the price of consumer goods and energy in this country.

Ms Quinn—I can refer to the analysis that was done in 2008, where we explored—

Senator EGGLESTON—What new modelling?

Ms Quinn—Well, you asked what modelling. I can answer that. As I have said, we have not currently updated scenarios on new modelling. But the previous modelling, which was the largest and most complex modelling exercise undertaken in Australia's history, did look at putting a price on carbon and did look at the implications on a national, sectoral, household and state-by-state basis. The results of that suggested that the impact on overall inflation would be in the order of one or 1.1 per cent, depending on exactly which carbon price you were looking at. The implications for the Australian economy were quite modest—a 0.1 percentage point reduction in GNP relative to what it otherwise would have been over time. That is in the context of fluctuations in GNP significantly larger than those in response to other economic shocks, such as the global financial crisis or exchange rate movements.

Senator EGGLESTON—We will have to wait and see how this plays out. But most people would be concerned about higher prices for consumer goods and energy.

Senator PRATT—It feels a little like groundhog day in here. I know I have asked this question of you before, Ms Quinn. It is in relation to the benefits of early action as opposed to later action.

Senator BUSHBY—That is surely a question for the climate change department.

CHAIR—She has not finished yet, Senator Bushby.

Senator BUSHBY—It is a very important set of questions.

Senator PRATT—Particularly as it relates to economic adjustment.

Ms Quinn—As I have previously mentioned in these committees, in the economic modelling undertaken in 2008 we explored the benefits or implications for countries that moved earlier rather than later. In the context of a global scheme, those countries that moved earlier were found to reap the benefits of that early action. It meant that they were less likely to invest in energy intensive industries and, therefore, have some capital in the event of pricing eventually being placed on them. So, in the context of eventual global action, we found that it was less costly to move earlier rather than later.

Senator PRATT—Are there any modelling exercises that compare the costs of market based mechanisms with other forms of government action?

Ms Quinn—There have been exercises looking at emissions trading schemes versus renewable energy targets and there have been assessments on an ad hoc basis looking at other regulatory regimes, none of which have been produced by Treasury.

Senator PRATT—What about things like direct investment?

Ms Quinn—Do you want to define 'direct investment' a little?

Senator BUSHBY—'Direct action', I think, is the term you are looking for.

Ms Quinn—It depends a little on the mechanism that is put in place. There have been assessments of carbon pricing out of some schemes, such as the New South Wales schemes and the other schemes in Queensland. Typically those studies all suggest that the average cost of abatement—there is a slight technical difference in definition between the 'average' cost of abatement and the 'marginal' cost of abatement—is

higher through direct regulatory regimes or the buying of abatement in particular sectors. That is partly because they target particular sectors and reduce the opportunity for abatement from other sectors to be used.

Senator PRATT—You have touched on the 2008 modelling exercise. Can you tell us about the impact on economic growth of a market based carbon mechanism?

Ms Quinn—It found that if an efficient market mechanism were used, the impact on economic growth in Australia and the world would be quite modest—in the order of 0.1 percentage point off GNP over time. That suggests that economic growth would continue to grow in the event of putting a price on carbon.

Senator PRATT—Does the modelling also tell us that if we do not act at all and the rest of the world does act, we are hamstringing the economy and restricting economic growth?

Ms Quinn—If the rest of the world acts and Australia does not act, there is still a reduction in Australia's growth rate over time if the rest of the world puts a price on carbon and the demand for some of our energy intensive exports is reduced. Coal is an example. What we did not explore were the possible implications of retaliatory action that might occur if other countries were to act and Australia was not to act. We have not explored that possibility, but it is something that has been raised in the international negotiations about the free rider problem. If the rest of the world were to act and Australia were not to act, it has been raised that that would be an issue in terms of the international trading arrangements.

Senator PRATT—Given the carbon intensity of our economy, could that be characterised as a significant risk if that were to come to pass?

Ms Quinn—It would very much depend on what the actions contemplated by our trading partners would be. It is difficult to speculate.

Senator PRATT—Thank you.

Senator CAMERON—Thanks, Ms Quinn. Groundhog Day it certainly is.

Senator CORMANN—I know we will get to Groundhog Day if we pull together like last time.

Senator PRATT—We still have no price on carbon.

Senator CAMERON—Concept Economics with Henry Ergas did some modelling. Concept Economics went bankrupt and Henry Ergas is still lecturing about how to do things. But their modelling showed that 203,530 direct jobs would be lost across Australia's mineral industry by 2020 and 66,480 by 2030. The 2020 figure represents an 11 per cent drop in overall employment in the minerals sector while the 2030 result is a 24 per cent increase. Have you changed your view on the problems with that Concept Economics modelling, given that there has been a bit of time since we last spoke about it?

Ms Quinn—No. The issue with examining economic modelling reports is that it is very important to think about what is happening in the base case or the case where policy is not being applied. Results being presented relative to that reference case can be taken out of context. It is important to know what is happening in the reference case before making judgements about the implications on the economy. With regard to those numbers that you quoted, my understanding is that they are relative to a reference case. It is not clear what the underlying growth in employment in those sectors is. It could well be the case that because of the increased demand for resources in the Australian economy, the base case is that employment in those sectors is growing quite quickly and they would just be growing more slowly relative to a world without carbon pricing. So you should not confuse a loss of jobs in the future relative to a baseline to a loss of jobs currently in place. It is just less jobs than otherwise would be. There could still in the mining sector—it is highly likely—be an increase in jobs from today. So that is an issue about presenting modelling results. It is very important to be clear about whether it is relative to today or relative to a reference point in the future.

Senator CAMERON—But underlying this, there will still be strong employment growth in the economy despite the implementation of a carbon price either through a carbon price or through a trading scheme. There will still be job growth. That is the estimation of Treasury?

Ms Quinn—It is certainly the expectation based on the 2008 analysis. It is difficult to be precise about any proposed future policy that is as yet undefined. But in relation to the modelling we did in 2008, there was continued strong growth in the economy and there was continued growth in many of the emission intensive industries. The growth was somewhat slower than it otherwise would have been, but certainly in mining as a whole—I will have to check the precise details—there was continued strong growth in employment.

Senator CAMERON—So the Concept Economics modelling was basically flawed in terms of the regional estimations that it made, was it not?

Ms Quinn—The presentation of the reports was incomplete. That would be the characterisation. With the analysis of the microregions below state level, it becomes very difficult to be precise about those movements because the economic modelling is not complete to be able to give a complete picture. In particular, the economic analysis requires behavioural change by firms and households. The economic modelling that captures those behavioural changes is at a state and national level. By taking the current industry structure and assuming it is unchanged and pushing that forward in a world where there is a carbon price, you will get skewed results. If there is an industry that exists in the analysis and is relatively effective, you will get the negative impact. But if there is an industry that does not yet exist that will intend to grow in that region, it will not be captured in the modelling. So it is likely to result in a biased assessment.

Senator CAMERON—Given the high price for our minerals and growth in the mining sector—the reason I am going to the mining sector is that we will have the mining industry out with their scare campaigns pretty quickly, I would think, given their past performance—do you see anything in relation to implementing a modest carbon price that would mean employment losses in any of the mining sectors in this country?

Ms Quinn—It is difficult to be precise because you need to know the precise mechanism and precise price levels that you are exploring.

Senator CAMERON—I said a modest carbon price.

Senator CORMANN—What is a modest carbon price?

Senator CAMERON—Small, low. A low price.

Senator CORMANN—What is small?

CHAIR—I think Ms Quinn is better placed to answer that.

Ms Quinn—In relation to the analysis that was done in 2008, as I said, mining employment continued to grow under that analysis, even under the 450 parts per million scenarios, which had quite high carbon prices. Since that time, the underlying prospects for the mining sector have improved relative to what we were previously looking at in 2008. The continued strength of demand from China, India and other developed countries and the continued high commodity prices being received by Australian exporters is higher than what we had anticipated at the time. It is difficult to be very precise because, as I said before, the reason why you do economic modelling is to update all the components to see the complete picture. But the high commodity prices and the demand for commodities will suggest that prospects without a carbon price are better than we previously were expecting. So any impost from the carbon price would be off those higher growth prospects.

Senator CAMERON—During the inquiry that you gave evidence to, which was the Senate Select Committee on Climate Policy back in June 2009, Dr Heinz Schandl of CSIRO told the committee that overall the number of jobs will increase over the next two decades. There will be 2.5 to 3.3 million new jobs and 230,000 to 340,000 of these new jobs are in those sectors which have been identified as high impact sectors with regard to resource use, energy use and emissions. Is that CSIRO assessment consistent with Treasury's assessment?

Ms Quinn—I am not familiar with the details that you have articulated. I would be happy to take that question on notice and provide an assessment.

Senator CAMERON—Okay. In terms of the overall economy, have you done any analysis that can demonstrate the benefit of a market mechanism against this direct action mechanism—that is, government just taking money out of the budget and handing money over for projects to the polluters and saying, 'Do your best?' Have you done any analysis on that?

Ms Quinn—We have not undertaken any economic modelling evaluating those two alternative schemes at this moment.

Senator CAMERON—Do you know if there is any modelling outside of Treasury?

Ms Quinn—There has been some discussion about alternative schemes, as I mentioned earlier. There are other organisations that have reviewed the competing schemes. The OECD has done an analysis of some schemes as well—the different types of regulatory versus market based mechanisms—and they have concluded that market based mechanisms are a more efficient way to reduce abatement. I am happy to take it on notice and provide some of those reports for your consideration.

Senator CAMERON—Just to be clear, regulatory is not the equivalent of direct action, where government finds the money in its budget and hands it over to business to reduce—

Ms Quinn—We usually consider market versus non-market mechanisms. Direct action is not strictly regulation, which is banning certain activities or putting in place certain standards, which would be more directly regulation. It depends precisely on the details. Isolating things to one sector is typically considered non-market because you are not allowing agents in the economy to choose where the abatement comes from. You are directing the action in particular sectors.

Senator CAMERON—Thank you.

Senator BUSHBY—Ms Quinn, you say that there has been no new modelling done on this since 2008. For the record, you talked about a number of scenarios that you modelled at that point of time. I think, from previous evidence you have given before this committee, that did not include a modelling of the scenario where there was not global action essentially to put a price on carbon.

