COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

STANDING COMMITTEE ON ECONOMICS

Reference: Income Tax Rates Amendment (Temporary Flood and Cyclone Reconstruction Levy) Bill 2011; Tax Laws Amendment (Temporary Flood and Cyclone Reconstruction Levy) Bill 2011

WEDNESDAY, 16 FEBRUARY 2011

C A N B E R R A

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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON ECONOMICS

Wednesday, 16 February 2011

Members: Mr Craig Thomson (Chair), Mr Ciobo (Deputy Chair), Mr Buchholz, Mr Stephen Jones, Dr Leigh, Ms O'Dwyer and Ms Owens

Members in attendance: Mr Buchholz, Mr Ciobo, Mr Stephen Jones, Dr Leigh, Ms O'Dwyer, Ms Owens and Mr Craig Thomson

Terms of reference for the inquiry:

To inquire into and report on:

Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011; Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011

WITNESSES

Committee met at 9.30 am

CHAIR (Mr Craig Thomson)—I declare open this public hearing of the House of Representatives Standing Committee on Economics. I welcome witnesses, members of the public and the media. The recent disasters in Australia have led to a tragic loss of life and have inflicted significant physical damage to both urban and regional areas. Many people acted heroically to save the lives of others and many people have since acted selflessly in assisting the clean-up and reconstruction. As with any large-scale disaster, governments at all levels are also involved. At the national level, the defence forces have given much needed assistance on the ground to residents and businesses. Agencies such as Centrelink and the tax office have also played their part.

The Commonwealth government has indicated the wish to provide financial support to flood affected areas. The damage and financial cost is of such a scale that the Commonwealth is changing spending priorities and taking other action to meet the costs of these new commitments. One of these changes is to introduce a temporary flood reconstruction levy on individual taxpayers for the 2011-12 financial year, which is designed to collect $1.8 billion dollars in revenue. Under the new arrangements in this parliament, the bills that implement the levy have been referred to this committee for consideration and report. We are holding this public hearing today with key stakeholders and agencies to discuss the levy and any implementation issues that are relevant to it.

Before we start and get to the witnesses, we have some submissions that have arrived. Is it the wish of the committee that submissions 1 to 5 that have been circulated to this inquiry into the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011 and the Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011 be received and authorised for publication? There being no objection, it is so ordered.

On behalf of the committee, I welcome witnesses. I remind you that, although the committee does not require you to give evidence under oath, these hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House or the Senate. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament.

[9.33 am]

MRAKOVCIC, Ms Maryanne, General Manager, Tax Analysis Division, Department of the Treasury

PARKER, Mr David John, Executive Director, Revenue Group, Department of the Treasury

RAY, Mr Nigel, Executive Director, Fiscal Group, Department of the Treasury

WILLCOCK, Mr Michael, General Manager, Personal and Retirement Income Division, Department of the Treasury

CHAIR—I invite you to make an opening statement.

Mr Ray—Thank you, Chair. We do not have an opening statement. We are happy to go straight to questions.

CHAIR—I will kick off in relation to that. The estimate of the damage for which this bill is set to raise $1.8 billion is getting close to $6 billion worth—$5.8 billion. Has Treasury seen any work that has come up with that figure or was it Treasury that estimated that figure?

Mr Ray—We worked with our colleagues in the Department of Finance and Administration and the Attorney-General's Department as well as the Queensland authorities to derive that estimate. I think the government has made it quite clear that that is a very preliminary estimate. So there are a number of components to that, which the Prime Minister set out in an attachment to her press release announcing the package. Clearly, the single biggest component of that is the cost of reconstructing public infrastructure in Queensland following the floods. That estimate is one that is particularly preliminary. We have received quite detailed information from the Queensland Treasury, who in turn have compiled that information on the basis of material they have been provided by local councils in Queensland.

CHAIR—What are the risks, then, with this being such a preliminary cost? What sort of possible margin of error are we talking about?

Mr Ray—I do not know that we would want to put a margin of error on it, but we would stress that the estimates are preliminary. In terms of the damage from the Queensland floods, the estimates could go either way. As things stand with the direct Commonwealth payments, I think we are still within our estimates, so we have not yet reached what we estimated we would provide. But in terms of the impact on infrastructure, it is still early days.

CHAIR—What sort of timeframe do you think we are looking at before we have a—

Mr Ray—We will not get final estimates for a number of years—it is not a matter of weeks or months. But, as we put the budget together, we will put our best estimates into the budget at that time.

CHAIR—This of course is not the first time the Commonwealth has put a levy on taxpayers. How is this levy different, if it is, in any material way from levies that have been put on in the past?

Mr Ray—I might start, but my colleague Mr Parker, who looks after Revenue Group, is probably better placed to answer that. We used to have all manner of levies back in the middle of the last century.

CHAIR—I am specifically referring to the previous government's.

Ms O'DWYER—Of course you are!

Mr Ray—I think the previous government announced two levies on income, one of which was designed as an increase in the Medicare levy. So that was designed just as the Medicare levy is designed. The other, which was for Timor, which was announced but never implemented, was designed in a slightly different way. It applied only to people whose incomes were above $50,000 but it applied to the whole of the income. This levy is designed so that it only applies to the marginal income above the thresholds, whether they be $50,000 or $100,000. So it is designed in the same way that the personal income tax rates scale is designed, so that the marginal rate applies to the marginal dollar. So it is different from previous levies.

CHAIR—Were you involved in designing this levy at all?

Mr Ray—We certainly provided advice to the government on the design of levy, yes.

CHAIR—In relation to that advice, what were the sorts of considerations that went into structuring it in the way in which it has been?

Mr Ray—The government structured it the way it is. I think they have been quite public about this. They wanted a levy that was designed to be quite progressive in its structure. They wanted a levy that did not apply to people on lower incomes at all. And they wanted a levy that exempted certain categories of people.

CHAIR—There has been some discussion in parliament about the figure of $1.8 billion that it has been estimated will be raised in revenue from this levy. Is that a preliminary figure as well? How was that estimate reached?

Mr Ray—I will ask Ms Mrakovcic to help, and she might well answer, but that is in quite a different category. That is a more robust estimate.

Ms Mrakovcic—We estimated that figure in my division. Essentially, we estimated it by drawing on historical data that we had on the number of taxpayers and the distribution. We upgraded that data forward into 2011-12, taking account of broad trends in population and wages growth et cetera. You come to an estimate of how many net taxpayers you expect to have incomes above $50,000 and that in turn generates the estimate of $1.8 billion. The number of people who were exempt from paying or would be exempt from paying the levying was based on looking at expected client numbers of the AGDRP, which we obtain from the Department of Finance and Deregulation. We also looked at what those figures suggested around the proportions of people in those areas affected by the floods. We sought to extrapolate that to the NDRRA areas and came to an estimate of how many people we expected to be impacted by the floods. We also mapped their income distribution to the broader population and came up with an estimate of the number of people who would be exempt from paying the levy.

CHAIR—So do we have an estimate as to the number of people who will be paying the levy? Do we know that figure?

Ms Mrakovcic—The number of who we projected to have incomes above $50,000 and who will be paying the levy, before you take account of the number of exempt people, was around 4.84 million. Then there was an estimate of 185,000 people who you would anticipate to be paying the levy otherwise but who would be exempt by virtue of the fact that they were in receipt of an AGDRP payment or were expected to assess themselves as such from an NDRRA area.

CHAIR—So around 4.7 million people you estimate will be paying the levy?

Ms Mrakovcic—It is around 4.84 million and then 185,000.

Mr CIOBO—Was that the net figure or the gross figure?

CHAIR—The 4.8 is the net figure.

Ms Mrakovcic—Our estimate of the total number of net taxpayers earning above $50,000 is 4.84 million. Then 185,000 people, we anticipate, would not pay it, by virtue of the fact that they would be in receipt of an AGDRP payment or in an NDRRA area.

CHAIR—What proportion is that of taxpayers—the 4.8 million who will be paying the levy? Obviously there are those earning under $50,000 who will not, and those in the affected areas. So what proportion of taxpayers are actually going to be paying this levy, as a percentage?

Ms Mrakovcic—I think it is just under half.

Mr Parker—There are roughly 10 million taxpayers, so it is a bit under half.

CHAIR—I know that 70 per cent of my electorate do not pay it, but I was interested in the figure more generally. What proportion of taxpayers paid the previous levy, under the previous government?

Ms Mrakovcic—We do not have information on that with us at the moment.

CHAIR—There were not exemptions last time of this order of magnitude, though, were there?

Mr Ray—With the Timor levy you did not pay it until—

Ms O'DWYER—The Timor levy was not paid at all.

CHAIR—I mean the gun buyback.

Mr Parker—We can take that on notice.

Mr Ray—The gun buyback would have followed the distribution of people who would be subject to the Medicare levy, but we can take it on notice to see if we can come up with a number.

CHAIR—Thank you.

Mr CIOBO—The necessity for a levy is built upon what? Is it a political judgment or is it a consequence of the shape of the budget? What drives the necessity for a levy?

Mr Ray—That is a complex policy question, and traditionally we do not answer those sorts of questions. Traditionally we would leave ministers to answer that sort of a question. I will try to help you, if I can.

Mr CIOBO—From a Treasury point of view, what drives the necessity for a levy?

Mr Ray—I think the way to think about it is that when an event such as this happens the government has a number of choices. The first clear choice it has to make is whether it allows the consequences to the budget to go to the budget bottom line or whether it decides to adjust policy and maintain a particular bottom line.

Mr CIOBO—In other words, when you talk about the consequences going to the budget bottom line, you are talking about an erosion of the net Commonwealth position, whereby there is presumably less revenue coming in and more expenditure going out and, therefore, if you are in surplus you would be in a slightly lower surplus and if you are in deficit you would be in slightly more deficit. Is that correct?

Mr Ray—It depends, but in broad terms that is right. In this particular case, given everything else not changing, we would have had a bigger deficit this year and a larger deficit next year and a potentially smaller surplus the one after.

Mr CIOBO—So, taking everything else as being equal, we would have a slightly bigger deficit as a consequence of these disasters?

Mr Ray—As a consequence of these disasters—

Mr CIOBO—So the deficit would have been less had these disasters not occurred?

Mr Ray—If everything else was equal and if the government had not taken the policy action it took.

Mr CIOBO—So, from a policy perspective, if I put it to you that the reason you would introduce this reason is that it helps to ensure that your budget deficit does not get worse, would that seem like a logical, robust economic basis for introducing the levy? Is there another reason that you would not?

Mr Ray—I think you need to think about what the initial conditions for the economy are before—

Mr CIOBO—We know what the initial conditions of the economy are.

Mr Ray—One of the things to take into account is that, but for the natural disasters, the economy is very strong and is going to be approaching full employment. In those circumstances—

Mr CIOBO—And the level of debt?

Mr Ray—Beg your pardon?

Mr CIOBO—The level of debt.

Mr Ray—What about the level of debt?

Mr CIOBO—You said unemployment is low and the economy is strong. I am just asking about the level of debt.

Mr Ray—The level of Commonwealth public debt?

Mr CIOBO—Correct.

Mr Ray—It is, by world standards, very low.

Mr CIOBO—Can you just give me a figure on Commonwealth public debt and how it compares to, say, the last 12 years? I just want an accurate picture. You are providing a background, so I would like to complete the picture.

Mr Ray—The latest estimates we have for 2010-11 shows net debt as 5.7 per cent of GDP.

Ms O'DWYER—Can you give us the actual figure?

Mr Ray—Of net debt?

Ms O'DWYER—Yes.

Mr Ray—It is $79.6 billion.

Mr CIOBO—What is the difference between a levy and a tax?

Mr Ray—I had not finished my answer.

Mr CIOBO—Sorry. Please continue.

Mr Ray—I was going to say that the other factor that I think is worth thinking about is around fiscal credibility. One of the lessons of the recent past globally is that fiscal credibility is extremely important to macroeconomic management. That would be something that would be a relevant consideration.

Mr CIOBO—In layman's terms, when you say 'fiscal credibility' what are you referring to?

Mr Ray—That the government has a fiscal strategy which is credible; that is what it means.

Mr CIOBO—I think you have used the same word, just in a different context. So what are you saying?

Mr Ray—I am not sure that I can turn it into layman's language.

Mr CIOBO—Are you trying to say, 'So that we do not end up with a situation where debt and the government's bottom line are so bad as to make us not look credible'? Is that what you are trying to say?

Mr Ray—No. What I am trying to say is that it is quite important for macro management for the market to have confidence in the future path of what the government's budget position is going to be.

Mr CIOBO—So the budget position is a deficit surplus?

Mr Ray—Yes.

Mr CIOBO—So the market has faith that it is not going to continue to be in deficit, or the deficit is not going to continue to be worse—is that what you are saying?

Mr Ray—I think many OECD countries would love the market to have faith that their deficits were not going to continue to get worse.

Mr CIOBO—What is the difference between a tax and a levy?

Mr Parker—It is largely a matter of a label. In economic terms, of course, it represents a flow of cash between the taxpayer and the government. So in economic terms it is essentially the same.

Mr CIOBO—So a tax and a levy are the same thing? So it is not incorrect to call it a flood tax. Consider previous unfortunate natural disasters that we have had. In 1990, for example, Queensland and New South Wales—Charleville and other places—six were killed, unfortunately; 60 were injured; 2,000 homes were inundated. In 2006, from Cyclone Larry there was a damage bill of $1.5 billion. There were the tragic circumstances of Black Saturday in 2009: 173 people were killed; 2,000 homes were destroyed; there was about $4.4 billion worth of damage. Why is this different from those previous situations? And why was there not a need to impose a new tax previously?

Mr Ray—I think the short answer to the question is that in those previous cases the government of the day decided not to impose a tax.

Mr CIOBO—Is that because we were basically in a surplus position? Does that make it easier to decide not to impose a new tax?

Mr Ray—In 1990? I am trying to remember.

Mr CIOBO—Let us deal with 2009—the most recent—because we know that we took 10 years to pay off $96 billion of previous Labor debt. So let us deal with one when the government was in surplus.

Mr Ray—In 2009 the underlying conditions in the economy were very different. We were facing a very large shock to aggregate demand. The budget was going into deficit and was facing a major macroeconomic shock; those circumstances were very different from the circumstances that—

Mr CIOBO—Sorry—so why previously was there not a need to impose a tax and this time there is? Is it unrelated to the budget bottom line? Is there no connection? Because I got the impression from your previous answer that there was a connection between the two.

Mr Ray—What I am saying is that, in 2009, the underlying economic conditions were very different from the underlying economic conditions—

Mr CIOBO—I am sure. That is the whole point. The economy is never exactly the same; it does change over time. So my question again is: why, previously, for natural disasters have we not imposed a new tax but this time we are? Is it because it has some reference to the budget bottom line? From your previous answer I got the impression that the answer is yes.

Mr Ray—I think there are two factors. One is that you need to take into account the conditions that the economy is in at the time of the disaster. My recollection is that the magnitude of the fiscal cost of the bushfires in 2009, tragic as they were, or of Cyclone Larry, were much smaller than the magnitude of the fiscal cost of this particular disaster.