Ms Quinn—We did quite a large number of sensitivities in the report. We did a sensitivity where there was a delay in international action.

Senator BUSHBY—But not where the rest of the world did not come on? That was not modelled?

Ms Quinn—No. We did not do Australia taking action and other countries not taking action.

Senator BUSHBY—No. That is right. That was my recollection. I just wanted to clarify that. In terms of the shadow carbon price, which is a new term to me—I am probably way behind it in terms of hearing that—

Senator CORMANN—It is a direct true price.

Senator BUSHBY—Yes, it is. That is right. In terms of that—

Senator Wong—It is a reflection of the cost of different forms of government intervention. It is not an uncommon concept.

Senator BUSHBY—When I heard it, I recognised what it was being used to label. I had not actually heard it being used before.

Senator Wong—You used to believe in micromechanisms, probably because you recognised that regulation was generally more expensive.

Senator BUSHBY—I have not asked a question yet.

Senator Wong—No. I am responding to some of the assertions; that is true.

Senator BUSHBY—I was not asserting. I was making a comment that I had not heard that term used before. In terms of that, did you model shadow carbon actions as part of the 2008 modelling?

Ms Quinn—No, we did not. We looked at carbon prices.

Senator BUSHBY—Actual carbon price?

Ms Quinn—Efficient mechanisms. We looked at efficient mechanisms as opposed to inefficient mechanisms.

Senator Wong—We did not assume that our governments would actually impose less efficient mechanisms to do the same thing.

Senator BUSHBY—Which is what we have just heard evidence on.

Senator Wong—I am just saying—

Senator BUSHBY—Presumably, to be fair, it is less efficient than what other countries are doing? You are using those examples to highlight that if other countries were taking action to address carbon emissions but in a less efficient way than a market mechanism, that presumably would actually have some impact on their competitiveness vis-a-vis Australia in terms of how we approach these things and how they approach things?

Ms Quinn—Yes. It is a logical extension that if one country achieves an outcome inefficiently, raising the economic cost in their country, and Australia were to impose an efficient scheme reducing the economic cost in Australia, we would be relatively better off.

Senator BUSHBY—The reverse is true as well—that if we took an action, about which you have given evidence, that is not as efficient for various reasons as the most efficient but others were also doing the same thing, our relative disadvantage would not exist in the same way as if they had done it in the most efficient way and we had done it in a less efficient way?

Ms Quinn—It is certainly logical if one country imposes an inefficient economic policy that makes them absolutely worse off. It makes them relatively worse off if another country takes a more efficient action for the same outcome. If both countries were to do inefficient mechanisms, it would just lower both countries' GDP and they would be relatively about the same.

Senator BUSHBY—That is fine. It is also true that governments of all flavours in all sorts of nations make decisions that are not necessarily based on the most efficient, strictly speaking, economic approach to things because there are other factors at play that lead them to make decisions in other ways?

Ms Quinn—That would be the observed outcome.

Senator BUSHBY—Yes. Thank you. You are unable to tell us whether the \$26 price on carbon with the 2008 modelling would still stand because things have changed—technology has changed and a lot of the world situation has changed since 2008. That was in one way part of the question. You acknowledged that you could not then say whether \$26 would be higher or lower because you would need to assess all of that and remodel it, I think. Is that correct?

Ms Quinn—That is correct.

Senator BUSHBY—So what we do not really know at this point and what the government does not really know, because there is no modelling to actually provide that information, is what price on carbon would be required in order to deliver the outcomes in terms of carbon emissions that the government is saying it will meet?

Ms Quinn—Correct.

Senator BUSHBY—That is correct. So the government is essentially flying blind at this point in terms of what level of tax it would need to impose on the Australian people because it does not have any up-to-date modelling, taking into account current circumstances that Australia faces in terms of where that tax needs to be set to deliver the outcomes that the government has told the Australian people it will deliver?

Senator Wong—The government's announcement today is the first part of, as the Prime Minister outlined, the process of working through this with the Australian people and through the multiparty committee, Senator, I am a little confused though. You no longer support the targets, because you did for a long time. You just said you could get there differently. You are now saying the targets are not—

Senator BUSHBY—I do not really—

Senator Wong—I am just confused about the opposition's position. Do you support the reduction of five per cent or not?

Senator BUSHBY—Once again, Minister—you were doing this at the last estimates as well—you are sitting on that side of the table and I am sitting on this side of the table. Fortunately for me I get to ask you the questions. You do not get to ask me questions. If and when I ever get to sit on that side of the table, I will enjoy questions from you and I will answer them then. But in terms of what I am trying to get at, the government today has announced it is going to proceed with a carbon tax. It said that is a fact. It will take effect on 1 July 2012. What we have heard in evidence tonight is that the government, in making that announcement, has no idea other than an indication from three years ago, which we have heard is no longer necessarily accurate, what level it needs to set that tax in order to deliver the targets you just promised to achieve.

Senator Wong—What the government has announced is—

Senator BUSHBY—Surely it would do the homework first before it announced it.

Senator Wong—What the government has announced is the mechanism and what the government has said is that there are a range of other decisions, one of which you refer to but there are many others, which the government will need to undertake. It will do so through the multiparty committee on climate change and in dialogue with the Australian people. Senator, the fundamental issue here is not that you think we should model. It is not that you think we should talk about—

Senator CORMANN—Yes, we do.

Senator Wong—No. The fundamental problem—and you are both on the record on this—is that you do not believe that this country should take action on climate change.

Senator CORMANN—When have we said that? Find it on the record.

Senator BUSHBY—Yes. You find me on the record saying that too.

Senator Wong—Well, I am sorry, Senator Bushby—

Senator BUSHBY—On the record in a speech where I called you the high priestess of climate change, I actually said that I believed we should be taking action on climate change. I am aware of a reference.

Senator Wong—I have noted quotes from Senator Bushby:

...I have no choice but to refuse to believe what I am told is truth and to declare myself a ‘sceptic’ when it comes to the issue of mankind’s impact on the climate.

Senator, you are entitled to that view. That is your view. But—

Senator BUSHBY—But you took that out of context.

Senator Wong—Can I finish? May I finish?

Senator BUSHBY—No. You are referring to out-of-context quotes.

Senator Wong—May I finish? The fundamental problem here is that the view you have, to which you are entitled, is not the view that we share. We are a government that is committed to acting. We have outlined the way forward. The fundamental problem here in terms of the questions you are asking is you start from the position that you do not think anything needs to be done. That is the position you have.

Senator BUSHBY—Minister, since you have raised that quote, that was in the same speech where I concluded very shortly after that—

Senator Wong—Where you accused me of being the high priestess. I do remember that.

Senator BUSHBY—That I believe we should be taking action but it should be common-sense action. If you actually read the words that preceded that quote, I made it clear that I was a sceptic in the sense of the Greek sceptics, who believed that all things put to them should be questioned and not accepted without an examination of the facts.

Senator Wong—It is extraordinary that you would think that as a number of people, including John Howard, came to the view that pricing carbon through a market mechanism was the most efficient mechanism—

Senator CORMANN—An appropriately comprehensive goal. It was an appropriately comprehensive goal.

Senator Wong—That is actually not what the task group says.

Senator CORMANN—That is exactly what it says.

Senator Wong—That is actually not what the task group says. If you took the time—

Senator CORMANN—Kevin Rudd and Peter Garrett intimated that—

CHAIR—Senator Cormann, I am trying to listen to the minister’s answer and all I can hear is you.

Senator Wong—If you took the time to read the report—I do not think you were in the government then, Senator—that your—

Senator BUSHBY—I was, actually.

Senator Wong—Sorry, were you? Okay. If you took the time to read the report that your party in government commissioned, you will see that they came to the same view in the task group report as have most other people when they have held government and expert economists when they have turned their mind to this issue. If you are going to act on climate change, you have to price carbon. The most efficient way of taking action is to introduce a market mechanism. So it is not a revolutionary concept but it is one that you disagree with.

Senator BUSHBY—The point I am concluding from the evidence that I am hearing tonight is that the government has announced it will introduce a tax. As I understand it, and I do not believe we have moved from that either, you have a target that you wish to reach within a certain period of time. You are selling the tax as the main tool that you will be using to get to that target, but you have no idea at this point what that tax is going to be. You do not know whether it is going to be \$26 a tonne. You do not know whether it is going to be \$40 a tonne or \$80 a tonne because you do not have current modelling. Yet you have made the decision to proceed without knowing what cost and what impact that is going to have on the Australian economy.

Senator Wong—Is there a question in that, Senator?

Senator BUSHBY—The question is: is that an accurate summation?

Senator Wong—No.

Senator BUSHBY—Minister, tell me why not. Where am I wrong? Where is my reading wrong?

Senator Wong—What the government has said is that it has outlined a two-stage plan for a carbon price mechanism. The government has also said that a range of decisions have not yet been made, which would include design issues such as starting price, assistance arrangements for households, communities and industry and support for low emissions technology and innovation, phase coverage of sectors, coverage of the electricity sector et cetera. Those sorts of issues are yet to be determined.

Senator BUSHBY—But the primary issue is the level at which the tax will be set. We have heard evidence tonight that clearly demonstrates that there is not modelling that is sufficiently up to date to be able to accurately assess that, even to the extent that modelling is accurate. We have had plenty of evidence in the past from Ken Henry about the predictive nature of modelling and the assumptions that it is based on. But even to the extent that you can rely on modelling, we have no up-to-date modelling that takes account of it. So we have no idea what level that tax will need to be set at to deliver the outcomes.

Senator Wong—Senator, we will have to make those decisions and we will be accountable for them. They will be made after the process that the Prime Minister outlined today has been gone through. But, again, I would say it is really quite disingenuous of you to focus on the modelling issue. We undertook, as Ms Quinn said, the largest, most complex modelling exercise the nation has undertaken and you still simply called it a great big new tax and voted against it. So let nobody pretend in this room that this is about—

Senator Bushby interjecting—

Senator Wong—I have not finished. Let us not pretend in this room that this is actually about good public policy or your concern—

Senator CORMANN—You are defensive now.

Senator Wong—for whether the modelling is done or not. The reality is you oppose action on climate change. That is not me being defensive.