Mr CIOBO—At $4.4 billion? That was the estimate on the Black Saturday costs. Let me rephrase the question then. Are you saying that there is no connection between the budget bottom line and the need to impose a tax?

Mr Ray—No, I am not saying that. Indeed, the government has said that the reason that they are imposing the levy and the reason that they are adjusting spending priorities is so as to pay for the reconstruction effort—I think the term that the Prime Minister has used is, ‘as we go’.

Mr CIOBO—Because otherwise the deficit would be worse.

Mr Ray—Otherwise the deficit would be larger.

Mr CIOBO—All right. Thank you.

Mr Parker—There is one other dimension that was mentioned in the Prime Minister’s announcement. It is that the economy is at or approaching a full employment situation. There are pressures, particularly in the labour markets that are relevant for reconstruction work. So, as well as the macroeconomic dimensions to this, there is a second layer of economic management. For that reason, the government has announced cuts and reprioritisations of various spending programs. These are designed to help to free up labour that might otherwise be employed so that not too much pressure is put on those labour markets, such as the construction worker market. This will make room, if you like. There is a similar dimension to the tax.

Mr CIOBO—Would it have been less expensive for government had the Queensland government insured the public infrastructure that is at the epicentre of the costs of rebuilding?

Mr Ray—If I may be so bold, the better question is: would it be more expensive for the economy and for the population at large if different insurance arrangements had been in place in Queensland? I do not think that any of us know the answer to that question, because we do not know how expensive those insurance arrangements would have been and therefore the impost on Queensland taxpayers.

Mr CIOBO—But the Commonwealth would not have had to pay the premium; the Queensland government would have. Therefore, the costs would have been lower to the Commonwealth. Why are you aggregating it all?

Mr Ray—The natural diaster arrangements are designed to spread the burden of natural disasters across the Australian community rather than having them fall particularly on those in disaster affected areas. If we were approaching that problem, we would not be looking at it as a Commonwealth versus state spending issue. We would start by looking at what the impact was on the economy and society as a whole. We do not know the answer to that question, because we do not know how expensive it would have been.

CHAIR—I want to clarify an answer you gave to something that deputy chair raised with you so that I understand it clearly. He was trying to get you to say that the state of the government’s budget was the sole consideration in relation to the levy. Your answer was that it was the state of the economy, which is much broader than the state of the budget.

Mr Ray—I may have been fumbling to an answer. I was trying to say that there is a factual connection. If the government had not adjusted its spending or proposed to raise this levy, the deficit would have been larger. That is factual; A leads to B. But the point that I was trying to make was that the decision in that regard whether to allow it to go on the budget or whether to adjust policy to pay for it was affected by its view of the current state and future path of the economy. That is what I was trying to say. Mr Parker added to that more eruditely than I.

Mr STEPHEN JONES—I am interested in going back to some of the costs associated with the recovery effort. Has the Queensland government or the federal Treasury availed itself of a breakdown of some of those costs? I am particularly interested in the infrastructure costs that you have identified.

Mr Ray—Certainly the Queensland Treasury has quite detailed estimates. I think that Mr Bradley is coming before you next and he will probably tell you their preliminary estimates. Those estimates have been shared with us.

Mr STEPHEN JONES—Are you able to provide the committee with a breakdown of some of those costs?

Mr Ray—Why don't I take it on notice and see what we can provide the committee?

Mr STEPHEN JONES—To the best of your knowledge, are you able to give us a breakdown in relation to the infrastructure costs against line items?

Mr Ray—In round numbers the Queensland flood infrastructure cost is estimated to be about $5 billion. Of that, the Commonwealth's share would be three-tenths of $5 billion. Then there is a round estimate of $1 billion for infrastructure costs for other natural disasters in 2010-11. The other line items for the Queensland floods and the AGDP are an estimate of $600 million, the Disaster Income Recovery Subsidy of $120 million and there have been donations to the state relief funds and appeals.

Mr STEPHEN JONES—I am particularly interested in the breakdown of costs for infrastructure itself, because you have identified infrastructure.

Mr Ray—It is only public infrastructure.

Mr STEPHEN JONES—We will come back to that issue because Queensland, like many other states, has a mixture of public and private infrastructure. That is the largest component and, as it has been said many times, risks are on the upside so it would be useful for us to get an understanding—

Mr Ray—I do not know that I said that risks are on the upside. At the moment we would say the risks go both ways.

Mr STEPHEN JONES—What about private infrastructure? Will any of the earmarked $5.8 billion be going towards—

Mr Ray—No.

Mr STEPHEN JONES—So an additional rebuild will be required for some of the private infrastructure?

Mr Ray—Yes, and, as a result, there will be some cost to the Commonwealth budget through revenue, but we do not directly pay for it.

Mr STEPHEN JONES—You talked before in relation to a response to a question from, I think, Mr Ciobo about a macro-economic strategy in capacity constraints. I assume that

Treasury has looked at this area and at the risks associated with a massive rebuild in, amongst other places, South-East Queensland to our capacity constraints?

Mr Ray—Indeed, we have. I am not sure that we have that much to add to what Mr Parker has already said. Clearly, given our expectations of construction activity in Australia, particularly associated with the mining sector and the current state of the labour market—which I think is about five per cent unemployment nationally—and given where we see unemployment going over the next 12 to 18 months, there will be a need to make room for the reconstruction activity. As Mr Parker has said, that is one of the reasons why the government has reprofiled some of its infrastructure spending.

Mr STEPHEN JONES—That is, pushing back certain projects and reprioritising projects. Is it true that the levy, as proposed by the government, also has a material job to do in terms of managing some of those inflation pressures?

Mr Ray—The levy is small. It is being paid by higher income earners and it is clearly temporary. So in those circumstances we would expect there would be some minor adjustment, probably to saving behaviour as much as anything else.

Mr STEPHEN JONES—A couple of questions about Queensland's contribution to GDP and the impact of the flood and the disasters in Queensland on GDP. Has the Treasury done some modelling on the impact of the disaster on—

Mr Ray—Yes, we have. The government has published the broad results of that. Our estimate is that it will affect GDP growth by about half a percentage point in 2010-11, negatively, and most of that will be in the March quarter. Then in the recovery phase there will, as a result, be some increase in GDP growth.

Mr STEPHEN JONES—How important does Treasury think it is for the rapid rebuilding, replacement and repair of public infrastructure to meet those GDP estimates or forecasts?

Mr Ray—We would think that the primary need for rapid rebuilding of the infrastructure is to help affected communities. That would be our primary concern rather than the GDP forecast.

Mr BUCHHOLZ—I want to pick up on and drill down a bit more on those costings. Do you guys have an idea of the difference between the cost of flood damage and the cost of cyclone damage, and is that all included?

Mr Ray—The estimates I described that were in the Prime Minister's press release were clearly estimates before the cyclone damage. There was some allowance for natural disasters outside of the Queensland flood area because we knew about the Victorian floods, the Western Australian floods and the New South Wales floods. We have not yet got a reasonable estimate of the cost of Cyclone Yasi. It is a bit harder to tell. Whether or not that is going to add anything to the global envelope, I do not know.

Mr BUCHHOLZ—You would think it would. So we are in an environment at the moment where we really do not know what the true cost is yet?

Mr Ray—Of Cyclone Yasi? No, we do not.

Mr BUCHHOLZ—We do not have the total cost. We have part of the reconstruction cost but we do not have the reconstruction costs for Yasi.

Mr Ray—We have not got as firm an estimate for the reconstruction costs of Yasi. But we know that, in magnitude terms and in dollar terms, it would be quite a bit smaller. We have the Cyclone Larry experience to base that on.

Mr BUCHHOLZ—Would you like to make an estimate?

Mr Ray—I think the way the Prime Minister has handled this is the way that I would handle it, and that is that in Cyclone Larry the infrastructure cost to the Commonwealth was about half a billion dollars. I would expect that the government will publish detailed estimates in the budget.

Mr BUCHHOLZ—So we will have detailed estimates?

Mr Ray—We will have updated estimates on the cost of the floods and we would have an estimate of the impact of Cyclone Yasi.

Mr BUCHHOLZ—But, at this point in time, with the bill before this committee, we do not particularly know what the big number is going to be?

Mr Ray—Well, as to the bill before the committee, I do not think it is affected by that, but that is not really for me to say. All I can tell you is what our estimates are at the moment.

Mr BUCHHOLZ—I would assume that the effect of the cyclone will have an effect on that number. I will be interested to stay abreast of what that is.

Mr Ray—It will certainly have an impact on the costs of natural disasters to the Commonwealth budget; yes, it will.

Mr BUCHHOLZ—We are going to move on to the next question, but we do not really know what that full number is just yet. I want to pick up your point on fiscal credibility. Can you remind me how much the ceiling insulation program was as a program?

CHAIR—What is the relevance of that question to this inquiry?

Mr BUCHHOLZ—It is absolutely relevant when it comes to fiscal credibility. Chair, please allow me to continue this line of questioning.

CHAIR—We are here to look at a bill about a levy. I want to make sure that we are not wasting our time. We have about five more minutes with this witness.

Mr BUCHHOLZ—I will direct my questions back through the chair. We have established that the levy is considered a tax. The next line of questioning has gone along the lines of: is a tax required in an economy or in a market where you have a strong stimulus or a debt? This is just the next progression of the line of questioning with reference to how much that program cost. It will be along the lines of: if that program was run more successfully, would we now be in the same situation?

CHAIR—If you are asking your question—

Mr BUCHHOLZ—Yes. I am addressing it to the Treasury officials who are here. At this point in time I am looking to find out how much that program was. I thought it was a relatively unobtrusive question.

Mr Ray—I do not have that number with me. I would need to take the question on notice. We will get your number.

Mr BUCHHOLZ—How many new taxes from Treasury are we expecting in this next political cycle?

Mr Parker—The decisions about the structure of the tax system are matters for the government not for the Treasury, so I am not a certain precisely how to answer your question.

Mr BUCHHOLZ—So you do not cost up the benefits of an ETS or a resource profits tax? Does Treasury have any involvement in forecasting revenues on those?

Mr Parker—Certainly.

Mr BUCHHOLZ—So I go back to my original question: how many new taxes that you are aware of, that the Treasurer has been involved in, will come online in the next political cycle?

Mr Parker—My apologies, now I understand your question. There is the MRRT as part of the government's response to the AFTS package. That was one element of the response. There is a whole range of other things in that response, all of which the Treasury has been involved in costing—for instance, the cut in the corporate tax rate, the changes to superannuation arrangements, the changes to the taxation of interest income. In terms of your question of changes to the tax system, there are rather a lot and I could not count them off the top of my head. In terms of new taxes, there is of course the MRRT, as you have mentioned. In terms of the climate change area, that is a policy process that is still in development.

Mr BUCHHOLZ—So, is that two?

Mr Parker—If you were to count new taxes and you count the levy as a tax. Perhaps, if I had understood where the earlier question was going, we could have talked about the relevance of the label. If you would like me to, I will go into that some more. Counting that and the MRRT, it would be two.

Mr BUCHHOLZ—That is fine. I want to talk about the people who get picked up to pay the levy. I have a concern that if people under 60 years of age who are looking to retire draw down on their super in that cycle they will pay a percentage of their life savings into the levy. I think the way it reads is that it is over 60 years of age. If you get someone who is between the ages of 55 and 60, there is the potential for them to be paying a percentage of their life savings out of their super if they draw down on it. Are you guys are aware of that?

Mr Willcock—We are aware of an issue having been raised in the parliament, yes. As you mentioned, the issue relates to people who have reached preservation age for the purposes of superannuation, which is 55, and who retire and draw down a lump sum payment in the period ahead of the so-called tax-free super age of 60, so between 55 and 60 years of age. There is a potential for such people to draw down a large lump sum payment from a tax superannuation fund and, in that case, that large lump sum payment would be taxable income. If they draw down such a large lump sum payment during 2011-12, in the period in which the levy would apply, that would form part of their taxable income and would then be subject to the levy in the way that any other form of taxable income would be subject to the levy.

Mr BUCHHOLZ—So if it were a $700,000 fund, what would be that person's contribution to the levy?

Mr Willcock—We are aware of a particular the question that has been asked in the parliament. We are not aware of the relevant individual's personal circumstances, including the nature of the superannuation fund that that person may have their retirement income currently held in. So there are a whole lot of personal circumstances et cetera which might result in different outcomes. The particular set of circumstances that we are aware of, regarding the question that was asked in the parliament, posited a situation where that individual would be liable to a levy of about $6,500. Working backwards, if they were to be paying a levy of $6,500, that would imply that they would have to have taxable income in 2011-12 of $725,000. I suppose we are meeting there.

I will go on and make the point that that individual would have a series of other tax obligations. It would not just be the flood levy that that individual would be paying. If they had taxable income of $725,000 in 2011-12, they would also be paying income tax of approximately $85,000, they would be paying a Medicare levy of $8,475, and then the flood levy of $6,500. I will also make the point that this all turns on a case where the individual decides to take all of their superannuation as a lump sum payment in that particular year. It may be possible for that individual to adopt alternative strategies that would not necessarily involve them taking that lump sum in one go in that year. It would be possible, for the example, for them to take a smaller amount as a payment for them to live on through the year and roll over the rest of their superannuation, which would therefore mean that it would not be considered taxable income through the year and would not attract the flood levy.

The situation is one where the relevant individual, given their personal circumstances, really ought to seek some advice on their circumstances, including, if they wish, approaching the ATO to consider what the possible implications for them might be and make their decisions in a way that presumably results in them having the best possible outcome. It is not a straightforward tax.

Mr STEPHEN JONES—So it is $6,500. Thank you.

CHAIR—Thank you for your appearance here today.

Ms O'DWYER—We have several more questions.

CHAIR—I am sorry. We have a program here that we are going through.

Ms O'DWYER—You are shutting down debate on this very significant national issue if you do not allow the rest of the committee members to ask questions.

CHAIR—I am hearing what you are saying, but I am making a ruling.

Ms O'DWYER—It would be quite improper, Chair, for you to do that given the significance of this issue. There is certainly time that we could spend with the line of questioning, given that we have morning tea. I am sure you would not mind answering our questions for a little bit longer if we were able to ask you.

CHAIR—That is not going to be possible. We are going to continue—

Ms O'DWYER—So you are shutting down this line of questioning?

Mr CIOBO—A forty-five minute session on a nearly two billion-dollar budget levy.

CHAIR—If you would let me finish, both the coalition and the government have had two people asking questions. I will rotate so that different people get the opportunity—

Ms O'DWYER—You did not say that up front, Chair, that we would not all be allowed to ask a question—

Mr CIOBO—You are gagging further questions.

Ms O'DWYER—and you actually gagged my questions before when I wanted to ask questions. I let you know that I had a line of questioning. So, Chair, I think it would be quite inappropriate for you to shut down the line of questioning now, given that we do have the witnesses in front of us today and we do have the opportunity to ask them questions. There is time on our agenda to do so. I think it would be quite improper for you to shut it down. And, if you are proposing to shut it down, my question to you is: what does the government have to hide? Why are they not prepared to let us ask witnesses questions about this levy?