Senator BUSHBY—This is about the transparency of the government in terms of the decisions it makes and the case it makes.

Senator Wong—Nothing that could be done—

Senator CAMERON—I raise a point of order. Chair, Senator Bushby and Senator Cormann are continually trying to talk over the minister when she is giving an answer. I know they are agitated and I know that they are concerned about where this is going, but they should just sit back and relax and at least listen to the answer.

Senator BUSHBY—On the point of order: the minister is being completely unresponsive to the questions and is using her ability to answer the questions to grandstand and to shift the focus away from the questions and the transparency we are seeking to place on the government. She is trying to score cheap political points against those who are asking the questions from the coalition side.

CHAIR—I would suggest, Senator Bushby and other senators, that we are firmly stuck on climate change rather than the fiscal group of Treasury. We might all consider moving on.

Senator BUSHBY—I have finished my questions.

Senator Wong—Those estimates were earlier this week.

Senator CORMANN—I want to go back to the modelling. What you have reported as a two-stage plan, Minister, is essentially a government announcement of yet another tax without the government coming clean with the Australian people as to how much tax you are going to charge them. You want to go out there and whack yet another tax on them but you do not have the courage to tell them how much it is you are going to charge them. So I am going to ask the question very clearly: does Treasury have any estimates of what the fixed price of the first three years of a carbon price regime would need to be in order to achieve a five per cent target reduction by 2020?

Ms Quinn—It is difficult to answer that question because there is a great deal more information that needs to be provided.

Senator CORMANN—But either you do have the estimates or you do not.

Ms Quinn—The question is incomplete in terms of me being able to answer it. A fixed price on carbon depends on the coverage, the timing, the rate of increase, what happens after the fixed price and whether there is international linking. There is a great deal of architectural information that is required in order to be able to answer that question.

Senator CORMANN—Okay. That means that the most recent and the closest actual information you have is the one out of the most comprehensive modelling ever conducted in the whole world, which is the 2008 modelling. So I have got to—

Ms Quinn—I think we have only said Australia.

Senator CORMANN—Sorry?

Ms Quinn—I believe I only said Australia.

Senator CORMANN—Sorry. The biggest exercise in modelling in Australia. Sorry. I was trying to make it much better than what it was.

Ms Quinn—And reach world domination, yes.

Senator CORMANN—Essentially, what we are then dealing with is a \$26 a tonne price on carbon in the absence of any other information. That is the most recent, most accurate information we have got. So what impact will a \$26 carbon price have on headline and underlying inflation if the government is to pursue that between now and 2020?

Senator Wong—Senator, whilst Ms Quinn is looking—

Senator BUSHBY—I think she is there.

Senator Wong—What I was just going to say is that this was canvassed, from memory, with the Reserve Bank governor in the context of the CPRS. But I think it might have been Mr Gruen who could probably talk about it. Ms Quinn can assist on this.

Ms Quinn—Looking back at the analysis that was done for the Carbon Pollution Reduction Scheme, as it was outlined in 2009, the proposal on the table at that time was for a \$10 fixed tonne price of carbon in 2011-12 and a flexible price that was estimated to be around \$26 a tonne in 2012-13. I have to make the point that in an emissions trading scheme the price is set by the market and it is not determined in advance. It is a function of the supply and demand for permits. In that analysis, the impact for a \$10 carbon price was about 0.4 per cent on the CPI. In the second year, the additional \$16 was 0.7, bringing the total to 1.1 per cent on CPI.

Senator CORMANN—How much?

Ms Quinn—1.1 per cent.

Senator CORMANN—1.1 per cent?

Ms Quinn—A one per cent increase in the price level of headline inflation.

Senator CORMANN—Of course, the 2008 modelling—and this is all based on assumptions that were quite generous—

Ms Quinn—This was explored in 2009.

Senator CORMANN—This was what?

Ms Quinn—This analysis was included in the legislative package of the CPRS in 2009.

Senator CORMANN—Yes, indeed. Of course, what was included at that time as well was that the five per cent reduction in carbon by 2020 from 2000 levels would increase wholesale electricity prices by 48 per cent over 2010-15 and 86 per cent over 2015-20. That is right, is it not?

Senator Wong—This is the modelling that you did not trust last time, Senator.

Senator CORMANN—No. Because we thought it was actually telling a story that was a bit too friendly; it was actually underestimating the impact, Minister. The situation is probably worse. I am keen to be reminded what the modelling said.

Ms Quinn—In table 6.1 for the average wholesale electricity price increase from the modelling exercise, it was estimated that for the country as a whole over the period 2010 to 2015 under the CPRS minus 5 scenario, average wholesale electricity prices would go up 48 per cent.

Senator CORMANN—And 86 per cent in the period 2015-20?

Ms Quinn—Relative to what they otherwise would be, yes.

Senator CORMANN—Indeed. And with retail prices rising 20 and 25 per cent—

Ms Quinn—That is not a 48 plus an 86 plus—

Senator CORMANN—No—

Ms Quinn—It is the difference from the reference case.

Senator CORMANN—Understood, yes. We are talking, though, of an 86 per cent increase in the wholesale electricity price to 2020. When you assessed those inflation outcomes did you assume an economy at full capacity?

Ms Quinn—These inflation outcomes are the morning after impact, so they are assuming that the price is put on carbon and what would happen if there was no change in behaviour both at a firm and a consumer level. It reflects the emissions intensity of the Australian economy. It does not have any behavioural element in it. You could think of them as an upper estimate because once you have behavioural changes it is highly likely that the impact would go down.

Senator CORMANN—Will Treasury be modelling the inflation impact of a fixed carbon price?

Ms Quinn—You are asking me about something I might do in the future. It is difficult to answer that.

Senator CORMANN—So you have not given any thought yet as to what you are going to be modelling into the future?

Ms Quinn—We work at the direction of the government.

Senator CORMANN—Sure. I actually remembered that when I asked you why you used the assumptions you did, including why you did not assess the net impacts in terms of reducing global emissions out of the effort in Australia. You told me then that you made all these decisions at the direction of government, which I thought was interesting. How would a carbon price set at \$26 per tonne, which you confirmed was the expectation for 2012-13, affect the price of a loaf of bread?

Ms Quinn—I do not have the estimate down to the price of a loaf of bread. I can give you the aggregate impact on the CPI.

Senator CORMANN—Maybe walk me through the process of what gets affected by the carbon tax. We have got the grower growing wheat, we have the wheat getting milled, we have got the wheat getting transported. Tell me how is the carbon price of \$26 a tonne going to impact on all of that, every step of the chain?

Ms Quinn—It very much depends on the framework and the coverage of the carbon price.

Senator CORMANN—Which we do not know.

Senator PRATT—It won't impact—

Senator CORMANN—Well, sort of.

Senator BUSHBY—Yes, sort of.

Senator CORMANN—They will pay higher electricity prices, I think. They will pay higher fuel prices. They will pay higher other prices. Sorry, I am waiting for the answer to that.

Ms Quinn—It is difficult to be precise without additional information. In principle, the impact of increasing prices reflects the emissions intensity of the Australian economy. You put a price on emissions; it gets passed through to consumers.

Senator CORMANN—Is this climate change modelling your full-time job in your unit—is that what you do?

Ms Quinn—The macroeconomic modelling division covers other economic modelling as well, not just climate change mitigation.

Senator CORMANN—You have not been sitting idle over the last two years while the government was figuring what the hell they are doing?

Ms Quinn—Personally I have had a third child, but the unit as a whole has been—

Senator CORMANN—Congratulations, that is great news. That is good. So you have not been sitting idle.

Senator Wong—You really wish you hadn't asked that! That was beautiful.

Senator CORMANN—I am actually very pleased I have asked the question. That is very good news, Ms Quinn, I am very happy for you.

Senator Wong—That was very good.

Senator CAMERON—You have to be nicer than that after—

Senator CORMANN—I think that that is a nice conclusion to the discussion on the carbon price.

CHAIR—Go ahead, Senator Cameron.

Senator CAMERON—Ms Quinn, the propositions that have been put forward by the opposition senators have basically been on what happens if you put a \$26 carbon price. You did indicate earlier that you have to take into account behavioural change.

Ms Quinn—That is right. Putting a price on carbon is about changing the emission intensity of the Australian economy, which happens through consumers and producers changing the way they do things. The mechanism works by putting a price on the emissions and people seeing that price and changing their behaviour accordingly. Our expectation is, over time, as industries change their production processes and consumers change the way they consume, that the impact on the economy is mitigated.

Senator CAMERON—So you just cannot say that a \$26 price put on carbon equates to this cost without taking the behavioural change into account; you have to take behavioural change into account?

Ms Quinn—Over time, certainly; behaviour does not change overnight. But over time as behaviour changes you need to take into account that possibility for assessing the overall economic costs.

Senator CAMERON—Has Treasury done any assessment in relation to business uncertainty, so if business cannot get some certainty in relation to a carbon price what impact that would have on electricity prices?

Ms Quinn—We did not in the 2008 analysis and we have not to date. There have been other studies that have looked at what the uncertainty in the electricity sector is doing and tried to investigate what that might mean for electricity prices. There was an economic paper published in the *Economic Record* recently and Frontier Economics has also looked at these implications. The conjecture is that the behaviour is such in the electricity market that investors are hedging their bets. They are choosing technology options that are viable in a world with and without carbon prices, which means that even if there was not a carbon price put into place, electricity prices would be rising.

Senator CORMANN—Having a tax after promising no tax creates a lot of uncertainty.

CHAIR—Senator Cormann, I think you have had a reasonable go and Senator Cameron was asking questions.

Senator CAMERON—I am not quite clear what you are saying there because what I have read, in layman's terms, is that electricity prices will rise unless there is business certainty.

Ms Quinn—I can give you a concrete example. When building a new power plant, investors are looking at different types of technology. Some of them are more emission intensive than others and some can operate in a world with carbon pricing and without carbon pricing. For example, open cycle gas turbines can be used in a world without carbon prices to make money in peaking periods and in a world with carbon prices they become efficient relative to coal, but a closed cycle gas turbine is more efficient on average at producing electricity. If people in an uncertain world choose to build the open cycle turbines then electricity prices would be higher than if they had chosen the closed cycle turbines. The uncertainty about whether there is a carbon price is leading, potentially, hypothetically—and people who investigated this know more about the electricity industry—to people making decisions that will raise the electricity price even without a carbon price.