CHAIR—You can play the political game, but I will remind you that this was a unanimous program to meet today and go through as many witnesses as we could and to report back to the parliament on Monday.

Ms O'DWYER—So we are being gagged.

CHAIR—That was something that was agreed unanimously by the committee.

Mr CIOBO—Mr Chair, we have adequate time to go through in more detail. We agreed on the witnesses but not the time. We have plenty of time. I am happy to forego my lunch break and my morning tea break. Are you happy to do that?

CHAIR—We have a program. We are already over time. We are making sure that the witnesses get—

Mr CIOBO—So you are gagging us?

CHAIR—No, of course we are not. There are many witnesses here who are very important.

Mr CIOBO—I formally move that we have an extension of time for these witnesses.

Ms O'DWYER—I second that motion.

CHAIR—I am making a ruling, first of all, that—

Ms O'DWYER—You cannot ignore the motion.

Mr CIOBO—We have a motion on the table that the committee formally extend the time for these witnesses.

Ms O'DWYER—You are going to have to vote on that motion. You are going to have to formally shut us down.

CHAIR—You have your motion; we will deal with the motion. All those in favour? All those against?

Ms O'DWYER—So we have been shut down?

CHAIR—I have the casting vote and declare the motion lost. Thank you for your attendance here this morning. There were a series of questions on notice, many of which are probably of some interest, particularly to my colleagues. I ask that, if it is at all possible, we have the responses to those questions by tomorrow. We report to parliament on Monday and need to have our report in order by then. I know that I am giving you a fairly onerous task but, given the importance of this levy and the debate that will ensue in parliament, I ask that that happen. You will be sent a copy of the *Hansard* transcript: if there are any errors or omissions, let the secretariat know as quickly as possible. Once again, thank you for your attendance here today.

[10.22 am]

BRADLEY, Mr Gerard Patrick, Under Treasurer, Queensland Treasury

CHAIR—I welcome representatives from the Queensland Treasury to this meeting. I remind you that, although the committee does not require you to give evidence under oath, the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House or the Senate. The giving of false and misleading evidence is a serious matter and may be regarded as contempt of parliament. Thank you for taking the time at very short notice to come before this committee. I invite you to make an opening statement.

Mr Bradley—If it is helpful to the committee, I might quickly give an overview of the situation in Queensland and some of the current developments. Firstly, I thank the committee for the opportunity to appear on behalf of the Queensland government. The natural disaster events in Queensland have been of unprecedented scale, severity and intensity. They have devastated a large area of the state and have resulted in massive damage to essential infrastructure and to community, business and personal assets. They have also resulted in severe personal hardship. The Premier and the Queensland government have welcomed the support of the Australian government and the broader Australian community in the rebuilding of Queensland. The Queensland government recognises the importance of the flood levy as a fiscal measure to fund the essential Australian government contribution required for the rebuilding task. The Queensland government is working quickly to put in place the necessary organisational and accountability framework to ensure that all funds provided are managed effectively and efficiently. Yesterday, in the Queensland parliament, the Premier tabled the Queensland Reconstruction Authority Bill. The new, independent authority will manage and coordinate the government's program of infrastructure reconstruction and recovery within disaster affected communities. It will be overseen by a Queensland Reconstruction Board, which will be chaired by Major General Mick Slater and will include two members nominated by the Australian government.

The task of the authority will be very substantial. The Queensland Mid Year Fiscal and Economic Review released in January estimated the cost to essential infrastructure at some $5 billion for the floods. That was before the impact of Cyclone Yasi. Repairs to national, state and local government roads represent over 80 per cent of the amount, with the balance being personal and business assistance measures and repairs to other state and local government assets.

The Commonwealth-state Natural Disaster Relief and Recovery Arrangements, NDRRA, is the primary mechanism for responding in the federation to natural disaster events. The Australian and Queensland governments are developing a national partnership agreement, which is intended to further strengthen the governance and accountability provisions of the NDRRA. This will include detailed performance monitoring and reporting arrangements and new governance arrangements, including the establishment of the Australian Government Reconstruction Inspectorate.

Finally, the Queensland government has established the commission of inquiry into the Queensland floods with wide-ranging terms of reference, including flood preparation and planning, the performance of private insurers, the flood response efforts, land use planning, early warning systems and infrastructure operation. Again, it has a major task, but it is intended that it report by January 2012. I should also say that the recovery effort is already well underway, with priority restoration of essential water, energy and transport services and disaster recovery assistance for affected people in the community. The big task ahead of course is restoration of our community assets and personal homes, and that is a very big challenge for the authority and for the Queensland community more broadly.

CHAIR—Thank you, Mr Bradley. We will now go to some questions. I only have one question and then I will hand it over to others. How important is it that the contributions from the Commonwealth flow in a timely manner to the people of Queensland who are affected by the floods and the other natural disasters?

Mr Bradley—Obviously it is extremely important that people in personal hardship get access to assistance immediately. That is certainly occurring at the present time through the Commonwealth-state mechanisms at a personal level. It is also very important that local and state authorities quickly get on with the job of restoring essential public infrastructure assets. As soon as we can put in place these accountability and governance arrangements, receiving Commonwealth assistance to enable funds to flow to those authorities will be very important for ensuring the effort proceeds at a quick pace, but also at a pace where we ensure that the works are delivered in an appropriate way as well. The underpinning of this is of fundamental importance. Given the scale of the rebuild, having assurance around the quantum of funding available and available quickly is very important to Queensland.

Ms O'DWYER—Mr Bradley, thank you very much for your appearance today. In your experience and knowledge has there ever been any other levies imposed as a result of various different disasters?

Mr Bradley—I am not aware of particular levies that have been imposed, although I would say that the severity and scale of this disaster is unprecedented. Even in the Queensland context, to have multiple disasters impacting such a wide area of the state—a cyclone and floods at the same time—is quite unprecedented.

Ms O'DWYER—But to your knowledge there have been no other levies imposed in the past?

Mr Bradley—I am not aware of any.

Ms O'DWYER—Given the size and scale of what you have just discussed would it be your view that, if further disasters were to occur, heaven forbid, it would be logical and appropriate to also impose additional levies?

Mr Bradley—The imposition of a levy by the Australian government is a matter for the Australian government to consider in the context of the—

Ms O'DWYER—I am asking you in the context of somebody who works, obviously, for the Queensland government and if a disaster were to occur in Queensland.

Mr Bradley—In the Queensland government context obviously we have had to look at funding strategies ourselves for our share of the costs. In our midyear review our Treasurer did state that we were going to direct the proceeds of some major asset sales to that purpose. Given the importance of the flood recovery efforts and the priority that they have the state, at the same time—

Ms O'DWYER—You were going to sell those assets before then, though, were you not?

Mr Bradley—Yes, they were previously indicated—

Ms O'DWYER—So they are actually not related to the flood?

Mr Bradley—But in this case they have been dedicated to that purpose. We have not factored those proceeds into our budget because we do not do that ahead of sales actually taking place.

Ms O'DWYER—But when you say they are going to be dedicated, and they go into consolidated revenue, the government can change its opinion, presumably, as to where that money is going to be directed?

Mr Bradley—The Treasurer has announced that the proceeds will be paid to the reconstruction authority for use in the flood restoration works.

Ms O'DWYER—If the legislation gets through; but I think we are diverting slightly. Given that we have heard today from the Treasury that there are only estimates as to the damage that has been caused and the potential reconstruction costs, and given that we know that the levy is going to be a $1.8 billion levy and it is only going to be imposed by the government for 12 months, in circumstances where that estimate proves to be incorrect and the cost is much higher, would you want to see an increase in the levy? And secondly, following up on that, would you want to see the period of time for which that levy applies extended beyond 12 months—assuming the costs are higher?

Mr Bradley—I think that the imposition of a levy is a matter for the Australian government. If the cost of the natural disaster is higher than we have estimated—and, indeed, we have yet to incorporate the costs of the cyclone into the estimates—then the costing arrangements are clear under the NDRRA. The strategies that each government may then use to fund their relative shares are a matter for them to consider in their relevant budget formulations. I imagine that we will have better estimates leading up to the preparation of budgets for this coming year.

Ms O'DWYER—But presumably Queensland would want to make sure that it can reconstruct and therefore if, in fact, the flood levy will not cover those costs it would want to see an increase in that flood tax, or an extension of the time during which it applies.

Mr Bradley—But the funding strategy of the Australian government is entirely a matter for the Australian government to make judgments on. I understand they have identified a range of measures to assist in their funding efforts, as have the Queensland government. It would be a matter for the Australian government to consider.

Ms O'DWYER—Are you at all concerned that there have been people affected by the floods and the cyclone who, let us say, are small business people who themselves will potentially have to pay the flood levy due to the anomalies within the current legislation? Does that concern you?

Mr Bradley—Obviously, the design of the flood levy is a matter for the Australian government. I understand that they have made provision for persons in receipt of assistance to be exempted from the levy and that they have also set certain income thresholds. Those are matters for the Australian government to consider in the development of the levy.

Ms O'DWYER—Okay, so you are not going to give me a comment on that. I think my questions are better directed to the Australian Treasury.

Ms OWENS—I want to ask about insurance; the story that Queensland did not have insurance has been out quite widely. Would you like to comment on that and on why the state may or may not insure Cape York against cyclones?

Mr Bradley—As I mentioned in my opening comments, the NDRRA is the established mechanism by which the Australian federation manages the risk of catastrophic events. The Queensland government has considered its insurance arrangements in the context of those NDRRA arrangements. We do have in place appropriate insurance through our Queensland Government Insurance Fund, which is a captive insurer.

Also, for infrastructure and other matters that fall outside the parameters of the NDRRA arrangements, for example our major utilities in gas, water and energy and public transport, the authorities who are involved in provision of the infrastructure do consider their appropriate insurance arrangements. Indeed, there are insurances in place for certain assets that have been impacted by the floods but do not quality for NDRRA arrangements. We have considered the issue or reinsurance for our captive insurer, but at the time that we considered that we did not consider that that represented value for money for the state. It is the case that some other states do have reinsurance arrangements in place. I am advised by them that generally they do not cover road infrastructure. As I have mentioned, 80 per cent of the cost of this natural disaster relates to roads, so the availability and cost of seeking reinsurance for that infrastructure would be a major challenge.

Ms OWENS—I am seeking more clarification on when you said that it was decided it would not be 'value for money'.

Mr Bradley—We looked at the case of the Queensland Government Insurance Fund and looked at the availability of reinsurance to cover major events. We sought reinsurance advice from our broking advisers and we did take that to the international insurance industry. But the costing of that and the risk provisions that they proposed did not represent value for money for the state in terms of the deductions for events and the exposures they were willing to cover. They did not, for example, cover natural disaster.

Ms OWENS—I want to talk about capacity constraints. Queensland is obviously a state that was in boom already. There is now considerable rebuilding and a large flow of investment in it. I assume that capacity constraints is not something that just concerns the federal Treasury; it is something that concerns the state as well. Would you like to speak about how the state is trying to manage that issue.

Mr Bradley—We have done an assessment in our mid-year economic and fiscal update around the economic impact of these events, and there will be a very severe impact on the state economy. We will see much lower economic growth through this year. We have made estimates of around 1¼ per cent growth whereas previously we had estimated 3¾ per cent growth, so the overall growth in the economy will be lower. Also, in the events following the global financial crisis there was a slowdown in major construction activity, particularly in the commercial and residential sectors. We were obviously expecting the improved business investment coming through, particularly from resources, to assist in rebuilding business investment in the state. Obviously there has also been a setback in the resources sector with floods impacting our mining. But nevertheless you are correct: there are some vary large coal-seam gas investments in particular that are scheduled to start to play a big impact, so we do see quite a strong pickup in growth into the next financial year. So, certainly the capacity constraint issue will be one that we will have to look at and consider carefully in the scheduling and in the nature of putting infrastructure works out for tender and construction.

Mr CIOBO—I am interested in getting an accurate snapshot as to the state of the Queensland economy. We know that the federal position with respect to this flood tax is that it is being imposed to reduce the size of the federal government’s deficit. With respect to the rebuilding costs that the Queensland government will be required to meet, or would have been required to meet if the Commonwealth did not step in, what impact would that have had on Queensland’s fiscal position?

Mr Bradley—Are you saying that if the entire cost of the disaster—

Mr CIOBO—Both, so it is two parts: one is based on what you currently have to do and the second is based on what you would have to do if you had to pick up the whole tab.

Mr Bradley—Our mid-year economic and fiscal update provided the estimates of the fiscal impact on the state, and that does indicate that Queensland will have a very substantial budget deficit even on the basis of funding our own share of the disaster.

Mr CIOBO—Which is approximately how much?

Mr Bradley—We have certainly factored in the $5 billion of natural disaster costs. Our share of that would be around a quarter, so we have allowed for roughly a $1.25 billion or $1.5 billion cost to the state budget. I should emphasise that that is in addition to previous natural disaster events, which we estimate will cost around a further $2 billion. There is also the additional natural disaster event of the cyclone, which will have further impacts which we are yet to factor into our numbers.

Mr CIOBO—So, on the bottom line impact on the budget, what is the budget deficit forecast to be?

Mr Bradley—The budget forecast for 2010-11 is not estimated at $1.468 billion, and that will increase in 2011-12 to $3.959 billion.

Mr CIOBO—For how many years has the Queensland budget been in deficit?

Mr Bradley—We have been in deficit for the past couple of years. Prior to that we had a long period of surpluses.

Mr CIOBO—So it has been in deficit for the last two financial years.

Mr Bradley—Yes.

Mr CIOBO—How many years are you forecasting to still be in deficit for post this financial year?

Mr Bradley—In our mid-year fiscal economic update we projected that we are seeking to achieve a surplus by 2015-16, so we will remain in deficit until that period.

Mr CIOBO—So that is about eight years in total of deficits in Queensland.

Mr Bradley—Yes.

Mr CIOBO—What is the total level of state government public debt?

Mr Bradley—Do you wish to include public trading enterprises and—

Mr CIOBO—In Queensland, correct.

Mr Bradley—It is estimated that by the end of 2010-11 the borrowings will be $52.8 billion.

Mr CIOBO—For the state that is substantial, isn’t it?

Mr Bradley—Yes.

Mr CIOBO—You spoke earlier about the decision being taken to not seek insurance or reinsurance of public infrastructure. That is Queensland state infrastructure, isn’t it? When I say ‘Queensland state infrastructure’, I mean the Crown of Queensland’s infrastructure. The title is vested in the Queensland Crown. Is that correct?

Mr Bradley—Yes. The consideration related to our assets other than in the case of a natural disaster event.

Mr CIOBO—But, just to clarify, they are not Commonwealth assets; they are Queensland assets.

Mr Bradley—The assets that have been damaged here do include national highways but they are state controlled in the sense that we maintain those assets even though they have been funded by the Australian government.

Mr CIOBO—So, contrary to other states, the decision was taken not to have insurance on them. Give me a ballpark figure on the annual premium they were talking about for insurance on those assets.

Mr Bradley—We did not seek a premium in relation to natural disaster events. I would emphasise that, as I have already mentioned, most states do not have reinsurance cover for the major exposure here, which is the road infrastructure.

Mr CIOBO—But there are other forms of state assets that are not insured in Queensland that are insured in other states—is that correct?

Mr Bradley—Yes, reinsured. All states have a captive insurer, as we do.

Mr CIOBO—So for those assets what was the premium going to be for reinsurance?

Mr Bradley—I do not have that number.

Mr CIOBO—But that surely was at the core of whether or not it was fiscally responsible—or whatever word you want to use—as to whether or not to go ahead with the reinsurance, wasn't it?

Mr Bradley—It is not the just the case of the premium; you also have to look at the total risk-sharing arrangements which are put forward in terms of deductions—

Mr CIOBO—This is an interesting point. So, but for the fact that the Commonwealth stepped in to pick up the tab, it possibly would have been a very different situation. Is that the point you are making?

Mr Bradley—Obviously any consideration, if you are speaking about a natural disaster, has to be in the context of the long-established federal arrangements for dealing with natural disasters at a national level.

Mr CIOBO—But the decision taken by Queensland was contrary to the decisions taken by other states.

Mr Bradley—All states have made their own decisions in the context of their own circumstances.

Mr CIOBO—So Queensland's decision is different to the decisions taken in other states.

Mr Bradley—Certainly Queensland's decision is different in many regards in that the nature of our assets is different, the road infrastructure in Queensland is different, the incidence of natural disasters is quite different to that of other states—

Mr CIOBO—In terms of being more frequent, do you mean?

Mr Bradley—Certainly there is frequency and the nature of those events is different.

Mr CIOBO—So it is more frequent and yet the view is taken that it was still not wise to seek reinsurance. Is that what you are saying? When I say not wise, uncommercial, not necessary, superfluous, whatever word you want to use.

Mr Bradley—We did not take that decision in relation to natural disaster events because of longstanding arrangements which are in place for natural disaster at a national level.

Mr CIOBO—Because the Commonwealth will step in and pick up the tab.

Mr Bradley—There are sharing arrangements which work and have worked over a long period of time between the Commonwealth and the states.

Mr CIOBO—So in this case around three-quarters of the bill is picked up by the Commonwealth and one-quarter by the state government. Is that correct?

Mr Bradley—In relation to essential public infrastructure, there are costs outside of that which fall solely to the state.

Mr CIOBO—Sure. I am only referring to infrastructure. Is that the correct split, three-quarters to one-quarter?

Mr Bradley—For essential infrastructure there are other sharing arrangements for other assistance measures, which in some cases are 50-50, for example.

Mr CIOBO—Okay, but the relationship you are referring to when you said that was part of the decision as to why reinsurance was not obtained is because the cost is split three-quarters to one-quarter. Is that correct?

Mr Bradley—We considered reinsurance in the context of our captive insurer and the risks that it had. We considered the natural disaster arrangements as the appropriate risk-sharing arrangement, which provides for effectively self-insurance—

Mr CIOBO—That is what I am asking: what is that risk-sharing arrangement. Can you explain to me what the ratio is of that risk-sharing arrangement?

Mr Bradley—It varies from year to year. There are thresholds that apply in terms of how those events are shared. They can vary from the state having to meet in low disaster cost years the cost, to other years when they are shared 50-50, to in these unprecedented extremely severe events it triggers in at 75-25.

Mr CIOBO—Okay.

Dr LEIGH—You are going to feel that you have gotten a lot of questions on insurance this morning but a high-level issue: what is the Queensland government’s philosophy on when you should take out insurance and when you should not?

Mr Bradley—Similar to other states, we have established a captive insurer, the Queensland Government Insurance Fund. We think providing for an internal funding mechanism for normal insurance events is appropriate. That insurance fund has been able to cover all the normal insurance events which the state regularly encounters, such as fire, injury and medical factors. Had we put in place the reinsurance arrangement which was offered when we went to the market, in practice we would not have called upon that insurance arrangement given the reserves we have established for our insurance fund. Separate from that, the insurance fund only applies to government budget funded agencies, so outside of that each of our public utilities and commercial entities would make their own decisions in relation to the insurance arrangements they would put in place and many of them would seek external insurance to cover events. For example, Stadiums Queensland has insurance which would cover the damage to Suncorp Stadium and to the tennis centre. The Queensland Motorways has insurance coverage for the Gateway Bridge. Other public utilities such as rail and energy would have in place in some cases their own internal captive insurer as well.

Dr LEIGH—Can you take me through a little of the macroeconomic impact on Queensland of the recent flooding? What were your projections for growth in the coming fiscal years and how have they been affected by the floods?

Mr Bradley—The impact will be quite severe, we think, in the current financial year. As I mentioned previously, we had originally forecast growth in 2010-11 of 3.75 per cent. In the midyear update we estimated growth of 1.25 per cent. We would estimate that our 3.75 per cent growth might have been around three per cent due to generally more subdued economic conditions prior to the natural disaster events. So the natural disaster events have really taken that three per cent down to around 1.25. We are still assessing the impact of the cyclone, but we will potentially be pushing that number lower again.

In terms of Queensland which has traditionally had average growth of around four per cent, this is a pretty major economic impact. That includes estimating the impact of lost coal production, the impact on key rural industries—including sugar, for example—as well as the broader economy, tourism and so on. It has been an event of unprecedented scale in terms of its impact on the Queensland economy as well as the Queensland community.

Dr LEIGH—But you still have positive growth. In some sense, I can think of this as having been a dreadful natural disaster, but one that has not plunged the Queensland economy into recession. Would that be a reasonable characterisation?

Mr Bradley—It will be very modest growth after we consider the impact of the cyclone and very low growth in terms of Queensland's traditional level. Obviously we have been held up to some extent by the resilience of our resource sector who have been able to continue with significant investment. Also the support of the state's significant infrastructure programs, so there are some major infrastructure projects which are still underway in the state. That is certainly underpinning a level of activity, but nevertheless it is a pretty challenging time for the state.

Dr LEIGH—What are your growth forecasts for the coming fiscal year? Do you foresee getting some of that lost growth back?

Mr Bradley—Yes, we do anticipate with the very major rebuild of state assets that that will see stronger economic growth into next year, so we are forecasting growth of five per cent next year. In our budget last year we were expecting growth to come back to 4½ due to strong resource sector investment as well. We are seeing about half a per cent additional growth likely next year due to the substantial investment in public infrastructure and the rebuilding of community and housing assets more generally.

Dr LEIGH—From what you say, critical to that is the timing of the rebuild. If there were to be some hold-up on the relief package then that would affect these growth forecasts.

Mr Bradley—Certainly if there were an unavailability of funding that would be of serious concern. Some of the investment is extremely important to getting some of our major resource industries back on track, our rural sector back on track, our communities back and creating economic activity. The state is attaching a very high priority to the speed with which we seek to commence the rebuilding effort, hence the measures I have already mentioned in terms of establishing the authority and getting our governance and other arrangements in place expeditiously.

Dr LEIGH—Queensland has traditionally had challenges with capacity constraints. How do you see those over the coming year?

Mr Bradley—Some of this is occurring at a time when there has been some slowdown in activity, as I mentioned previously, in the commercial and housing sectors. Indeed, some of this—particularly the restoration of some of our community and personal housing assets—will come at a time when some of the fiscal stimulus from the Australian government is coming to an end. Some of the BER programs in schools, for example, are coming to an end, so there will be some ability for that capacity to be shifted into the basic rebuilding effort across the state. Also, we are trending down in terms of our own state capital programs, so the ability to shift some of that construction capacity across into these works hopefully will be there as well. Nevertheless, yes, it will be a very challenging time for capacity given that we are talking about a vast area across the whole state. In some rural and regional areas it is sometimes more challenging to secure those construction resources.

Dr LEIGH—Presumably the higher commodity prices will ensure that there is demand also from the resource sector for skilled workers who might otherwise be needed in the rebuilding effort.

Mr Bradley—Certainly. Obviously with the new coal seam gas investments, they are looking to secure significant workforces certainly in the build phase, which we are now entering into. So there will be significant competition for resources. We have gone through a period where interstate migration has been at a lower level. Hopefully, by encouraging workers to move from Queensland from other states, if there are attractive opportunities available in Queensland, we will see a resumption of stronger interstate migration as well.

Dr LEIGH—I want to now turn to some of the particulars around the rebuilding. How are you dealing with the issue that economists cold-heartedly refer to as 'moral hazard'—the temptation to rebuild in flood-prone areas?

Mr Bradley—As I mentioned, the authority has a very extensive role to play. It will have a capability to look at that issue and it will have the ability to work with local government around the planning of how restoration should occur in severely impacted flood-prone areas. It does have provision to, for example, declare reconstruction areas and to designate areas as acquisition land. When land is declared as acquisition land, owners will be prevented from disposing of the land, other than to the authority or another nominated entity, such as local government. But that will occur only in circumstances where the local government has sought the assistance of the authority in considering the appropriate land planning issues for that area.

Dr LEIGH—It sounds as though you are not foreseeing that a large share of Queensland will be declared acquisition land, that there may be certain areas that are declared off limits for rebuilding but that that will be the exception.

Mr Bradley—Maybe, but it would be a matter for local government to work with the authority to consider appropriate arrangements. In some areas there may be other solutions—for example, raising the levels of houses, which is one option being canvassed; or shifting settlements in some areas to slightly higher areas. There may be a range of local circumstances where they consider appropriate arrangements. Flood mitigation might also be an appropriate strategy in some areas.

Dr LEIGH—In the rebuilding of infrastructure, one issue that has come up quite a bit in the public debate is the question of whether infrastructure can be rebuilt in such a way that it is less susceptible to flood damage in the future. How are you addressing that issue?

Mr Bradley—The NDRRA do allow for what is termed 'betterment'. Where there is an opportunity identified for improving an asset's resilience against future events, that is considered by the various funding parties as to whether that would an appropriate investment and then it maybe eligible for funding. It is considered on a case-by-case basis for betterment events. Obviously in the scale of infrastructure we are talking about here, the identification of where those opportunities might lie is something that is yet to occur. Certainly we have not allowed in our estimates for substantial betterment. For example, flood-proofing the national highways would be a massive investment which we have not factored into these numbers.

Dr LEIGH—How are you modelling flood risks in the future? Has this event caused you to change your modelling of the risks to the state of Queensland?

Mr Bradley—Certainly, as I mentioned, the public inquiry, which will be underway over the next 12 months, will be looking at all the issues around the risk of these flood events and the appropriate planning and responses to those events. Obviously the outcomes of that inquiry will be very carefully considered by the Queensland government as to what policy response or other measures are required to improve our capacity to manage and to withstand the impacts of such events, although I would like to emphasise again that the sheer severity and scale of these events is quite unprecedented and would test any regime of planning or preparation.

Dr LEIGH—And the flood levy has been designed in such a way as to have an exemption for those who were receiving an Australian government disaster payment. Does that seem to you to be a reasonable exemption to put in place?

Mr Bradley—I think the Queensland government has welcomed the fact that it will have regard to the difficult circumstances of those people who were directly impacted by the floods. It also has regard for income thresholds, as I mentioned previously. So those elements of the design are certainly welcomed by the Queensland government.

Dr LEIGH—Because those on lower incomes are not required to pay the levy until they earn an income of $50,000, what do we know about the propensity to consume out of incomes, of lower income taxpayers and higher income taxpayers?

Mr Bradley—I think you are probably getting into territory that you would be better off seeking answers from the Australian government Treasury in terms of their consideration of those broader balance of measures between welfare and other impacts on households.

CHAIR—Thank you, Mr Bradley, for your attendance today.

Proceedings suspended from 11.01 am to 11.15 am

ESLAKE, Mr Saul, Private capacity

Evidence was taken via teleconference—

CHAIR—On behalf of the committee I would like to welcome Saul Eslake from the Grattan Institute to this hearing. Mr Eslake is attending by teleconference. I remind you, Mr Eslake, that although the committee does not require you to give evidence under oath the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House or the Senate. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament. For the *Hansard* record, would you please state the capacity in which you appear before the committee.

Mr Eslake—I am a program director with the Grattan Institute in Melbourne, although my views are being expressed here in a personal capacity and do not necessarily represent those of the Grattan Institute, its board or other staff.

CHAIR—A very careful disclaimer to start off with. Do you have an opening statement that you would like to make to give an overview of your position or do you want us to go straight to questions?

Mr Eslake—There are a few things I would like to say if I could. Thank you to you, Chair, and your colleagues for the opportunity to share my views with you. Could I say by way of a preface to the other remarks I intend to make that I am not opposed in principle to the concept of either temporary or permanent levies on income tax or other forms of taxation payments for certain public purposes. By way of illustration I mention that I am instinctively sympathetic to the proposals that have been put elsewhere for a Medicare style levy to fund a disability insurance scheme, although I am holding my final judgement back until I see the report of the Productivity Commission on that subject. I emphasise therefore, apropos of what I want to say about this particular proposal, that my views are not formed by any instinctual or ideological objection to the concept of temporary or permanent levies on income tax.

Turning to the specific proposal that is the subject of your inquiry, I want to make the point that the choices which the Prime Minister outlined as the means by which the government proposes to fund its share of the cost of repairing the damage done by the recent floods in Queensland are political choices rather than economic imperatives. In saying that they are political choices, I am not trying to say that they are wrong or will be damaging to the economy. Rather, what I am saying is that they are political choices as distinct from things that had to be done in order that the government be regarded as economically responsible or that unwarranted or regrettable implications might flow to the Australian economy if other choices had been made.

By that I mean that compared with what the government did decide, there were at least two other alternatives that could have been pursued without damaging consequences for the Australian economy. The first of those is that the government could have elected to fund part or indeed all of the $5.6 billion that it estimates will be its share of the reconstruction and rebuilding effort through additional borrowings—that is, by allowing the deficit for the financial years between now and 2011-12 inclusive to be higher, the surplus for 2012-13 to be lower than presently forecast or indeed the year in which the budget returns to surplus to be pushed out a bit further. I say that because the numbers entailed here, the $5.6 billion, represent a very small proportion of GDP, about 0.4 per cent of one year's GDP. Bear in mind that we are talking about a sum being spent not in one fiscal year but rather spread over two or three fiscal years. As a proportion of any one year's GDP, the additional borrowing that might be entailed if the government chose to fund all of it through borrowing would be about 0.2 per cent of GDP as a maximum. That is smaller than the amount by which the forecasts of the budget bottom line presented in each year's Budget Paper No.1 are out from year to year.

Differences of that order of magnitude are not the stuff of which increases in interest rates, for example, are made. As the Reserve Bank said in the statement on monetary policy released earlier this month, the impact that the floods and cyclones and the rebuilding and reconstruction that is required after those events will have on inflation and economic activity respectively will have no implications for the conduct of monetary policy and hence for interest rates. As it happens, the pattern of expenditure and hence borrowing that might have been required had the government chosen to go down the path of funding it all by borrowings would not have had any material impact either on the profile of the budget or on the way in which the financial markets or the Reserve Bank would have responded to it. That is the first point: the government could have chosen, without any adverse consequences for the economy, to have funded some or all of the costs that it will incur by borrowing.