Senator CAMERON—What analysis has been done either in Treasury or in the economic literature in relation to the viability of a direct action approach?

Ms Quinn—There was some discussion about climate change, of which I do not know all the details, looking at whether the abatement to beat a minus five per cent target relative to 2000 levels was possible under a direct action scheme. That analysis was looking at other similar schemes at the state level and factoring it up over time to see whether it was possible. The conclusion from that analysis is it would be difficult to achieve the five per cent target through some of those mechanisms because the coverage of the schemes is not significant enough to get the abatement that you need. The OECD has looked at some of these issues in other countries and concluded on average that market based mechanisms are more efficient over time. Because they are more efficient and lower cost, you get more abatement for less economic cost.

Senator CAMERON—As to what has been projected in Australia, to spend something like \$10 billion on direct action, have you looked at whether that would have any real economic effect?

Ms Quinn—We have not done that analysis, no. It is difficult; you have to define exactly what action you are talking about.

Senator CAMERON—You did say that it was underlying carbon prices in other countries?

Ms Quinn—I was referring to the Vivid Economics and Climate Institute report *Climate Change* that was looking at the shadow price of carbon, the implicit price of carbon in the electricity generation sector in other countries.

Senator CAMERON—Do you have the figures there?

Ms Quinn—I do.

Senator CAMERON—Are they on the record?

Ms Quinn—Yes, the report is published. I read out some of them earlier but I can certainly provide the information on notice.

Senator CAMERON—Yes, I would like that, thank you.

CHAIR—Senator Eggleston, off climate change?

Senator EGGLESTON—Off climate change it is.

Senator CORMANN—Thank you so much, Ms Quinn, that was a sterling effort.

Senator Wong—What, the third child or the responses? Both.

Senator EGGLESTON—In both features.

Senator CORMANN—I was reflecting on her performance here tonight, Minister.

Senator Wong—Yes, as always.

Senator EGGLESTON—This is about a completely different subject. I understand that in the Health and Ageing red book, *Guidelines for preventive activities in general practice* seventh edition 2009, there is a reference to the health expenditure working group which has been established under the deputy heads of Treasury structure ‘to quantify the costs of services agreed for transport to government under the agreement’—the first agreement, that is—‘which was to form the amount of GST revenue to be withheld in the Commonwealth forward estimates for dedication to health and hospitals’. Is that the case?

Mr Ray—Mr Robinson could answer that question.

Mr Robinson—That is correct; a working group was formed under the deputy heads of Treasury which included not only Commonwealth and state treasurers but also health departments and first ministers’ departments in some cases. Part of our work program was to work through the financial estimates around the transfers associated with the National Health and Hospitals Network reforms, and that work was proceeding.

Senator EGGLESTON—‘To work through the financial estimates’—does that mean you are preparing advice, for example, about the amount of GST which would be required to finance the proposal?

Mr Robinson—That is correct. Our immediate task was to prepare estimates of the amount of dedicated GST that would be required for the 2011-12 budget.

Senator EGGLESTON—Was it quantified? Do you have a figure that you could give us about the amount required?

Mr Robinson—We were in the process of doing that work. We had some very preliminary work from some states. It was very much preliminary, as the basis of discussion between the Commonwealth and individual states was all provided on a ‘no prejudice’ basis, in that the states were continuing to work on those numbers through until a period into March when we would need to start crystallising them for budget purposes.

Senator EGGLESTON—It was not specifically quantified but there were broad outlines given to you; is that what you are saying?

Mr Robinson—We had some returns from some jurisdictions but not from all jurisdictions. We were in the process of commencing discussions around the numbers.

Senator EGGLESTON—Is it the case that the amount of GST proposed to be recovered under the 30 per cent claw-back would not have been sufficient to cover the health and hospitals costs that were going to be

needed over the forward estimates? In other words—you are in this working group—is it not the case that there was not enough GST to cover the anticipated costs?

Mr Robinson—We certainly had not come to that conclusion, no.

Senator EGGLESTON—That is very interesting. Can you tell us what percentage of the costs the GST recovery would have potentially covered?

Mr Ray—You are talking about the April last year package? That was designed to be neutral as between the states and the Commonwealth over the forward estimates. So the question of the GST did not start until after the forward estimates.

Senator CORMANN—I might just jump in here for a second. Was it neutral for the period 2014-15 to 2019-20?

Mr Ray—No.

Mr Robinson—No.

Senator CORMANN—Let me clarify—and I am quoting Professor John Deeble here, who is hardly an apologist for coalition policies on health and health financing. He made the point that the \$15.6 billion in additional funding committed by the Commonwealth over 2014-15 to 2019-20 period was like a fictitious benefit because it only reflected the growth that the Commonwealth would have had to put on the table anyway. I thought he was being generous. The question then: was the money that was on the table actually enough to cover what you would have been expected to put on the table in additional federal funding for health and hospitals over that period?

Mr Ray—The \$15.6 billion number was our estimate of the cost to the Commonwealth of the agreement last April, the new arrangements from 2014-15 to 2019-20, over and above the GST arrangements.

Senator CORMANN—Yes, but do you expect that that is going to be enough to cover the federal funding growth for health and hospitals or do you think you will have to supplement it down the track? As in the past, whenever there was a new federal healthcare agreement, over and above the past trends, the Commonwealth had to put additional money on top of it.

Mr Ray—Under the new COAG arrangements the indexation factor is not automatically reviewed periodically. The indexation factor that was agreed back in late November 2008 just keeps running.

Senator CORMANN—It just keeps running on?

Mr Ray—So that modelling just assumes that the indexation factor in the underlying SPP payment sits there.

Senator CORMANN—The \$19 billion is on top of the indexation factor that keeps running, is it—the \$19 billion out of the most recent deal, which is the equivalent of the \$15.6 billion.

Mr Ray—It was \$16.4 billion.

Mr Robinson—The \$16.4 billion.

Senator CORMANN—So the \$16.4 billion is on top of that, okay, and the indexation factor?

Mr Ray—Correct.

Senator EGGLESTON—Thank you. It was just a matter of clarification of the numbers underlying it. We were not sure that the GST did actually cover the anticipated costs.

Mr Ray—It quite expressly did not; that was part of the April 2010—

Senator EGGLESTON—The additional, yes. Thank you very much for clarifying that.

Senator BUSHBY—I know we have discussed this, particularly at the last estimates, and I think it probably gets discussed in Finance as well. For the record, what is the purpose of the conservative bias allowance? Why is it included in budget papers?

Senator Wong—We seemed to have a very long discussion previously. That is all right.

Senator BUSHBY—This week as well?

Senator CORMANN—Yes, it is good to go through it again.

Senator Wong—He wanted us to fund the floods out of it until we made the point that it would actually hit the bottom line. This is the CR or the CBA?

Mr Ray—No, this is CBA, conservative bias allowance. Through time it has been observed that estimates of demand driven programs in successive budgets over a long time have tended to underestimate the growth in those demand driven programs, particularly as you go out through the four years of the forward estimates. The conservative bias allowance is an allowance which is included in the CR, in the contingency reserve, to adjust forward estimates to provide a better estimate of the likely progress of those demand driven programs. That is the purpose of it. It is successively unwound as you get closer and closer—

Senator BUSHBY—And have a better understanding of the reality of what you are likely to face?

Mr Ray—That is right. It is not appropriated. It is included to improve the estimates; it has nothing to do with the actual spending that happens.

Senator BUSHBY—I understand that there is now an annual review of the CBA. At what time of year are those normally conducted?

Mr Ray—My advice is that is not done annually but when it is done—and it was done before the 2009-10 budget—it is done before the budget.

Senator Wong—I actually tabled that review in Finance estimates.

Senator BUSHBY—That is fine, I am just interested in the time of year.

Senator Wong—I think it was Senator Cormann who had a question on notice about it, and I tabled it at the lunch time of the estimates.

Senator BUSHBY—You say it is not annual, is it ad hoc? Is that what you are saying or is it always done before the budget now? Evidence that was presented before the finance committee in October suggested that there was an annual review now that was being done.

Senator Wong—I do not recall that being the evidence, but that is my recollection.

Mr Ray—I think it would be best if we check with our colleagues at the Department of Finance and Deregulation.

Senator BUSHBY—I have actually got the relevant sections here but I will ask some more questions and then I will come back to you if I can find the point. Certainly the evidence was that there were regular reviews now as opposed to what was entirely ad hoc up until that point. Does Treasury participate in those reviews?

Mr Ray—We did in 2009-10, yes.

Senator BUSHBY—Are you able to tell me the dates of when that review started?

Mr Ray—Not off the top of my head, but I am happy to take it on notice. As the minister said, the review has been tabled which probably had the date of the review on it.

Senator BUSHBY—Would it have had the date when—

Mr Ray—It may have had some information in it so I will take it on notice.

Senator BUSHBY—I am interested in the date that Treasury was first advised that the review was about to commence and notified you that you could participate in that review.

Senator Wong—I thought the evidence—and again I think it was in my portfolio estimates not these—was that government, both when you were in government and obviously in the last term, is advised by departments of the appropriateness of reconsidering the CBA. I am talking from my memory here, so I might be wrong. If I am wrong, we will correct it. Departments went away and did the review and the results of the review were then advised to the government.

Senator BUSHBY—I have the quote here from Tuesday, 19 October:

Mr Tune—Not so much in the way it operates, because we think that the way it operates is probably appropriate, the process itself, the mechanism. But we do do an annual review of the appropriateness of the percentages that apply under the conservative bias allowance.

Senator FAULKNER—How long has that annual review—

Mr Tune—The last couple of years, and we have done ad hoc reviews in the past as well, I should add.

So I think my recollection was correct.

Senator Wong—I am not sure what he was referring to in the first part of that answer, whether that is looking at it in terms of putting the budget together or the actual review process which produced the report,

such as the one I tabled. I thought the evidence was that, prior to that one, it had been a number of years since there had been one done. There are small 'r' reviews and capital 'R' reviews I suspect, but that is fine.