The second choice that they have could have made was to have funded more than they have decided of the Commonwealth's costs by further reductions in expenditure as opposed to a levy. In my view, there certainly would have been scope for further reductions in government spending. Most of the reductions in government spending which the government announced fell into one of two categories. The first category was reductions which they had to make because there would not have been sufficient skilled labour to undertake both the rebuilding and reconstruction of infrastructure effort that is likely to be required and other infrastructure projects according to their original timetables in Queensland and in other parts of the country. Alternatively, as the Prime Minister said in explaining some of the other savings measures that the government has proposed, if we get a carbon price—an objective that I personally strongly support—then some of these other measures were in her view not necessary. One would therefore have to ask why those expenditure cuts were not announced anyway instead of waiting until Queensland had been inundated with large quantities of water.

In passing, there are one or two spending decisions that I must say are most regrettable. In particular, there was the decision to scale back yet again the expenditure on the National Rental Affordability scheme, a scheme which in my view quite helpfully adds to the supply of low rental housing at a time when Australia is desperately short of that. But there are other areas of government spending which the government could have elected to have pursued, including in the housing area the abolition of the first home owners grant for buyers of established dwellings, had it wished to do so. My point is simply that the decision to choose to fund a third of the cost through a levy is a political choice rather than an economic one.

The last point that I want to make about that and its relevance to the government's timetable for returning the budget to surplus—by 2012-13—is that the levy does not materially impact on the achievement or otherwise of that objective at all. The levy is, as you all know, designed to raise about $1.8 billion. Nearly all that $1.8 billion is expected to be raised in the 2011-12 financial year, a year in which on present forecasts the government expects to have a budget deficit of about $12.25 billion. Only about $200 million of the revenue that the levy is expected to collect is expected to be collected in 2012-12. Therefore, if the government decided not to collect a levy but instead funded the amount that the levy is expected to raise by additional borrowings there would still be a large budget deficit in 2011-12, but not by so much bigger a margin as to have any impact on interest rates, financial markets or the economy. And there would still be a budget surplus for 2012-12, less than currently forecast but only by the amount of about $200 million that the levy is expected to collect in that year plus perhaps an additional $100 million of extra interest payments on the additional borrowings that the government would have to undertake primarily in 2011-12. So the levy is not designed to have any impact one way or the other on the government's target for returning the budget to surplus by 2012-12. Rather, it reflects political choices that may well be designed to appeal to Australian notions of fairness. It is not my position or intention here to criticise that judgment. That is a political judgment that elected governments are perfectly entitled to make.

What I am here to say is that it is of no significance to the quality of economic management or to the outcomes for interest rates or other aspects of Australia's economic performance whether the government's reconstruction effort is funded entirely by borrowings, entirely by reductions in government expenditure or by some combination of the three.

One last observation which I want to make, and which I should have made earlier when discussing the possible implications of choosing to fund all of the reconstruction effort by borrowing, is to note that the borrowings set to be undertaken by the Queensland government, compared with what that government expected at the time of its last state budget in May 2010, is an increase of about $4.8 billion on net over the same period that we are talking about with regard to Commonwealth forward estimates. Nobody is suggesting, nor would they have any valid reason to suggest, that the additional borrowing being undertaken by the Queensland government as a result of the impact of the floods on its revenues and as a result of the costs which it will incur in rebuilding, reconstructing and repairing the damage done by the floods is going to put upward pressure on interest rates or have any other adverse consequences for the economy. I mention that as a way of reiterating that there is no reason to believe that different choices from the ones which the government has made on what I regard as essentially political grounds would have had any adverse consequences for the economy either. Those are my prepared remarks, Mr Chairman. Thank you for allowing me to make them. If I can be of further assistance by answering questions, I would be glad to do so.

CHAIR—Thank you. You have said that you have no philosophical objection to levies—I think that is how you started your presentation. You went on to talk about there being three possibilities for how the money could be raised—that is, going into greater debt, cutting expenditure or by the levy. Is it not the position in relation to any policy issues that, generally, there are those sorts of choices that governments have to make and that, adopting a mix of those responses, is an entirely appropriate response for a government to take in terms of raising this money?

Mr Eslake—Broadly, yes, I would agree with you about that. As I said, there were three different paths that the government could have gone down, or some combination of all three.

My point is that they were political choices rather than economic ones. Had the scale of the damage wrought by the floods and cyclones in Queensland been, say, 10 times bigger in terms of the cost to government than they actually are, then it might have been possible to say that different choices, particularly with regard to how much of the cost would be funded by borrowing as distinct from expenditure cuts or tax increases, might well have had implications for the economy and for interest rates. But, taking the government's estimate of the cost of $5.6 billion as being correct, and I have no reason to challenge them at this stage, even though the Prime Minister herself has said that they may be subject to upside risk, the scale of the numbers is such that there is no consequence of any economic significance from any of the possible choices or permutations of choices that government could have made. My point is that these are political choices, which, as you say, the government is perfectly entitled to make, but the choices which the government did make are no more economically responsible by definition than any of the other combination of choices that the government could have made.

CHAIR—Mr Ray from the Commonwealth Treasury appeared before us this morning and raised the issue of fiscal credibility with the markets, saying that, in his view, that was a consideration of Treasury in advising the government. What is your view in relation to the point that he has raised about fiscal credibility?

Mr Eslake—Fiscal credibility is an important thing for governments and their advisers to consider, especially in a world where a number of governments' fiscal credibility has been substantially undermined by the global financial crisis and their reactions to it. But I would say that the governments whose fiscal credibility is now under question have much worse fiscal positions than the Australian government does. These are governments that have gross public debt of anywhere between 70 per cent and over 200 per cent of their respective GDPs, whereas, as honourable members will know, the Australian general government debt is expected to peak at about six per cent of GDP.

I offer the judgment—and I note that the Prime Minister has said that her decisions have been based on, more than anything else, matters of judgment—that had the government chosen to borrow all of the costs associated with the Queensland reconstruction effort, the financial markets would have not altered in their judgment as to the present government's fiscal credibility. That is partly because the numbers entailed are so small, relative to GDP, partly because the prospect of returning to surplus by 2012-13, to which the government has attached particular importance, would not have been altered by different combinations of decisions from the ones which the government has made and finally, I guess, the Reserve Bank itself has said that the consequences of the Queensland floods and of the rebuilding effort for the profile of monetary policy are nil.

CHAIR—Thank you for that.

Mr CIOBO—My questions relate to the political considerations you speak of. We heard from Treasury officials earlier that it was their view that, in large part, this matter went to—this is their phrase, not mine—fiscal credibility. When I questioned Treasury officials about it, they said that without this tax the debt and deficit would have been worse and implicit in that is that Labor's physical fiscal credibility would have been worse. Do you think that is part of the political considerations that you referred to?

Mr Eslake—It is hard for me to make judgments as to the political considerations that the government weighed up in coming to the decisions which it did. Apart from anything else, I am not a politician nor am I a political scientist; I am an economist. What I would say is that, to the extent that fiscal credibility was a concern of the government and of its Treasury advisers, had the government chosen to fund all of its expenditures by cutting government spending, as opposed to two-thirds of them by cutting government spending and one-third by increasing taxes, then there would have been absolutely no implications for the government’s fiscal credibility. To the extent that fiscal credibility is an issue at all, it goes to the question of whether or not the government’s expenditures are funded—that is, on the one hand, funded by some combination of cuts in government spending and increases in taxes and, on the other hand, funded by additional borrowing. Had the government chosen to fund all of its costs by cutting government spending then that would have been no less fiscally credible than the combination which it actually chose. Hence, as I say, decisions as to how much a particular program is funded by cuts in government spending elsewhere and how much is funded by increases in taxes are essentially political matters, not matters of economic credibility.

The second observation I would make is to reiterate the answer I gave to the chairman, which was that the amounts involved here are so small and the timing of them in relation to the government’s previously announced profile of returning the budget to surplus by 2012-13 are such that, even if the government had decided to fund half or all of it by borrowing rather than by spending cuts or by increases in revenue, then in the eyes of the financial markets there would have been no material impact on the fiscal credibility of the government.

Mr CIOBO—Sure. With respect to what I would phrase ‘moral hazard,’ we heard from Queensland Treasury’s representative that part of their consideration in electing not to seek re-insurance on public infrastructure assets was the spread of costs and responsibility for the reconstruction efforts, which he said under arrangements with the Commonwealth represented somewhere between as low as 25 per cent and as high as 75 per cent, borne by the Commonwealth, depending on the intensity of damage following a natural disaster. I am interested in your economic comments around the moral hazard of a state government electing not to obtain insurance because of the Commonwealth stepping in. Is that of potential significance for the Commonwealth down the track?

Mr Eslake—Prima facie the answer I would give to that question is yes. As I understand it, some other state governments do have reinsurance policies in place to cover them for at least part of the cost of natural disasters. The Queensland government and previous Queensland governments have made different choices. To the extent that the Queensland government’s choice has been influenced by the knowledge that three-quarters of the cost that would in the first instance fall to the Queensland government would subsequently fall to the Commonwealth, I think that is something the Commonwealth ought to be rather concerned about.

Mr CIOBO—I specifically asked Mr Bradley, the Queensland Under Treasurer, about the level of debt in Queensland and, in addition, the number of deficits in Queensland. He said the Queensland public debt was at $52.8 billion. I said to him that that was quite substantial and he said yes. They expect to run deficits from 2008 through until 2015-16. Would this be yet another consideration from an economic perspective about why it is better that the

Commonwealth picks up the tab and then for the Queensland government to seek reinsurance if they already have their budget bottom line under so much fiscal pressure?

Mr Eslake—That would depend on the actual cost of reinsurance arrangements—the insurance premium and the like.

Mr CIOBO—He would not give me an answer on that, incidentally. I did ask him for the quote.

Mr Eslake—Obviously, I am not in a position to second-guess Mr Bradley or indeed to have any idea of what the cost of reinsurance premiums would be, other than to note that they are probably in the throes of going up, be it for Queensland or for any other government in Australia or perhaps elsewhere that would be seeking that sort of insurance. I note that some press reports have indicated that insurance companies may be coming to the view that Australia represents a bigger risk for insurance of this kind than it has done in the past. Again, that is something that government and policymakers need to be giving some fairly careful attention to. That said, I would be surprised if the cost of insurance, had Queensland elected to take it up for this purpose, would have been so large as to have had a material impact on the numbers you quoted before for ongoing deficits or the level of Queensland state government debt.

Ms OWENS—Good morning, Mr Eslake. I enjoyed reading your article. Thank you. If I have understood your article and your statement this morning, what you are saying is that because of the state of the economy and the size of the economy, whatever decision the government made—between a 100 per cent levy, 100 per cent budget cuts and 100 per cent debt—would be economically sound. Is that right?

Mr Eslake—Yes, in those terms I think that is right. When I say that had they decided to fund all of it by borrowing—as distinct from some combination of expenditure cuts and revenue increases that fully funded the costs which the government will incur—the basis for that judgement is that the additional borrowing entailed in the government choosing to fund all of it by adding to the deficit is so small relative to the economy that it would have had neither any impact on the economy itself nor on the level of interest rates nor on the judgements which financial markets and others would have made about the credibility of the government's fiscal policy. Had the cost been 10 times what has been estimated on this specific occasion then I think their judgement might have been different, but that is because of the size rather than because of the intrinsic nature of the decision itself.

Ms OWENS—You described the choice that was made as political. Is there any choice the government could have made which you would not have described as political?

Mr Eslake—No, probably not. Let me emphasise, as I said in my opening statement, that just because I use the term 'political' does not mean I am saying it is wrong in any way. What I am saying is perhaps contrary to the depiction that the Prime Minister made when she first announced these decisions. The particular choices which the government has elected to make are not ones dictated by the imperatives of economic management. That is the distinction which I am seeking to draw. I am not seeking to impose my own political judgement, because I do not have one. Nor am I seeking to suggest that some other political choice might have been better. What I am seeking to say is that it is a political choice, not an economic one.

Ms OWENS—So, as far as the economy is concerned, you would tend to think we are arguing about something that is essentially sound?

Mr Eslake—Yes, and other choices would have been equally sound in this particular context. Hence, as I say, it is really a political judgement, which political parties are perfectly entitled to make. But I believe it is not correct to say that had the government made different choices they could legitimately have been depicted as economically irresponsible.

Ms OWENS—Of course, if every choice is described as political then it is a choice that the government had to make, not necessarily wanted to make. Anyway, thank you.

Ms O'DWYER—Mr Eslake, thank you very much for giving testimony here today. I want to pursue your response to Ms Owens before in relation to the current costs and, all things being equal, debt or cutting expenditure or a levy basically being an appropriate response. You did mention that your view would be somewhat different if it was 10 times the cost, so I just want to explore your view in those circumstances.

Mr Eslake—Let me emphasise that we are speaking quite hypothetically here. Given the damage that was caused by the floods and cyclones which we actually did experience, to contemplate floods or cyclones that might have caused ten times as much damage in terms of their financial cost is a rather terrifying thought. But let us for the sake of argument pursue the hypothetical situation in which we are talking about a damages bill of $56 billion, rather than $5.6 billion. Had the government in those circumstances sought to borrow the entire amount of $56 billion then I think the financial markets would have done more than raise their eyebrows at the prospect of government borrowing and debt increasing by that amount. I think in those circumstances, had the government chosen to fund all of it by adding to the deficit, there would have been implications for the economy—having regard for the fact that we are pretty close to full employment—and for the level of interest rates. In those circumstances I think the government would have had to rule out funding even a relatively small proportion of the total bill by additional borrowing. Instead, economic responsibility would have dictated that it fund its immediate share of the bill by some combination of expenditure reductions or deferrals and increases in taxation. Again, the choice between those options would have been a political one, rather than an imperative of economic management. But to go back to the circumstance we are actually dealing with, because the amounts involved are so small—especially when you recognise that they are being incurred not in one single year but over three financial years—smaller than the amount by which government budget forecasts are typically in error from year to year, I think it is very difficult to say that a decision, had it been made, to fund all or part of the government's costs by additional borrowing would have been considered by anyone to have been economically responsible.

Ms O'DWYER—As I understand it from the information provided to us today, never before have the Australian people been asked to make a contribution in the form of an additional tax in relation to any form of natural disaster. In fact, when these terrible events occur, they have always been funded out of consolidated revenue. I just want to get your view on whether you think as a matter of practice it is a sensible policy position for the government to take to seek to impose new taxes in circumstances where there are unforeseen events. If this were to become a pattern would that be of concern to you?

Mr Eslake—There have been occasions in the past, as committee members will be well aware, when governments have imposed levies for other purposes—

Ms O'DWYER—But not for disasters.

Mr Eslake—No. To the best of my knowledge, and I am really only going back to the early 1990s, I cannot think of an occasion such as that. Although, speaking of the early 1990s, the Victorian government imposed an additional levy on petrol in order to fund payments to people who had lost their savings in the collapse of the Pyramid Building Society and, I think, Estate Mortgage. Now that was not a natural disaster, of course, but it was a financial disaster and, as the Treasurer and others have noted, the floods in Queensland may well have been the most costly in terms of economic losses and cost falling to government of any of the natural disasters that have afflicted Australia in recent memory. So it may be that, notwithstanding the absence of any history as regards the imposition of levies funding natural disaster relief, this is a precedent which, in the government's political judgment, is worth setting.