Senator BUSHBY—I guess what I am talking about is the annual review of the adjustment rates that apply under the conservative bias allowance. Senator Faulkner goes on:

Senator FAULKNER—You might let the committee know when the ad hoc reviews took place and when they became annual. They became annual relatively recently, I understand.

Mr Tune—In the 2009-10 budget onwards.

... ..

Mr Tune—There have been two annual reviews. We have had two, we had the 2009-10 budget and then we did one in the lead up to the 2010-11 budget.

Quite a bit of a discussion that took place at the hearing establishing that they have become annual. I am interested in knowing when that is done and particularly for the last one, the most recent one, when that process commenced and when Treasury first received advice that that was occurring and when, to your knowledge—and I know you have to take this on notice—the process wound up and Treasury's involvement ceased?

Mr Ray—This is not the 2009-10 budget, this is the 2010-11 budget?

Senator BUSHBY—The 2010-11 budget, yes.

Mr Ray—I think this might be one of those sorts of definitional things about what a review is. We, and our colleagues in Finance, tend to look at all the estimates each year. I think what Mr Tune was referring to is that we take a closer look each year at the conservative bias allowance ratios. I am happy to take it on notice but it is something that we do each year ahead of the budget, and our people work in consultation with Finance.

Senator BUSHBY—Because there has been an adjustment since the election in the conservative bias allowance?

Mr Ray—That is the standard.

Senator Wong—That is standard.

Mr Ray—That is the standard thing that has been done at MYEFO on a number of years.

Senator BUSHBY—That presumably was done on the basis of a consideration of what those rates should be?

Mr Ray—It was done on the consideration that it would be appropriate to do the standard drawdown.

Senator BUSHBY—You looked at it to decide whether it was appropriate to do the standard drawdown and a decision was made to change that and revise it downward, is that right?

Mr Ray—A decision was taken that the standard drawdown should be made at MYEFO, that is correct.

Senator BUSHBY—But the rates that were applied through MYEFO were revised downward compared to what were in the May 2010 budget?

Mr Ray—That is correct, and that happens every year. In recent times, that is what happened.

Senator BUSHBY—As you get closer?

Mr Ray—As you get closer.

Senator BUSHBY—And you have a better understanding of what is going on?

Mr Ray—We got closer and therefore our estimates are—

Senator BUSHBY—Okay that is fine. If the coalition had won the election which was held in August of 2007 would that same downward revision still have occurred?

Mr Ray—It would have been a decision for the Minister for Finance and Deregulation and for the Treasurer of the day.

Senator BUSHBY—If they decided to revise those downwards in accordance with that or in any other way, that would have been a legitimate decision of the minister for finance and the Treasurer?

Mr Ray—Yes, we have been through this before, but it would not have been a saving.

Senator Wong—That is the issue.

Senator BUSHBY—I have no further questions on that. In answer to question on notice SBT 238 on debt financing, I asked some questions about the interest payments received and the interest payments that were paid out. I note that there are other financing costs here which you list as, 'Other financing costs mainly comprises finance lease payments and certain public debt transactions that are regarded as financial transactions and not as interest.' What I am interested is in 2008-09, they were \$1.8 billion but they were only \$0.8 billion in 2009-10. I was wondering why there was a greater than 100 per cent difference between the two years—over a billion dollars?

Mr Ray—I think that is going to a level of detail for which we would have to go back and look at some very detailed spreads.

Senator BUSHBY—It is a billion dollars.

Mr Ray—That billion dollars is probably made up of a lot of small numbers and we would need to go back and check. But we are happy to take it on notice to see what more detailed information we can provide you.

Senator BUSHBY—I have only got one final question regarding question on notice SBT 236, which was about financial transactions. You took on notice to provide me with details of what financing transactions included, and you set out four different areas which include equity injections into public corporations, which was really what the discussion was about at the time. If the government decided to make an equity injection—I know and I understand all about the recording of how you actually show things on the budget—would that consume funds that would otherwise have been available for use in the budget?

Mr Ray—Assuming that we are not at a point at which we cannot borrow any more, then no, other than the interest on the debt. For example, if the government makes an equity injection of \$100, that is a financing transaction and is matched by another financing transaction which could be drawing cash down out of a bank. In a deficit world—when we are running a deficit—the government would borrow that \$100 and that \$100 would have a public debt interest cost which is above the line. It either adds to the underlying cash balance or something else is not spent.

Senator BUSHBY—Theoretically, the government could have borrowed that \$100, in the same way that it borrowed for the equity injection, and chosen to spend it on delivering health services?

Mr Ray—As I said, in order for the government not to be able to borrow that additional \$100 for the equity injection—

Senator BUSHBY—But it is a choice.

Mr Ray—In order for the government not to be able to have that \$100 there would have to be an extraordinary circumstance given where we are in Australia. Therefore it is not a constraint; they can borrow \$100.

Senator BUSHBY—It is not a constraint.

Mr Ray—It does not affect health spending that there is an equity injection.

Senator BUSHBY—But for any given level of borrowing—

Mr Ray—The constraints are that the underlying cash balance cannot change and gross borrowing cannot change.

Senator BUSHBY—Say the government of the day decided that it did not want to go any further into debt than a given point. So, all else being equal, there would be an opportunity cost between choosing to spend the money as an equity injection or choosing to spend it on the delivery of a service, or for that matter choosing not to borrow as much?

Mr Ray—Assuming it is not going to increase taxes?

Senator BUSHBY—Yes.

Mr Ray—So it is not going to increase taxes and it is not going to change—

Senator BUSHBY—Which are all relevant considerations of government.

Mr Ray—its underlying cash balance and so therefore it is not going to borrow any more, then yes.

Senator BUSHBY—If it wanted to spend the \$100 both on spending and on an equity injection, it would have to borrow more?

Mr Ray—That is correct.

Senator BUSHBY—Thank you.

Senator CORMANN—Mr Ray, there were suggestions before Christmas that the Prime Minister and the government would take the mining tax to COAG. That did not happen of course. Can you explain to us why not?

Mr Ray—I think you are in the wrong group.

Senator CORMANN—I thought you would say that because I went to Prime Minister and Cabinet and they said, ‘You have got to ask Treasury because they are responsible for federal financial relations and they know all about what happens in relation to the mining tax and COAG.’ I specifically asked them and they specifically said to me, ‘No, not us.’ I raised it before and I was told to raise it with you. ‘Fiscal’ is what I was told.

Mr Ray—I was not at COAG so I cannot answer your question.

Senator CORMANN—Is there somebody here who has got anything to do with preparations for COAG?

Mr Ray—The Department of the Prime Minister and Cabinet is responsible.

Senator CORMANN—But Treasury is involved in COAG preparations, and in fact in the program it talks about the fact that you are part of the administration of federal financial relations. I specifically asked the questions in macro when I was referred by your colleagues to you.

Mr Ray—I will thank them for that when I see them.

Senator CORMANN—I think the chair can confirm, because the chair was there when I raised it.

CHAIR—Yes, I think it was more in the nature of federal financial relations than the actual administration of it.

Senator Wong—If you had said the preparation for COAG, people’s response might have been different, because ‘federal financial relations’ covers more than just COAG. If we are not able to answer them we can simply take them on notice and if needed refer them.

Senator CORMANN—It is very hard to explore them on notice. I have got to say that it is pretty unsatisfactory. I have been going all week and it has been handed around like a hot potato. Nobody wants to take them. In fiscal group, outcome 1, you are ‘providing support through the provision of advice to government and the efficient administration of federal financial relations’.

Mr Ray—Correct, we do.

Senator CORMANN—This is part of that.

Senator Wong—That does not mean that they know everything about COAG.

Senator CORMANN—I am not saying that you know everything. Are you aware if there has ever been a suggestion that the mining tax proposal would go to COAG?

Mr Ray—I thought you were quoting the Prime Minister.

Senator CORMANN—The Treasury has been quoted in here as well. The headlines are: ‘Gillard to take mining tax to COAG’ and ‘Gillard seeks COAG backing for mine tax’. It was on the front page in the *Australian* before Christmas.

Senator CAMERON—It is part of the *Australian*.

Senator Wong—I think the difficulty we have unless—

Senator CORMANN—I think they were actually trying to give a bit of a hand here, Senator Cameron.

Senator Wong—The difficulty we have, unless somebody wants to tap me on the shoulder or wave at me and say that they can answer, is that the COAG agenda is not set by us.

Senator CORMANN—Let me ask the question a different way. I have got to say, though, that I am pretty unimpressed. I have raised it everywhere and everybody has pointed to you and now I am being told, ‘You should have raised it with all these other people.’

Senator Wong—That is the problem with being on Thursday night. It is the last man and woman standing.

Senator CORMANN—Yes, you can understand why that is frustrating for me.

Senator Wong—I actually do understand. I have been in your position before. We are not actually trying to obfuscate here.

Senator CORMANN—I will remember this when you are sitting here. If you are ever back here, I will remember this and send you from outcome to outcome.

Senator Wong—I was not in PM&C estimates.

Senator CAMERON—You may not be up there. It depends what your leader has for you.

Senator CORMANN—You never know; that is right. But there is a serious question here, and tell me if you can assist me. We have a proposal for a new tax. The original proposal was for it to replace state and territory royalties, but the current proposal is for there to be credit arrangements. The federal government is concerned that state and territory governments might increase royalties into the future, because that will undermine the revenue base from the Commonwealth's point of view. As far as I am aware, unless you tell me otherwise, so far there have not been any formal government-to-government discussions between the federal, state and territory governments about the implications of all of that for state and territory governments. When are these discussions proposed to start between the federal, state and territory governments about the implications for them of your expectation that they will not increase royalties into the future so as to not undermine you revenue base?

Mr Ray—I see where you are going. I cannot answer that off the top of my head because I am not privy to every conversation that goes on between governments. Maybe I can take it on notice to see what I can provide.

Senator CORMANN—If you are going to take it on notice, I am also interested to know whether any state or territory government has indeed given a commitment to the Commonwealth not to increase royalties on iron ore or coal into the future, and whether, in your assessment, the federal government has the constitutional capacity—which I do not believe they do but you might have a different view—to prevent the states and territories from increasing royalties in the future against their will.

Mr Ray—That is a constitutional law question, which we are not expert on.