I would be concerned if every time a significant or expensive natural disaster or indeed any other exigency fell to the Australian government the response was to slug the 40 per cent of the population who are considered rich enough to bear an additional tax burden. I think that would be problematic, although there is an element of political judgment in that as well as economic. But, obviously, if you continue to increase marginal rates of tax on a segment of the population by large amounts or with high regularity over time then there could well be some adverse consequences for incentives to work, save, invest and the like, which have been well documented in the economics literature.

CHAIR—Thank you, Mr Eslake, for making yourself available today. We appreciate your time and expertise. Hansard were making a recording of your evidence here today and they will send you a copy. If there are any errors or omissions, please get back to us as quickly as possible. Thank you once again for your contribution.

Mr Eslake—Thank you, Mr Chairman. I again express my appreciation to the committee for the opportunity to share my views with you.

[11.47 am]

McKIBBIN, Professor Warwick, Private capacity

CHAIR—On behalf of the committee, I would like to welcome you to today's hearing. I remind you that, although the committee does not require you to give evidence under oath, the proceedings are still legal proceedings of the parliament and warrant the same respect as proceedings of the House or the Senate. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. Thank you again for making yourself available at relatively short notice. We do appreciate that. Would you like to make an opening statement in relation to our consideration of this bill?

Prof. McKibbin—Yes. I would like to thank the committee very much for inviting me. I do have an opening statement which I would like to read. The comments that I wish to make today about the Temporary Flood Reconstruction Levy I make in my capacity as a professor of economics at the ANU and an expert on the theory and practice of economic policy. Although I am a member of the board of the Reserve Bank of Australia, nothing I say should be attributed to other members of the board nor the management of the Reserve Bank of Australia. These are my own personal views and not the views of any of the institutions with which I am affiliated.

I wish to comment on the principle of how to finance the cost of a natural disaster or any temporary negative economic shock. The main reason for focusing on this issue, despite the relatively small amount of money involved in the current case, is to make sure that important principles are in place for future disasters and future economic decisions which may be of significantly larger magnitude.

Most economists who study public finance would support the view that taxation is not the optimum way to finance the reconstruction of infrastructure after a natural disaster. The argument has a long tradition in economics. One of the goals of economic policy should be to smooth national consumption over time. A natural disaster reduces economic activity when it occurs. Financing reconstruction requires immediate delivery of reconstruction effort and therefore an immediate funding response. There are at least three main ways to finance rebuilding. The first is to raise taxes, which further reduces private demand and therefore reduces economic activity even further. The second is to cut government spending, which also reduces economic activity even further.

The third is to increase the fiscal deficit temporarily—and I stress 'temporarily'—to borrow to refinance the rebuilding. The advantage of borrowing is that this does not directly reduce economic activity today, but spreads the cost of rebuilding over many decades into the future. The macroeconomic goal should be to reduce the negative effects of the disaster soon after it occurs. Only borrowing achieves this objective. Both cutting spending and raising taxes worsens the decline in economic activity in the short term. The analogy to the problem facing a government is the case of a person whose house is damaged after a storm but who has no insurance: it does not make sense to stop eating until enough is saved to rebuild. A better strategy is to borrow to rebuild and to reduce consumption a little each day to pay for this.

The role of the government in income smoothing and risk sharing for the national economy is a fundamental tenet of sensible public finance policy. Of course, the general rule may not apply in all cases. If a government has no economic credibility then the ability to borrow may not be an option, and so pay as you go may be necessary. Also, if government debt to GDP were very high, the additional borrowing may raise the risk premium on government debt and therefore incur additional costs in excess of benefits for income-smoothing purposes. With Australian government debt to GDP at around 20 per cent, and the lowest of industrialised economies, it is unlikely that the additional borrowing of the scale envisaged could impact on risk premium in a negative way. Indeed, I believe that if it were explained to financial markets that the reconstruction was designed based on the optimal income-smoothing policy then this could very well enhance the economic credibility of the policy framework perceived to apply in Australia. Also, borrowing to finance something with a large and already known financial pay off, such as rebuilding infrastructure assets, should not result in a change in risk. Borrowing for wasteful purposes is when financial markets get nervous about government debt.

An additional public finance argument against a levy—and this is as distinct from both borrowing and cutting spending—is that there are significant compliance and enforcement costs associated with introducing a new tax. These may be significant, especially when there are exemptions from the levy that will need to be assessed on a case-by-case basis. These transaction costs will reduce the amount of revenue that is available for spending on reconstruction, and thus it is the highest cost way of financing the rebuilding in the current case.

Finally, there is the problem of unintended consequences. Announcing a tax to finance flood reconstruction has the danger that it may cause those who have generously donated money to the various flood relief campaigns for those in particular need to be unhappy that they are being forced, through the taxation system, to make additional payments in excess of what they were willing to give. By being surprised this way, people may not donate as much in the event of future natural disasters because they will expect that the government will tax them again. Thus, imposing a flood levy to finance infrastructure may make people more reluctant to give to disaster relief in the future. Whether this effect is large or small is an empirical question, and it would be very interesting if the data were available to test whether individual donations fell after the flood levy was announced. Perhaps the charities are better placed to provide some comment to the committee on this issue.

In conclusion, under the current circumstances in Australia it is clear that the economic argument comes down in favour of a temporary increase in the fiscal deficit to finance reconstruction after a natural disaster. I am sure there are many compelling political arguments in favour of the levy, or in favour of cutting spending to finance rebuilding; my arguments in this testimony have focussed on the economics of this policy.

CHAIR—Thank you for that. Mr Ray, the Acting Secretary of the Commonwealth Treasury, raised the question about fiscal credibility with the markets. You have addressed part of that. His view in advising the government on the advantages of a levy was that that was a consideration that was there. You do not think that that—while it may be a judgment call—at the end of the day it is a valid argument that can be sustained economically?

Prof McKibbin—It is one argument. I think the evidence is that the financial markets respond to responsible decisions which have a very clear framework underlying those decisions. The idea that governments have a role in our society is held by most people, and the idea that governments should borrow in certain circumstances is well acknowledged by most economists. I think that in the case of a disaster it is almost uniformly accepted by economists, in principle, that a tax is not the best way to fund it. And the particular tax that we are talking about is quite small, and therefore the impact on credibility would be very small. I think it probably could be made into a positive, not a negative, if the reason for doing it was seen to be sound economic management rather than any sort of political decision.

CHAIR—On the flip side of that, of course, is the impact on consumption, given it is a small tax as well as being relatively small, which was one of your arguments for not using a tax.

Prof. McKibbin—That is correct. Again, this is a small impost on the economy. My view is that we should always, where possible, establish good principles for economic management because when the big decisions have to be made we have a framework in which to act, whereas if we continue to do what we have always done then we end up becoming a banana republic. We have to be very careful that all decisions, even the small ones, are done in the appropriate way.

CHAIR—You would not, though, be arguing that putting this levy is irresponsible of the government in terms of raising money? It is one of the three options that were available to the government. You are not arguing that it is irresponsible; you are arguing that, in your view, going into greater debt is the preferable option?

Prof. McKibbin—My argument here is very clear. It is an option, and it is a reasonable option to take. A first best policy would be to borrow under current circumstances. Primarily, the most convincing argument to me is the fact that, if we use this particular tax, because it is a new tax we lose a fair bit of the revenue—perhaps up to 10 per cent—in churning and in collection costs, whereas if we use government debt we can actually collect the revenue gradually over time in the normal way through the taxation system without any additional cost. So it is definitely more costly, although the numbers, I agree, are very small.

CHAIR—Thank you.

Mr CIOBO—Professor McKibbin, in your view if the government had been in a surplus position, as it has been in previous years, would the need for this tax have been nil?

Prof. McKibbin—I do not think the initial conditions in the particular circumstances we face make that much difference. Whether we were running surpluses or whether we were running deficits, with debt to GDP of a low 20 per cent or so, I do not think it has any impact on whether the tax is the optimum policy or not.

Mr CIOBO—You said in your evidence that there were additional costs associated with a one-off tax versus debt financing and spreading it over the normal course of revenue raising by government. There are costs associated with doing that either way. They made the nominal. They may be nonmaterial. But if the government was in a situation where we had a surplus, I would have thought it was a matter of first principle that there would be less need to finance it through debt or through an additional tax.

Prof. McKibbin—In that sense I agree with that argument, that if you have additional assets that you have been accumulating over many years you can run down those assets without resorting to taxation to finance it. That is correct.

Mr CIOBO—In the current context we have got government with net debt—I am not sure of the exact figure; my colleagues may know, but I understand it is about $80 billion—and forecast budget deficits. Again, I know that it is not material in that context, but isn't that precisely the point—that it is not material and yet there are additional costs associated with the collection of this tax? Doesn't that of itself highlight that this tax would seem to have not been well thought through?

Prof. McKibbin—Again, taxation is a legitimate exercise to undertake, and you can use taxation to finance all sorts of activities. I think the decision here was a decision of a political nature, not of an economic nature, because the simple economic argument is to borrow under current circumstances that we face.

Mr CIOBO—So there is no economic basis for this decision, it is purely a political consideration?

Prof. McKibbin—There is an economic basis because the consequences of the decision have economic implications.

Mr CIOBO—I know there is an economic implication, but what you said was that it was not on the basis of economics that this decision has been taken.

Prof. McKibbin—I would say that most economists would draw the conclusion that a borrowing in this case was the way to undertake this policy reform. I have to be careful because in my discussing this policy I am talking about it in a stand-alone situation. In fact, this decision is being made in an environment where there are many other factors going on in the economy: an overheating economy, strong excess demand, government stimulus package still running through the economy. So the decisions that are made in the broader context are made as economic decisions as well, which make more sense to me. But those decisions, I would argue, should have been made as part of the budgetary process, not as part of financing the rebuilding of Queensland infrastructure.

Mr CIOBO—So at a time when there is still, as you said, stimulus in the economy and the government is still spending money in the economy, this tax, masked as it is—my words, not yours—as part of a recovery effort to repair the damage from the floods, just also happens to neatly fit with the government trying to in some way reduce stimulus without having to cut programs in other areas by making sure that the tax take is slightly larger. Is that what you are saying?

Prof. McKibbin—No, I would argue that is part of the argument. The other part of the argument is there is a clear target of a fiscal surplus by 2012-13 and the need to finance any perturbations in revenue or incomes of the government means that you would want to use the tax more often to try and meet the deficit target at that point in time. I think the problem is the deficit target that we have self-imposed ourselves—from both sides of politics; the conservative opposition and the government—is not the appropriate sort of target for a country like Australia that has enormous investment opportunities and a shortage of access to funding. The government can play a very important role in providing that funding and borrowing against future income streams.

Dr LEIGH—Professor McKibbin, Mr Ray, this morning, characterised the point of the macroeconomic cycle as being strong and approaching full employment. Does that seem a reasonable characterisation as to where we are?

Prof. McKibbin—Yes.

Dr LEIGH—So, which matters then when we are thinking about how to fund additional expenditure—recent shocks or the overall macro position in the cycle?

Prof. McKibbin—The macro position in the cycle does matter. I would have thought that the policy response for that would have been undertaken in the budget cycle not in the response to a natural disaster which requires a rapid response and a clear mechanism of financing. You could bundle the two together—and that is my view of what the government has done—as long as someone explains to the Australian people that this is the purpose of this levy then that certainly is a legitimate exercise. My testimony is purely about the economics of what you do as a matter of principle in these circumstances independently of the financial cycle that we face.

Dr LEIGH—Thinking about what you have termed a 'deficit fetish' how do you see Australia as having gotten into that position in your characterisation?

Prof. McKibbin—There is a long history of very large fiscal deficits and accumulation of government debt under previous governments. It was a key part of the platform of the Howard government years of moving the deficit into surplus. That was pulling back from a threshold where debt to GDP was acting as a drain on the economy. Once you get below certain levels of government debt to GDP and that debt is being used to finance activities which generate very high social and financial rates of return then there is less of a concern. That idea that these deficits in the seventies were bad was probably correct because the way they were financing were probably very low return activities. I think that is the mistake that government and opposition parties have made. They should focus on the quality of spending, the nature of the spending and the rate of return to society over time when they incur spending. Many programs do not return anything like the cost of borrowing those funds and that is the fundamental problem with deficit financing—what you spend it on, the quality and the magnitude.

Dr LEIGH—In an environment in which Australia's debt levels are about one-tenth of the average for developed countries below 10 per cent, what does it do to sensible debates over deficit financing when one party in an election covers all of the polling booths with bunting that focuses on the issue of debt?

Prof. McKibbin—It is very counterproductive to the Australian economy. I think both sides of politics should actually move away from this focus on deficits and debt to focus on the quality of government spending and the distortionary nature of taxation that services that government spending.

Dr LEIGH—Is there a risk that you have contributed to that? In the context of the second stimulus package in 2009 you were quoted in one of the newspapers as saying that the danger is you add too much to the fiscal deficit?

Prof. McKibbin—I am very explicit in my testimony against the stimulus package in the Senate in March or February 2009 and I made it very clear in my own writings at the time. The first stimulus package was perfectly timed and appropriate. The second stimulus package was, firstly, too large because it was, in my view, far too large given my view of what the world economy was going to evolve into. Secondly, the composition of that spending was designed in such a way that the flexibility that you needed, given the uncertainty that we faced, was not there. You were spending on things like school buildings and political spending, which had rates of return which were appropriate, but that could never be reversed if it turned out Australia was in a boom in 2010. They were my explicit arguments and I still stick to that. I was never against deficit spending. I was against the quality of the spending that was in the package and the scale of the increase in debt because it was not necessary given the information that we had at time.

Dr LEIGH—But you were quoted in the *Australian* on 26 May 2009 as saying:

> The danger is you add too much to the fiscal deficit—

Prof. McKibbin—That was in the context of a complete statement which included ‘to spend on programs which were wasteful’. I do not like being taken out of context by journalists, but that is the context. My written comments, which are on the record, are very clear on this issue and all of the public points I have made are well documented in the media and the academic literature.

Dr LEIGH—You have been a prominent commentator for a long time now in the Australian public debate. You have been on the Reserve Bank board since 2001—

Prof. McKibbin—And my term is about to expire.

Dr LEIGH—so over quite a period you have been one of the leading economic commentators in Australia. Did you speak out at all on the levy to fund the gun buyback?

Prof. McKibbin—No, I did not.

Dr LEIGH—What about the East Timor levy?

Prof. McKibbin—No, I did not.

Ms O’DWYER—I think we need to be clear on the East Timor levy. We keep talking about it, but it was never actually introduced.

CHAIR—I think the question was in relation to a commentary about a policy and I think that is fine in the circumstances.

Ms O’DWYER—I do not want to create a misleading impression.