Senator CORMANN—But in terms of the fiscal impact of the tax I think it is highly relevant, and I suspect that you would seek advice on these sorts of things. This article is quoting extensively the Prime Minister and the Treasurer about wanting to prevent states and territories from increasing royalties into the future. I would like to know whether, in your judgment or on the basis of advice that you may have obtained, that is actually a constitutional possibility. Take it on notice and see what you can do. As I said, it is quite frustrating to have raised this exact point with—

Mr Ray—This particular issue is one actually that should go to my colleagues in the Revenue Group, but I will take it on notice and see what they can provide.

Senator CORMANN—Thank you very much. I have waited all day for this and now I get that.

Senator Wong—Can we all go home now?

Senator CORMANN—We have still got the Commonwealth Grants Commission; you cannot.

Senator PRATT—Treasury has done some work in recent years in the form of working papers on labour supply, particularly as it relates to women. There is some analysis around childcare costs and access to child care. You had one entitled *The added worker effect and the discouraged worker effect for married women in Australia*. I am not asking you about the specific details of those papers. My question goes to the productivity trends. Clearly, as a nation we have a skills shortage. I am interested in the department's analysis of the kind of work that might need to be done into the future in relation to women's workforce participation.

Ms Furnell—The particular work to which you are referring was actually done by some colleagues—I understand in the Revenue Group—for participation modelling. There is obviously quite detailed modelling looking at some of that. The general question about what influences participation decisions for women is obviously quite a broad question and is the sort of area for which there has been quite a lot of research done from time to time. There are issues such as family commitments, the government's introduction of the Paid Parental Leave scheme—which is obviously a step looking at attachment to the workforce—and other issues around child care and the costs of child care. I understand that research has obviously picked up in that space. The flexibility of the labour market is obviously another key area: the ability to vary hours of work and come to those arrangements with employers. That sort of flexibility at the enterprise level more broadly is also influential in women's choice. It is not only women; it is obviously parents' choices in how they make their own arrangements between care and their own work commitments. There are a range of influences. A broader influence, not just for women, is clearly issues around skills and education and attainment standards. I recall some work looking at correlations between education levels and participation rates, and that was done by

another area of Treasury. Over time, as successive generations of Australians have gained on average greater levels of skills and educational attainment, you see better outcomes for them in the labour market; their ability and choices to participate in the labour market in general are enhanced. There are a range of influences and that is obviously just some.

Senator PRATT—That is the kind of answer I was hoping for and expecting. I am interested to know whether there is a program of work in that area currently taking place, given the labour constraints that we are currently facing as a nation?

Ms Furnell—I am not sure I can really comment in any detail.

Senator PRATT—I will put that on notice. That is fine, thank you.

CHAIR—There being no other questions for Fiscal Group, I thank Fiscal Group for coming in and doing the climate change stint.

[10.07 pm]

Australian Office of Financial Management

CHAIR—I welcome the Australian Office of Financial Management. Is there an opening statement that you would like to make?

Mr Nicholl—No, there is not.

CHAIR—Thank you, Mr Nicholl. We will go straight to questions.

Senator CORMANN—Welcome, Mr Nicholl. You are new in the position—very new, I gather.

Mr Nicholl—I am.

Senator CORMANN—So this is your first federal estimates, is it?

Mr Nicholl—Yes.

Senator Wong—Do not be mean.

Senator CORMANN—No. Am I being mean?

Senator Wong—I am just pre-empting it.

Senator CORMANN—I am not even mean to you, so how would I be mean to him? Mr Nicholl, ignore all of that. By way of getting to know each other, can you share with us some of the experience and background you have had in terms of the area of responsibility that you are now in.

Mr Nicholl—I have had 18 years in the Tasmanian treasury, ranging across a number of policy, regulatory, financial and commercial areas. I have sat on a debt management committee for many years in the Tasmanian treasury. Although I have not worked at their central borrowing agency, TASCORP—the Tasmanian Public Finance Corporation—I have had a lot to do with them over the years and through the ratings agencies process.

Senator CORMANN—How long is the contract for? It is probably on the public record. I do not mean to ask an inappropriate question, but is this a long-term contract? Is it a five-year contract or something permanent?

Mr Nicholl—It is an ongoing appointment.

Senator CORMANN—Sorry, I really did not know. What do you see as your challenges? What are the main things that are keeping you awake, I guess, as the new CEO of AOFM as you look at the two- or three-year period ahead?

Mr Nicholl—Coming into the organisation I see an organisation that is extremely well run with processes that are very well bedded down. Its attention to regulatory and compliance detail is very impressive. It has, in the last couple of years, built a very strong relationship with the investor community and has done that out of a matter of necessity from two years ago, as you would be aware.

Senator CORMANN—Because your activity cranked up about two years ago?

Mr Nicholl—Yes, that is correct.

Senator CORMANN—In terms of issuing bonds and the like?

Mr Nicholl—Yes, that is true. That required quite a lot of change in activity in the office and I think that has been implemented, I would say, very successfully. If you look forward at the government's fiscal position,

it seems like we are coming into another transition where the extreme impact of the financial crisis has moved beyond us and we are moving into another phase where the extent to which the Commonwealth will need to issue debt into the market will abate to a degree.

Senator CORMANN—Is that a very technical way of saying you will be less busy over the next few years?

Mr Nicholl—No, because it will take some time for the debt to be wound down and during that period there is a lot of cash management and other financial management activities that will need to be undertaken in order to meet the government's financing and debt management requirements.

Senator CORMANN—What is the current level of debt that is issued through AOFM?

Mr Nicholl—We have fixed coupon bonds to a face value of \$151.7 billion, Treasury indexed bonds to a value of \$13.2 billion and, as of today, Treasury notes on issue to a value of \$19.7 billion.

Senator CORMANN—How are you expecting this to track over the next two or three years? What are your trends in terms of how that is going to grow or reduce in the years ahead? It is not going to reduce, I guess, but how is it going to go in the next two or three years?

Mr Nicholl—In the immediate years we would expect that it will plateau but we will have to wait and see what the budget says about that. I think the current program for this year is a gross issuance of about \$50 billion to \$55 billion. In net terms, that will turn out to be in the order of about \$34 billion to \$39 billion. There will be gross debt of \$50 billion to \$55 billion issued but there will be bonds maturing.

Senator CORMANN—Are you going to be involved in the context of issuing bonds to fund the NBN?

Mr Nicholl—My understanding is that NBN will take a share of the infrastructure bonds that are issued. There is a gross amount of debt that will be issued and they will just take a share of that.

Senator CORMANN—Do you have a figure around that?

Mr Nicholl—No, I do not.

Senator CORMANN—You do not have a figure with you or you do not have a figure at all?

Mr Nicholl—It is in the MYEFO, as I understand. I do not have the figure with me, no.

Senator CORMANN—Maybe your 2IC or 3IC might be able to assist us.

Mr Parry—We might have to take it on notice, I think.

Senator CORMANN—Okay.

Senator Wong—If the question is the NBN, the extent of the government's injection into the NBN was outlined in the previous budget over the forward estimates.

Senator CORMANN—I know exactly what the figures are in terms of the amount of debt but I do not know what the figures are in terms of the level of bond issuance or other financing mechanism. I was trying to get a handle as to whether there is a specific figure that AOFM has for its own purposes in that context. If you can share it with us, that would be great; if you cannot then let us know.

Senator BUSHBY—Welcome, Mr Nicholl. I do believe that you and I might have met many years ago. You may not recall, but when I was working in the Department of Premier and Cabinet in Tasmania in the mid-90s you were at Treasury then, as you have already outlined.

Mr Nicholl—And you had a brother as I understand it working for the department of—

CHAIR—Don't you love Tassie? Tassie is great, isn't it?

Senator BUSHBY—That is correct; he is now CEO of the Roads and Traffic Authority in New South Wales.

Mr Nicholl—Although I should correct the record; I am not actually a Tasmanian but I have spent a lot of my career there.

Senator BUSHBY—Welcome and thank you for coming.

Senator Wong—I have an uncle in Tassie too; do you know him?

Senator BUSHBY—You never know. I probably do actually. On to serious matters. I am interested in the total Commonwealth government securities on issue. Literally, five minutes ago, I printed off from your website the same figures that you just quoted or what should have been the same figures but they were

different to what you have actually mentioned to me. Which is more up to date, what you have just stated or what is shown on your website?

Mr Johnson—Mr Nicholl has just given you an update as of the end of today.

Senator BUSHBY—I assumed it was because the figures that Mr Nicholl gave were actually higher than the figures that were shown on the website, and I would have been very surprised if it was going down at this point.

Mr Johnson—The figures do fluctuate on a day-to-day basis.

Senator BUSHBY—Yes they do; things come off, things go on as you meet the current—

Mr Johnson—If it is maturing it will go down tomorrow.

Mr Nicholl—If you ask the question tomorrow there will be about \$4.5 billion.

Senator BUSHBY—How often are the figures on the website updated?

Mr Johnson—It is weekly I believe.

Senator BUSHBY—But obviously you have a number of issues a week depending on the government's need for finance and what is maturing and what—

Mr Nicholl—Between two and four a week.

Senator BUSHBY—I get your emails telling me what is happening, when you are going out to market and then the results of each one, so I keep a track of that.

Mr Nicholl—We make an announcement each Friday at noon about what the following week's issuance will be.

Mr Johnson—Typically there will be a bond tender on Wednesdays and Fridays and no tender on Thursdays.

Senator BUSHBY—One thing that I ask of the AOFM at every appearance before estimates is for updated graphs of each of the lines that are offered through the AOFM and the rates that have been achieved over a period of time. I think I can see they are generally very messy and look like that.

Mr Nicholl—A similar number of colours and a similar number of lines. I am happy to give you an update and table that.

Senator BUSHBY—If you could table it and if I could have it in front of me when I am asking the questions, it would be quite useful.

Mr Nicholl—I have several copies.

Senator BUSHBY—Could the other senators have a copy too. I think I made the point at the last estimates that we do not have access to a colour photocopier here and to actually understand that graph in black and white is reasonably challenging. At the last estimates we were looking at these and you could see that there was a convergence occurring in the last half of last year. That seems to have moved out a little bit. Is that an accurate reading of the picture I am looking at there?

Mr Nicholl—That is correct.

Senator BUSHBY—What do you think is causing that at this point?