Dr LEIGH—There is no misleading impression. There was a debate over the introduction of a policy—

Prof. McKibbin—Can I just respond to the question as it was asked? That is not a question of macroeconomic policy, per se. I am talking here about a macroeconomic shock, which was the flood, and subsequent other activities which have macroeconomic implications. My field of expertise is macroeconomics and climate change and that is where I comment. I do not comment, unlike many others, on areas that are outside my expertise.

Dr LEIGH—My characterisation of your testimony is that it very much focuses the issue of deficits rather than the appropriate level of taxation in Australia. Would that be a reasonable characterisation of your concerns?

Prof. McKibbin—No, my characterisation is focusing on the need for governments to smooth income and use borrowing and lending as a way of doing that.

Dr LEIGH—You made a comment briefly before—and I just want to clarify it a little—on the collection costs. You quoted a figure of 10 per cent on collection costs. It was not clear to me why the collection costs would be lower if it were to be financed by future taxation rather than current taxation. Can you explain that to me?

Prof. McKibbin—The figure of 10 per cent was just a number which I assumed was approximately what the cost of collecting taxes would be where there are lots of exemptions in the taxation bill. If you look at this particular bill, my understanding of the way in which the tax is levied is that it is not levied on all Australians; it is levied on a particular income group of Australians and it is levied on those who were not affected by the floods where that is defined in a particular way. I think this will have to be revisited, because there are people who were affected by floods that did not receive payments through the government agencies, and they are being used as the definition of being affected. I am sure that there are Queenslanders out there who had no insurance, who incurred significant damage and did not receive any assistance from the government. They will now be hit with the levy. Those sorts of cases will incur transaction costs in collecting the revenue and this must be greater than just using consolidated revenue, tax revenue, over time and will not require reprinting of forms and literature, or dealing with potential legal actions and a whole range of other complications that come into a tax bill which is full of exemptions.

Mr BUCHHOLZ—I appreciate your comments on the best policy being to borrow in this situation. I just want to expand the three options there: increasing tax, reducing government spending programs, or increasing debt, and what the impact on inflation would be. Would the impact for each be upwards or downwards or would there be no impact on inflation?

Prof. McKibbin—I would probably need to pull out one of my economic models to do the calculation precisely, but I would have thought that, if we financed it by reducing government spending by reducing demand in the economy, you would have a very small downward effect on inflation. By doing it through taxation and also reducing demand in the economy, probably depending on how that feeds through some wage claims—which is highly unlikely—it will probably have a downward impact on inflation. And by doing it through borrowing there would probably be no effect on inflation.

Mr BUCHHOLZ—I was not too sure about the tax, but I had a gut feeling that a reduction in government programs would put downward pressure—

Prof. McKibbin—Let me just qualify. It depends on the government spending that is cut. Some government programs over time can have reasonably high productivity improvements in the economy. So, if you are cutting programs which are going to reduce private returns at future dates, that has medium-term inflationary effects. So it depends on what you cut. The quality of the government spending is important when you are cutting government programs.

Mr BUCHHOLZ—Can we go to the quality of government spending? What is your view of the secondary stimulus that is still in the marketplace today which was introduced back in 2008?

Prof. McKibbin—My view is that there is excess stimulus still in the economy today, even though it is true that the amount of fiscal consolidation that we have seen from the package being introduced until today is historically unprecedented in Australia. I do not dispute that. There is fiscal consolidation in the design of the fiscal stimulus. Unfortunately, it is not big enough consolidation given the historically unprecedented terms of trade shock that we now face. It is true that the policy was designed with a fiscal consolidation idea in mind; I just think it was predicting the future that did not occur. If the policy was optimal in 2008 when the crisis was occurring—and we have discovered that the crisis was very different to what we thought—the policy should have changed in 2009-10, which is what I had been advocating in public.

Mr BUCHHOLZ—That is a fair enough comment—that there is a broad range of programs and there is isolating them out. Unless you isolate them, it is difficult to get an idea of which way the inflationary pressure would fall. If we look at the opportunity cost foregone on the $2.5 billion insulation program against the levy, how would that sit?

Prof. McKibbin—I understand there was a lot of waste in the program. I have not yet seen the cost-benefit analysis of the return to the insulation that was installed appropriately, so I am not in a position to give expert commentary on that. I was against that program because, if the goal was stimulus—not environmental enhancement but stimulus—the people you should be stimulating are the domestic producers and the installers, not importing large quantities of installation from overseas. Again, it is an empirical question. I hope that somebody is doing, as they should do in all government decisions, a very significant cost-benefit analysis, looking at a particular return to each of the activities. What concerns me about the government spending that has been cut out of financing the flood reconstruction is that I do not know what the return has been to those activities that have been cut. I thought the Solar Flagship Program was a very good idea in theory at the time and I thought the carbon sequestration research was a very good thing to invest in from a climate policy point of view, but I do not know what decision was made and where the cost-benefit analysis was done to take a program that was a good idea a few years ago and axe it immediately. I would like to see whether it is possible with those figures.

Mr BUCHHOLZ—In summary, the reduction in government spending will put downward pressure on inflation?

Prof. McKibbin—Yes.

Mr BUCHHOLZ—Thank you.

Mr STEPHEN JONES—In your opening comments you talked about a consensus amongst academic economists around the optimum way to fund natural disaster recovery. Without wanting to verbal you in any way, I think the force of your testimony was that the optimum way, in principle, is to do that by debt financing?

Prof. McKibbin—It is. I did not say ‘a consensus’; I said ‘most’. There is a big difference. ‘Most’ in economics means more than half.

Mr STEPHEN JONES—Would you agree with the proposition that the optimum theory of debt financing for disaster recovery may need to be qualified by the objective circumstances that appear around any given disaster?

Prof. McKibbin—I agree. I think that in my subsequent comments on questions I made the point that I am talking about particular theoretical concepts, and then I put them in the context of where the Australian economy sits today. I agree with that.

Mr STEPHEN JONES—Would you also agree that Queensland, the state that was most heavily hit by the natural disasters we have had, has unprecedented levels of private sector investment in the mining industry, which does not appear to be affected at this stage by the natural disasters?

Prof. McKibbin—We do, yes.

Mr STEPHEN JONES—We also have record low levels of unemployment, don’t we?

Prof. McKibbin—Correct.

Mr STEPHEN JONES—We also have a significant amount of public and private sector infrastructure investment going on, which is essentially creating capacity constraints at the moment.

Prof. McKibbin—Yes.

Mr STEPHEN JONES—Would you agree then that, given all of these objective factors, debt financing would carry the risk of adding to those capacity constraints in the context of these disasters?

Prof. McKibbin—Firstly, the numbers are very small, so the amount added to those constraints would be very small. I am arguing here on a matter of principle: when this becomes a big issue with a big shock, how should we think? If we think back to the decisions that are made today on this particular policy and if that guides our decisions because everyone says, ‘Well, we did it this way back in 2011,’ then we could be setting a policy framework which makes mistakes in future cases. I think the numbers are small enough that you would not see an effect of the magnitude that you are talking about from this policy.

Mr STEPHEN JONES—I agree with that in theory. If you move from the abstract and focus on the particular types of infrastructure that need to be repaired and rebuilt, there are, for instance, a limited number of civil construction companies out there who can rebuild roads.

Prof. McKibbin—But raising taxes or issuing government debt is not going to dramatically change the supply of labour in this industry. Taking people off school building projects that are part of Building the Education Revolution has a much bigger positive impact on supplying workers to rebuild Queensland infrastructure. So the relativities really do matter in this discussion.

Mr STEPHEN JONES—Okay. Thanks.

CHAIR—Thank you, Professor, for making yourself available today. As I said at the start, it was on very short notice and we really do appreciate your testimony here today. We will send you the *Hansard* transcript of your evidence. If there are any omissions or errors, please get back to the secretariat as quickly as you can. Thank you again for your contribution here today.

Prof. McKibbin—Thank you, Chair, and thank you to the committee.

[12.17 pm]

SANCHEZ, Mr Alex, General Manager Policy, Economics and Taxation, Insurance Council of Australia

SULLIVAN, Mr Karl Kanib, General Manager Policy, Risk and Disaster Planning Directorate, Insurance Council of Australia

CHAIR—On behalf of the committee, I welcome representatives of the Insurance Council of Australia to this hearing. I remind you that, although the committee not require you to give evidence under oath, these hearings are legal proceedings of parliament and warrant the same respect as proceedings of the House or the Senate. Giving false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. Thank you for coming along today. Are there some opening comments that you wish to make to this committee in relation to the inquiry?

Mr Sullivan—Yes. Thank you, Chair. They will be brief. Just as an outline, we are here representing the Insurance Council of Australia, whose membership in turn is made up of direct insurers and reinsurers operating in the Australian market. Those members provide private cover and, in some instances, cover to governments for particular assets.

Coming out of the flooding events in Queensland, there is $2 billion reserved at the moment to pay claims. That will grow over time. With Cyclone Yasi on top of that—as it stands this morning—there is an additional $500 million. There were 43,000 claims lodged for the floods and 30,000 claims for Cyclone Yasi. So they were considerable events from that perspective. The point to remember there is that that is Queenslanders, Australians, funding their own recovery by choosing a product.

We have issued a 10-point plan to improve that picture, to encourage further people to insure and hopefully at more reasonable rates. We have recently seen the government national disaster resilience strategy released over the weekend, which is a welcome development indeed, which again outlines many measures that will start to improve the risks in the community, the information about those risks and then how we might go about actually offsetting those risks, perhaps through financial instruments. All of that is geared towards the community being better able to sustain their own recovery, being more self-reliant.

We are not here to comment on the particular funding of this levy. Our area of expertise is in insurance, so we would like to particularly offer the opportunity to answer any questions you might have on what insurance options there are to fund this sort of recovery activity in the future. Some of the options that are used internationally are catastrophe bonds or parametric insurance. Parametric insurance is used in some very disaster prone regions where it is simply triggered by a predefined parametric trigger. For example, government might strike an arrangement or a contract with a global insurer to receive a certain payout if the wind gets above 200 kilometres an hour or floodwaters get above a certain height. That triggers an automatic payment of the agreed sum. There are no delays, no damage assessment, in fact no damage actually has to occur generally under those arrangements. It is simply an immediate payment of funds. And, importantly, if you strike that with global reinsurers, those are funds coming from outside Australia into Australia. So on the one hand we have the private insurance market being encouraged by government to ensure that the community and individuals in the community are able to sustain their own recovery. There are options of course going forward to fund government recovery operations in infrastructure. There is no doubt that with a flood event, particularly one of this magnitude, and other flood events the majority of damage sustained is infrastructure costs and a smaller proportion goes down to the private market.

I conclude by saying that our position is that we do not have a view on how this particular levy at this particular time should be funded. What would we would be keen to see is that in future this is not a precedent, that there are in fact some considerations given to how you might insure or reinsure those costs to prepare for that rainy day so that that funding can come at least in part or in full from the global market back into Australia.

CHAIR—Thank you for that. I will start off with some questions. The deputy chair was questioning the Queensland Treasury about why they did not have insurance on government assets. What is your view in relation to that?

Mr Sullivan—I think there is a difference here of how insurance might be defined in this context. I think most people when they think of insurance think immediately, as you have said, of insuring assets. Our particular remarks are going to how you might fund recovery activity. You may not be ensuring a bridge or a road or a particular building; in this context you would be funding yourself for the contingency funds that would need to flow. Then it would be up to you where you allocate them going forward. That might be to particular assets or it might be to community stimulus.

CHAIR—So do those sorts of options overcome the concerns that the Queensland government raised in relation to the insurance of roads, for example? They said that even if they had taken out insurance roads were not going to be covered.

Mr Sullivan—Those arrangements would; it depends on the deal you strike globally. If you strike a deal where you were simply insuring yourself for a certain amount of money to come in if conditions are met, it is then up to you how you spend that money. That might be allocated to roads or it might be allocated to bridges, for example.

CHAIR—Can you give the committee an idea of the sorts of costs that would be involved in providing that sort of cover?

Mr Sullivan—No, I cannot. I do not go into that. That is a discussion the state would need to have with global reinsurers, who would of course sit down and assess the risks, and the risks are present, as we all know. It would become a financial discussion between them.

Mr CIOBO—Mr Sullivan, I am interested in exploring this further, because you spoke of the desire to encourage insurance—and that is a desire that I share—and the need to be more self-reliant. We know that a number of the state governments took the decision to obtain reinsurance for a class of public assets but that the Queensland state government did not do that. Does this go to the core of what you are talking about in terms of sending the wrong message and arriving at a situation where you have government not practising what they preach?

Mr Sullivan—I think that is a matter for the state government to discuss. To draw a parallel, if we created a situation in the private market where it became apparent that you did not need to insure your property and your assets because there would essentially be a community bailout if a situation occurred then that would not be a positive outcome for Australia. You have to go into the economics and the feasibility of that type of cover. Our position is that you need to sit down and have a serious look at whether it is in fact feasible.

Mr CIOBO—Are there insurance products available on the market today that would cover the public costs that are being borne in this situation?

Mr Sullivan—There are examples internationally in far more disaster prone areas—for example, in parts of the Caribbean and in Alabama in the US—where they have taken out these products to fund their own recovery efforts. In many cases those would not fund 100 per cent of a recovery effort. That would be a matter of how much appetite for risk the state has, how much they want to push out to global reinsurers. There are certainly products available. They are highly configurable, and you can accept as much or as little of the risk as you like.

Mr CIOBO—So we are not reinventing the wheel here. The reality is that there are other governments in other jurisdictions that have purchased parametric insurance—as I think you called it—to cover exactly the kinds of recovery costs that are the subject of this new flood tax.

Mr Sullivan—Yes. I would still classify them as relatively innovative approaches to insurance but they have certainly been around for more than a decade.

Mr CIOBO—So for over a decade there have been products available to meet the costs of recovery.

Mr Sullivan—Yes.

Mr CIOBO—In terms of the decision not to take out this reinsurance—and you may or may not be able to comment on this—Queensland Treasury officials made it clear to us that part of their consideration was the standing agreement between the Commonwealth and the state vis-a-vis the costs of recovery. I think they said a range between 25 per cent and 75 per cent is borne by the Commonwealth based on the intensity of the disaster. Is this basically an issue where, because the Commonwealth is picking up the tab, the state government has not bothered purchasing the product?

Mr Sullivan—In some respects you could argue that the arrangements under which that is done is an insurance policy for individual states. Our position is that perhaps this presents an opportunity to look for a better mix that encourages state governments to rely less on other governments and less on the particular arrangements.

Mr CIOBO—In this case, the Queensland and even the Victorian state governments' insurance policy is the Commonwealth, effectively. Is that what you are saying?

Mr Sullivan—That is a matter for the individual states. I am not familiar with their precise levels of insurance or in fact what they cover.

Mr CIOBO—Sure, but I am paraphrasing what you are saying. You are basically saying the Commonwealth comes in and pays the cost of recovery. That is effectively the states' insurance policy.

Mr Sullivan—It certainly contributed to the decision making around how they might manage their financial risks going forward. In some respects, you might equate that to or mutual fund arrangements that canegrowers get into to share their risks.

Mr CIOBO—Isn't the key difference, though, that in this situation the Queensland state government is not paying a premium to the federal government, whereas they would in the private marketplace?