Mr Parry—Since the last estimates, the long rates have been relatively stable but shorter rates have risen and that means that the spread between the shorter rates and the longer rates is less than it was.

Senator BUSHBY—Is it caused because there is a variance in taste for the different length of periods that you are offering to the market basically? Some of those are staying fairly stable but others you need to offer a higher yield to get the securities out there; is that it?

Mr Parry—There are various reasons but expected future short-term interest rates is the main driver of the yield curve.

Senator BUSHBY—Also it appears that the trend across the board is up. You mentioned that some of the lines were fairly flat but others are going up. I do not really see too many there that, since October, look like they have gone down. It is messy in the middle but on the whole the average is going up. Do you have an average figure?

Mr Parry—I would just comment that, since October, the RBA has lifted the overnight rate by 25 basis points and that is a main—

Senator BUSHBY—That obviously feeds into this?

Mr Parry—That is right, to give an average.

Senator BUSHBY—But ultimately, regardless of whether it is because the RBA has lifted rates or because of reduced appetite by investors for particular lines, if the average yield goes up, the actual cost to the government of servicing those securities goes up.

Mr Johnson—The cost of new issuance will go up, the cost on existing debt will not change.

Senator BUSHBY—But on new issuance?

Mr Johnson—On new issuance, yes; that is right. I would just note on the chart that it does depend on what horizon you are looking at as to whether rates are going up or down. In terms of what you are saying, since September-October, yes, rates have been increasing sort of across the board.

Senator BUSHBY—Generally, how is investor appetite? Are you getting a lot of people putting in for the tenders?

Mr Nicholl—Yes.

Senator BUSHBY—In all lines?

Mr Nicholl—Yes, our coverage rates have been exceptionally high this calendar year and the end of the last calendar year. We should point out too that we do not issue the same bond every week.

Senator BUSHBY—I understand that you do an assessment of the government's financing needs, taking into account what is coming off and maturing.

Mr Nicholl—We take into account a whole lot of things and then make some decisions about what will go in. That is right.

Senator BUSHBY—Which is why you go to the market sometimes until 2020 and sometimes until 2013 and sometimes until 2015?

Mr Nicholl—That is correct.

Senator BUSHBY—I will just change the subject. I note that the limit on borrowing is still \$200 billion?

Mr Nicholl—That is correct.

Senator BUSHBY—The figure on the website showed that the total Commonwealth government securities on issue was \$182 billion; what was the updated figure for the total?

Mr Johnson—Mr Nicholl's net figure was in total \$184.6 billion.

Senator BUSHBY—So we are getting close to the \$200 billion. What is the AOFM's current predictions for the peak that that will reach? What have you been advised by Treasury that you will need to go to? I believe that Treasury makes that assessment?

Mr Nicholl—For the current financial year we would be within the cap.

Senator BUSHBY—And beyond that?

Mr Nicholl—We will have to wait for the budget. We will make a reassessment at the budget. I think the last reset or expectation was MYEFO and, given that we are very close to the budget, we will wait until the budget and then we will reset our expectations.

Senator BUSHBY—How close to the current \$200 billion are you currently planning to get this financial year?

Mr Nicholl—We will probably be somewhere between about \$175 billion and \$182 billion at the end of June.

Senator BUSHBY—So less than what it is now. Which components are you talking about?

Mr Nicholl—That is a 30 June expectation.

Senator BUSHBY—Just to clarify, which of those components that make up the \$182 billion actually fall under the \$200 billion limit, or do all of them together? Is it the total?

Mr Nicholl—No, all of them together.

Senator BUSHBY—The figures you just gave me then at the end of the year were lower than what you currently are now?

Mr Johnson—I offer one correction. The total that we mentioned was the total Commonwealth government securities on issue; a small component of that is related to TIBs that were issued prior to the legislative changes in 2008. Of that figure, \$4.6 billion does not count towards the cap.

Senator BUSHBY—So you knock \$4.6 billion off the \$184.5 billion?

Mr Johnson—That is right.

Senator BUSHBY—Basically back to about \$180 billion and that is where we currently stand when comparing to the \$200 billion limit?

Mr Johnson—That is right.

Senator BUSHBY—We have about \$20 billion worth of room between now and the end of the year. But from what you say we are not going to go anywhere near that before the end of the financial year on current projections?

Mr Nicholl—No, that is exactly right.

Senator BUSHBY—Where are we currently up to with the RMBS issue?

Mr Nicholl—In what regard?

Senator BUSHBY—Providing an update of what has occurred, if anything, between the last estimates and now in terms of issuing and what deals have been done. I think from memory—I have not actually checked—about \$13 billion of the then \$16 billion had been committed as at October last year and since then there has been another \$4 billion announced on top of that. Also, how are we going in actually getting that money out there and revitalising the securitisation market?

Mr Nicholl—The last deal that we did was on 21 December, just prior to Christmas. That took the total of AOFM investments to \$12.54 billion.

Senator BUSHBY—How much was that one?

Mr Nicholl—There was a private sector contribution of \$145.8 billion and the AOFM's contribution investment to that was \$104.2 million.

Senator BUSHBY—Less than 50 per cent?

Mr Nicholl—Yes.

Senator BUSHBY—Well under 50 per cent of it. Is that a trend that you are seeing, that the AOFM's contribution is falling in terms of what is needed to make those deals happen?

Mr Nicholl—Yes, it seems to be a trend over the last 18 months.

Senator BUSHBY—Because quite clearly the intention of the investment by the government in the RMBS market is to try and help recreate confidence in the area and to help facilitate private sector deals. That is certainly what Malcolm Turnbull intended when he first suggested it happen and when the government followed and adopted that. It certainly seems to be working to some extent. I am interested in how you are finding the market for RMBS and the degree to which you need to assist, the degree to which it is actually getting back on its feet in terms of investors having an appetite to get back into securitisation with lower levels of assistance and ultimately without any level of assistance?

Mr Nicholl—As you alluded to earlier in your statement, the trend is for AOFM's proportion of the total investment to decrease. In fact, the last deal that went to market, I think about a week ago by Westpac, had no AOFM investment whatsoever.

Senator BUSHBY—Is that the first major deal without it?

Mr Nicholl—I think that is the first major deal for a while that has gone to market. My understanding is that the price on the first, shorter tranche of that was about 100 basis points above the bank bill swap rate. That is about 30 basis points lower than the last deal that we did.

Senator BUSHBY—When the AOFM is involved, does that deliver lower prices generally or not?

Mr Nicholl—Not necessarily. It depends on a number of things. We are in discussions at the moment with two other potential issuers. One is at the point at which we have issued them with a letter of comfort and that

deal we would expect to happen within the next month. We are talking to parties about another one for which we are about to commence our due diligence process.

Senator BUSHBY—Obviously you could not have been involved with the Westpac one anyway because of the banking competition package. You have been banned from assisting any issuance that is related to the four major banks—that is correct, is it not?

Mr Nicholl—I am aware of the Aussie Home Loans issue, yes.

Senator BUSHBY—I am not going to go over that again today.

Mr Nicholl—I do not think the status of that has changed, to be honest.

Senator BUSHBY—The status has not changed.

Mr Nicholl—No. We are awaiting some reissue of the guidelines but that is between Treasury and the Treasurer.

Senator BUSHBY—At this stage, as far as you are aware with the Aussie Home Loans issue, since you raised it, that is not something you can participate in at the moment given your understanding of the directive from the Treasurer?

Mr Nicholl—That is correct.

Senator BUSHBY—In general, one of the impressions I was getting from your predecessor at estimates was that the deals that were being done have sort of matured and changed to suit the market. Is that something that you can talk about, how they are looking at new and potentially more innovative ways of actually partnering with institutions when you go to the market?

Mr Nicholl—I could not give you the level of detail that Michael Bath could give you but I am aware that the market is constantly changing and there are a number of different developments that are leading to people thinking about doing these deals in slightly different ways.

CHAIR—There being no further questions for the AOFM, thank you very much, and thank you for coming in for your first session, Mr Nicholl. We will welcome you back later for the budget sessions.

Mr Nicholl—Thank you.

[10.07 pm]

Commonwealth Grants Commission

CHAIR—I welcome the Commonwealth Grants Commission. Do you have an opening statement you would like to make or any opening remarks?

Mr Spasojevic—We have no opening remarks.

CHAIR—Thank you. We will go straight to questions.

Senator CORMANN—I think I am going to call you ‘secretary’ because I tried pronouncing your name last time and it was rather difficult. Has the Treasurer made his determination on the 2011-12 funding breakdown of GST revenue?

Mr Spasojevic—Not that I am aware of.

Senator CORMANN—When would you be expecting him to make that determination?

Mr Spasojevic—I actually do not know when he makes that determination.

Senator CORMANN—I am obviously getting my language wrong. Assist me, because we actually had this conversation during our mining tax inquiry when we talked about a lot of this. The Treasurer makes a regular determination, does he not?

Mr Spasojevic—He does.

Senator CORMANN—When did he make the last determination in relation to the share of—

Mr Spasojevic—I do not know.

Senator CORMANN—Why don’t you know?

Mr Spasojevic—Because it is not a function of the Commonwealth Grants Commission.

Senator CORMANN—Does he not give you a direction as part of that determination?

Mr Spasojevic—He gives us terms of reference and asks for recommendations which he then acts on, but I am not sure exactly when in the financial year—

Senator CORMANN—How often does he give you those terms of reference?

Mr Spasojevic—Annually.

Senator CORMANN—When did he give you the last terms of reference?

Mr Spasojevic—We received the last terms of reference on 17 February.

Senator CORMANN—We are getting there now. You have not received your terms of reference yet for this year?

Mr Spasojevic—The terms of reference we received on 17 February this year asked for recommendations for the financial year 2011-12.

Senator CORMANN—Is there any change in those terms of reference compared to the previous terms of reference?

Mr Spasojevic—I would not say any major changes, no.

Senator CORMANN—If there is no major change, what are the minor changes?

Mr Spasojevic—I believe there is some guidance on some specific payments which may not have appeared last time in Closing the Gap.

[22.10]

Senator CORMANN—When you say Closing the Gap, what do you mean?

Mr Spasojevic—These are payments made to the Northern Territory to close the gap on Indigenous matters.

Senator CORMANN—What is the effect of that minor amendment to the terms of reference?

Mr Spasojevic—They are not an amendment, they are just part of the terms of reference. Those payments will have no effect on the GST relativities.

Senator CORMANN—Keep going.

Mr Spasojevic—I am just trying to think what last year's terms of reference were. Last year we had a review, not an update, so it is hard to compare review terms of reference with update terms of reference.

Senator CORMANN—Once you have acted on your terms of reference and given your recommendation to the Treasurer, is that a public document or is that something that is a private communication between you and the Treasurer?

Mr Spasojevic—I believe that document will be tabled by the government as it always has in the past.

Senator CORMANN—Work with me here, I am trying to get my head around what are clearly the very involved processes of the Commonwealth Grants Commission. I am not across them way you are, but if you can assist me that would be really useful.

Mr Spasojevic—Sure.

Senator CORMANN—Would it be expected for there to be any consultations with state and territory governments as part of you acting on those terms of reference?

Mr Spasojevic—We have already consulted with the states.

Senator CORMANN—The consultation has already been concluded?

Mr Spasojevic—Correct.

Senator CORMANN—You started on 17 February and we are now 24 February—

Mr Spasojevic—No, we started well before 17 February.

Senator CORMANN—This is where I am getting very confused.

Mr Spasojevic—We anticipate every year that we will get terms of reference, that we will be asked to report by some time in February.

Senator CORMANN—So you act on all of this, just assuming that the terms of reference are going to be broadly the same as last year's terms of reference?

Mr Spasojevic—Correct.

Senator CORMANN—You go off and talk at an officer level with people in state and territory governments on the basis—

Mr Spasojevic—Correct.

Senator CORMANN—That is correct?

Mr Spasojevic—Correct.

Senator CORMANN—Is it at an officer to officer level or is it from the Commonwealth Grants Commission to the government level?

Mr Spasojevic—We ask for the views of state governments which are conveyed to us by the officials of those governments.

Senator CORMANN—Who do you ask? Who do you contact?

Mr Spasojevic—They are nominally addressed to the heads of treasuries.

Senator CORMANN—Yes, so they are the under-treasurers?

Mr Spasojevic—Correct.

Senator CORMANN—There have been no inclusions into the Commonwealth Grants Commission terms of reference that would be in any way unusual?

Mr Spasojevic—Not that I am aware of.

Senator CORMANN—Is gambling revenue counted as an on-source revenue?

Mr Spasojevic—It is.

Senator CORMANN—What is the implication of that?

Mr Spasojevic—None. It does not have an effect on the distribution of GST.

Senator CORMANN—It does to a degree because obviously in terms of gambling revenue, in a state like Western Australia the circumstance would be very different to the gambling revenue in states like South Australia and New South Wales. You explained last time about the potential to raise certain classes of own-source revenue. Surely that must then have an implication?

Mr Spasojevic—No, it has none because we make no differential assessment. We treat gambling revenue as if it could be raised equal per capita so it has no impact on the distribution.

Senator CORMANN—But this is my point, you are making an assumption that gambling revenue can be raised equally per capita but in actuality that is not the case, is it?

Mr Spasojevic—I am sorry, I am telling you what the commission does.

Senator CORMANN—Yes, I know.

Mr Spasojevic—It does not make a differential assessment of gambling because it cannot decide how much gambling revenue would be raised under equal policies across the different states and territories.

Senator CORMANN—I am trying to understand the practical effect of what it is that you are doing. If, on average, the gambling taxes in all states, other than one state, are higher, then the practical effect of your methodology is that you are making an assessment of per capita gambling revenue, in a state that has a lower average gambling tax, that will be higher than it will in reality be. What is the implication of that in terms of the share of GST?

Mr Spasojevic—It has no effect on the share of GST.

Senator CORMANN—How not?

Mr Spasojevic—Because we assess it equal per capita. Because we are assessing it equal per capita, it can have no differential impact on how much GST a state receives.

Senator CORMANN—Are you saying then that through horizontal fiscal equalisation, if New South Wales, South Australia and others raise more gambling revenue than Western Australia, that through the way it sort of plays out, that it gets equalised across the country?

Mr Spasojevic—No. I am sorry, Senator I do not know how to express it any differentially.

Senator CORMANN—I do not really understand at all what you are saying.

Mr Spasojevic—The fact that some states choose to raise gambling revenue or not is completely irrelevant in terms of how much GST revenue they receive.

Senator CORMANN—If it is irrelevant, why do you assess it?

Mr Spasojevic—Because we have to make the budget balance to what states actually report as revenue and so it is included in a category called ‘other revenue’, on which we make no differential assessment.

Senator CORMANN—The fact that you make no differential assessment on it will favour some and disadvantage others. It will have to because the assumption that there is no differential is not the way it works out in real life. In real life, there is a differential.

Mr Spasojevic—Correct.

Senator CORMANN—Exactly, so if we agree that in real life there is a differential and you in your methodology assume that there is no differential, what is the practical implication of that in terms of the share of GST?

Mr Spasojevic—It has no impact on the share of GST.

Senator CORMANN—Explain to me how.

Mr Spasojevic—If all revenue and all expenses were treated equal per capita, then every state would receive an equal per capita amount of GST.

Senator CORMANN—Yes.

Mr Spasojevic—So the fact that some are assessed differentially is what drives a different share of GST. Gambling, as with many other revenues, has no impact on the distribution of GST because we make no differential assessment.

Senator CORMANN—Let us take a different own-source revenue then: royalties. It is commonly understood, unless you tell me that it is a wrong understanding, that royalty revenue gets assessed nationally and that essentially the practical effect of your processes are that, because the state of Western Australia has got an increased capacity to raise royalty revenue, through the GST redistribution a lot of the royalty revenue raised in Western Australia actually gets distributed across other states. How does that happen?

Mr Spasojevic—In exactly the way you have just described.

Senator CORMANN—Why is that the way I have just described it for royalties on resources but not for own-source revenue related to gambling?

Mr Spasojevic—Because the commission believes it can make a reasonable assessment of how much different states would be able to raise if they followed average policy on mineral royalties, but they do not believe they can do so on gambling.

Senator CORMANN—Again, there must be a distortion as a result of all of that in terms of the way gambling taxes flow through?

Mr Spasojevic—No, I do not believe so.

Senator Wong—I am not really sure how many more times you can ask—

Senator CORMANN—Do you understand it?

Senator Wong—I always have to read the principle of fiscal equalisation to understand what Mr Spasojevic’s job actually is.

Senator CORMANN—You are very courageous, Minister.

Senator Wong—Reading the principle of fiscal equalisation?

Senator CORMANN—No, reading the name.

Senator Wong—I can understand what he is saying when I understand what the proposition is. I think the difficulty is that you are asking him a different question actually.

Senator CORMANN—I did not think I was. I am not proposing to take it any further.

Senator Wong—You keep suggesting to him that he should take gambling revenue into account. He is explaining to you why, in the context of what the grants commission is asked to do, they do not assume a different per capita rate of gambling revenue allocation.

Senator CORMANN—But they are not actually assuming a different—

Senator Wong—No, he said that.

Senator CORMANN—I am trying to understand what the practical implication is for states that have lower than average per capita gambling revenue compared to those states that have higher per average gambling—

Mr Spasojevic—Sorry, Senator, that is not what you asked me. What you asked me was the impact on the GST distribution.

Senator Wong—Yes.

Mr Spasojevic—The impact on a state's own budget is very different from the impact of a GST distribution. Which question are you asking me?

Senator CORMANN—I am asking both, so give me an answer to both.

Mr Spasojevic—It has no impact on the GST distribution but it has a big impact on a state's bottom line.

Senator CORMANN—If a state raises more gambling taxes or if they have got more gambling activity—

Senator Wong—If the state raises more revenue for—

Senator CORMANN—Let me ask it a different way then. If you compare royalties on resources with gambling on taxes, royalties on resources get equalised nationally and gambling revenue does not get equalised nationally.

Mr Spasojevic—Correct.

Senator CORMANN—So in a way a gambling tax is a more attractive tax for a state that wants to boost its own-source revenue? If you are a state that wants to boost your gambling economy, that is actually—I now understand it. If you go through to the logical conclusion of what you are saying, if you are a state that boosts your gambling industry, that is actually going to be directly beneficial to your state government's bottom line without you having to share that across other states. But, if you are a state whose main industry is the resources industry, then you have to share that revenue from that industry with every other state across Australia. That is the practical effect is it not?

Mr Spasojevic—I cannot comment on what the practical effect is to state governments.

Senator CORMANN—No, but it is the logical conclusion to what you have said?

Senator Wong—You can ask this witness a range of questions about the functions of the commission. I think what you are asking him to do now is to draw a conclusion about a consequence of what you assert might or might not be occurring in different states.

Senator CORMANN—To conclude this part of it, very simply, am I correct in my understanding that the state government revenue from gambling is not equalised across all states, whereas revenue from mining royalties is equalised across all states?

Mr Spasojevic—That is true.

Senator CORMANN—Thank you. Have there been any discussions over the concept of a floor under which a state or territory government's return of GST cannot fall?

Mr Spasojevic—With the commission?

Senator CORMANN—Yes.

Mr Spasojevic—No.

Senator CORMANN—Are you aware of any other discussions?

Mr Spasojevic—We had one at the last time I appeared before you.

Senator CORMANN—Indeed, because that is when you told me that the share could not quite get to zero but close to zero and you mentioned some mathematical reason as to why. We did have one, but there has not been any discussion with government on trying to address that sort of issue?

Mr Spasojevic—I am not aware of any discussions other than possible discussions with the commission of which there have been zero. Whether there have been any discussions with anybody else, I would not be able to answer your question.

Senator CORMANN—We are still in the circumstance, at present as far as you are concerned, where there is no floor below which the share of GST revenue for an individual state can fall below?

Mr Spasojevic—Yes, that is correct.

Senator CORMANN—Thank you.

CHAIR—Any other questions for the Commonwealth Grants Commission? I thank the Commonwealth Grants Commission for coming in and we will see you next time. Thank you very much Hansard and Broadcasting and the secretariat of the committee for their assistance during estimates. The committee is adjourned.

Committee adjourned at 10.22 pm