Mr Sullivan—They would certainly, if they took out private insurance, be required to pay to offset that risk.

Mr CIOBO—It is a pretty big carrot for the Queensland state government, therefore, to go with a quasi-Commonwealth-bailout-fund rather than use the private market, isn't it?

Mr Sullivan—That is a matter for the Queensland government and the federal government.

Mr CIOBO—You also spoke about not wanting to set a precedent through, effectively, a community bailout fund. Do you think we run a risk, where the Commonwealth has this 'mateship tax'—as I think the Prime Minister referred to it—of seeing fewer people take out private insurance because of the belief that in some way the Commonwealth or the state government will step in and help pick up the tab?

Mr Sullivan—I think the government has been particularly clear about what this levy will go towards funding and that is infrastructure, not the rebuilding of private homes. I think that message has been clear enough for the community and that they would understand that they still need to be reliant, they still need to be able to refund their own recovery going forward. We are hoping that the community dialogue also extends to the situation where, if those costs increase, because the risks are increasing, they will take appropriate steps to reduce their risks into the future—for example, building a little bit smarter in a better location so that they are less vulnerable to the risks. My reason for raising that is that government taking out a parametric insurance product or a cap on product would require them to pay a premium. That premium would be related directly to the risks they are exposed to and therefore there is an incentive for them to start managing their risks in a downward fashion through better mitigation and better policy decisions.

Mr CIOBO—That has not happened?

Mr Sullivan—They do not purchase that type of product presently. Certainly, where they insure individual assets, the assessment of the risks of those assets would be directly related to what mitigation they put around those assets.

Mr CIOBO—The precedent that you referred to in your early testimony was in relation to what? You spoke about not wanting to set a precedent.

Mr Sullivan—If a precedent is set by government where there is confusion in the community about actually having to take out that private cover then you could end up with fewer people taking out the cover, fewer people being able to fund their own recovery and a greater reliance on the taxpayer. That is a difficult issue and one to keep in the front of your minds as you go forward with these policies. I do think, however, the government has been very clear that this levy is not about funding personal recovery.

Mr STEPHEN JONES—If I could take up the issues Mr Ciobo asked you about. I think he was getting to underinsurance in a couple of the questions. It is true, is it not, that nationally at any rate the underinsurance in relation to buildings themselves is rather low.

Mr Sullivan—It really depends on the event that occurs, where it occurs and how large the event is. Underinsurance can be driven by a range of factors. In an event such as a flood event where you have total loss of properties you can find some underinsurance where the rebuild costs spike because of that particular period, because of supply and demand.

Mr STEPHEN JONES—That is because they have undervalued the cost of repair?

Mr Sullivan—All of the costs of the repair have actually shot up as a result of the particular event, only to come down some years later.

Mr STEPHEN JONES—But in terms of the number of buildings which do not have any insurance cover it is less than five per cent?

Mr Sullivan—I will leave that to my colleague.

Mr Sanchez—That is right. We can only draw from the Household Expenditure Survey and it is around four per cent nationally.

Mr STEPHEN JONES—Contents insurance?

Mr Sanchez—A bit higher—considerably higher. It is around 23 per cent. It is still 200,000 homes, so it is not an insignificant number of homes that have no building insurance.

Mr STEPHEN JONES—Do you have any evidence to suggest that in Queensland the pattern is out of step with those national averages?

Mr Sanchez—No, not at all. Again, from the Household Expenditure Survey, it is around 34,000 homes in Queensland.

Mr STEPHEN JONES—All the evidence that is available to your organisation, as the peak organisation representing general insurers and others, is that there is no greater or lesser insurance coverage for private dwellings in Queensland than there is anywhere else?

Mr Sanchez—It is pretty even across the board.

Mr STEPHEN JONES—There has been some debate about definitions of flood coverage. I anticipate that those debates will move to this place pretty soon. It is true, is it not, that this is not a new debate in Australian politics?

Mr Sullivan—Not at all. It has been longstanding. The essential problem is that, prior to 2006, you could not insure for riverine flood whatsoever anywhere in the country. The industry made a decision at that time to change that. The two ways of changing that are to, firstly, clarify what you are actually covering, by producing a standard definition and, secondly, developing the risk data so that you can put a price on individual properties and the level of risk that they carry. We made application to the ACCC to employ a standard definition. Unfortunately, that was rejected around concerns about the wording itself. At the same time, the data was being developed—

Mr STEPHEN JONES—At what point in time was that application made to the ACCC?

Mr Sullivan—2007. At the same time, the insurers started to develop the data that would be required to actually underwrite the risk. Those two processes—standard definition and data—were running in parallel. When we were no longer to employ the standard definition, parts of the industry were in a position to start underwriting the risk using their own definitions. Having said that, most of the definitions in use across the industry are remarkably similar. We are now in a position where every single property in Australia has a choice of flood insurance from some providers of insurance. Not all insurers will provide flood insurance. There is an issue there about potential disclosure and how people understand that going forward.

Mr STEPHEN JONES—You say there is no gap within the market, however some insurers may decide not to offer a certain product—is that right?

Mr Sullivan—Absolutely. There is no market failure in flood insurance for riverine flood. You can get it regardless of where you live. Most companies will base it on your risk. For example, if you live in a highly risky location, you will pay more for flood cover if you choose to have it than if you live somewhere relatively free of that particular risk. So it is available in the market and it has been for some years now, and has been heavily advertised. Our experience in flood zones is that consumers who are aware that they are in a flood zone generally do seek out flood cover and take out the cover. It is a little too early to tell how far that has gone for this particular event, but we expect that towards the end of the month we will have some data around that point. There is a small element of people know who for whatever reason—potentially that they did not understand that they live in a flood zone, that they did not understand the product or that they have not researched it appropriately—have chosen a product that on its face does not cover the flood risk.

Going back to standard definition, the industry has announced that it is willing to embark on a standard definition discussion with government and that is quite well advanced at this stage.

Mr STEPHEN JONES—I think we will have bipartisan support. My understanding is that as early as 2001 the then Treasurer Mr Hockey made an in-principle policy statement that we should have a standard definition for flood insurance in this country.

Mr Sullivan—I would urge all of you not to think that the inclusion of a standard definition would have changed the situation that we are currently in. If a standard definition had been introduced in 2006, it would still be the position now that some insurers would not offer the cover because it is beyond their risk appetite. It is an extremely difficult risk to underwrite. It costs around $400 million to $500 million annually, and it is focused on around three per cent of properties exposed to the risk. When you have $500 million over three per cent of properties, you get into an area where it is difficult to commercialise a product for those areas. It can be done and it has been done by some insurers. The key to producing more flood product in the market—giving even greater choice to consumers—is to get the mapping right which we see purely as the government's responsibility. That then also helps government communicate the risks through to individuals so that they are more aware of what they are facing and more inclined to take appropriate steps to protect themselves.

Mr STEPHEN JONES—What level of government do you think is best placed to collect and provide that data to the insurance industry?

Mr Sullivan—I stress that they would not be providing it to the insurance industry; they would be providing it to the community.

Mr STEPHEN JONES—To the public at large.

Mr Sullivan—Yes. Certainly the insurers would look very closely at whatever government data exists. There is a great deal of good government flood data available at the moment but it is patchy, some of it is old and some of it is difficult for us to obtain. As to your question about the level of government, at the moment most states approach it by delegating it to local government. That presents a difficulty for other users of the information at a national level who then need to go and negotiate with individual local governments right across the country. Our view is that this is national infrastructure and that it should be done centrally and federally with the cooperation of the states so that for the first time, much like they have done in the US, all Australians can get access to high-quality flood mapping that properly informs them of their risks.

Mr STEPHEN JONES—You are not suggesting that the Commonwealth should duplicate a role that is currently undertaken by local governments for planning and other purposes to collect and research flood and related data?

Mr Sullivan—I am not suggesting that they should take over the planning roles, because there is nobody better to do that than those familiar with the local circumstances. But there are core data sets—for example, elevation modelling and flood modelling—that can be made use of right across the country.

Mr STEPHEN JONES—I want to ask a separate series of questions. I believe I understood you to say in your opening statement that the industry sees some merit in some form of national disaster insurance scheme. Have I heard you correctly on that?

Mr Sullivan—No, that is not our position. We would see merit in some form of globalisation of the risk, if you like, through a greater reliance on the global reinsurance market by governments.

Mr STEPHEN JONES—What do you think the role of government is in facilitating that?

Mr Sullivan—Facilitating the discussion with insurers?

Mr STEPHEN JONES—Facilitating the globalisation of reinsurance risk.

Mr Sullivan—I am not exactly sure what you mean by that. I think the role of government is to manage their risks appropriately and to look at their liabilities each year. There are various inputs to those risks; for example, climate change, forecasts and the experience of your claims in the last year. I think the core responsibility is to manage those financial risks going forward. One of the clear things that could be done to better assist that is to look at how you might place those risks or liabilities externally to Australia.

Mr Sanchez—There is the instrument of the national disaster relief guidelines that are available. They are essentially a COAG instrument. There is the opportunity to use those arrangements to look at better ways of, if you like, globalising the reinsurance risk. One such way could be to have an independent agency, such as APRA, examine state government reinsurance arrangements. APRA examine the private sector arrangements and there are guidelines for that.

This is not unusual; the Obama Fiscal Commission actually recommended the idea of local authorities—in their case, state governments as well—examining reinsurance arrangements and offloading it that way for very much the same reasons we experience here, that the federal agencies often have to step in and assist state governments in the US, particularly those who are in the disaster zones, such as with Katrina, Andrew and the like.

Ms OWENS—In my community, and in most communities, private housing, in particular, which is in flood prone areas is quite cheap. In my area it is about $150,000 less than two blocks over. It is quite often bought by people who can afford that and usually rented by people who cannot afford to rent anywhere else. So when you talk about insurance costs being quite high in those known flood areas it is quite problematic from a social policy perspective. Do you have a view on that, or any possible answers?

Mr Sullivan—Absolutely, and I should say that I have walked through some very expensive properties in flood prone areas as well. It is quite a mix.

The answer to that is threefold. Firstly: competition. Those consumers need to have a choice, and where there are a greater number of choices of provider of the flood insurance you will find that competition starts to keep those costs low. The second tier is that they actually have to know that they have a flood risk. Many in the community do; the longer they are in the community, the better the chance that they will have it. The more mature and sophisticated their local government is at sharing knowledge about those risks, the more likely they are to take the right steps and either take out a policy or, in some cases, self-insure, or have a flood plan where they remove all their belongings at the start of a flood. It is critical that governments communicate that information to them.

Thirdly is the data; it needs to be there and it needs to be sufficiently accurate that local, state and federal governments can communicate the risks. They can take out appropriate fiscal instruments themselves to fund recovery. And lastly, the private market can see the same risks that government see and can configure themselves appropriately. Affordability will be an issue; insurance is a grudge purchase—nobody likes to part with even a dollar to buy it—but it is a necessity in a modern economy to be able to fund your own recovery. The way to keep the costs down, though, is through better competition and better information.

Mr Sanchez—One of the challenges for the industry and the community is the lower-income quintiles that disproportionately do not insure. That often results, when they do suffer a loss, in them finding it hardest to recover, for obvious reasons, and governments are faced with stepping in to provide reasonable assistance. The affordability question can also be tackled by looking at how some of the states and territories undertake taxation of general insurance products. The Henry tax review recommended those be removed. Unfortunately, it is a very unspoken recommendation—no-one quite wants to grapple with the challenge—but surely, when you have fire services levies in the case of New South Wales for example, in your electorate, where they can add up to 20 per cent on the cost of a policy and then you have the cascading effects of the GST and stamp duty that can add up to one-third, you are dealing with a situation whereby someone is buying one hundred bucks of policy but only getting 70c worth of cover. It is one of those issues that really should be examined strongly in the context of the current disaster. How do we change the mix of taxation away from general insurance?

Mr Sullivan—One additional point to affordability, as well, is that as the risks continue to grow and the value of assets continue to grow, and those risks are not mitigated, you can expect that premiums will increase. Something that needs to be refocused upon by government is mitigating those risks. The first step towards mitigating those risks is understanding where they are and being able to prioritise where the public dollars are going to be spent to build flood levees or to change building codes so that people cannot build a risky asset in a risky location. That comes back to data and government responsibility to understand the landscape and set appropriate policies around the management and use of the landscape so that these risks do not grow and the vulnerabilities do not continue to concentrate as they are in Australia.

Ms OWENS—With the government rebuild for Queensland, an expenditure of $5.8 billion and the additional state rebuild—I know you do not have a complete figure—do you have a sense of the private rebuild from insurance payouts?

Mr Sullivan—We are currently sitting at $2 billion. We do not have a sense of how far out that will go but it is going to grow. There are people who have purchased products that will not cover the risk, and the processes to appeal those decisions et cetera are well advanced now. The $2 billion is where it currently sits: 43,000 claims. I would expect that we would be approaching a final figure some time in the next three months if this follows the normal trajectory of a catastrophe event.

Ms OWENS—Do you have a sense of how much is lost and how much is just not insured and will not be rebuilt?

Mr Sullivan—We do not yet. There will be an element of the community that is not insured at all, which does not hold a policy, and the Queensland government will be in the best position as they go through their relief process with the Premier’s fund to determine how many applications are made on the grounds of not having insurance cover.

Ms OWENS—There is quite a generous discussion going on in my community about insurance and the fact that if a flood comes through my suburb there will not be an army of people helping. So there is a difference in the way people are treated, whether they are insured or not. There is quite a discussion in my community about insurance generally and people’s obligation to have it. Do you see evidence that people are starting to think that if they are involved in a catastrophe they will receive great assistance from outside? Is there that unintended consequence?

Mr Sullivan—There is, and Alex might be better placed to answer this, but generally the bigger the event the greater the expectation is that we understand the community will rally and provide assistance.

Ms OWENS—And they do.

Mr Sullivan—Yes, but certainly, I do not think there is a growing sense in the community that they can rely entirely on that. Even the best intentions of volunteers coming into a community are that they are not going to rebuild the house. They are not going to replace everything. But most losses are not during a catastrophe. Most losses are the single house burning down in the middle of the night; the single house being broken into or those smaller events. There are no volunteers available to come and help then. You are completely on your own to fund your own recovery. Did you want to add anything, Alex?

Mr Sanchez—That is a very good question. Insurance is essentially the most mutual obligation product that one can buy. One of the questions we have been asking ourselves is: in the government assistance are there ways of introducing mutual obligation arrangements for those who do receive assistance, because the assistance is quite measured and it is modest? From recollection it is $1,000 per adult and $400 through the Centrelink arrangement. As Karl makes out it does not at all compensate you for the loss of the property. It is essentially an adjustment mechanism, as it should be.

The question that we have been asking ourselves is: is it possible to introduce an arrangement where you encourage a financial literacy component in exchange for the assistance? We have other sorts of mutual obligation arrangements, if you like, for other styles of insurance arrangements; for example, those offered by the state through social transfer payments. We say to those who are unemployed, ‘In exchange for loss of income insurance you have to do these sorts of activity test,’ or these sorts of things. We see that clever hands could apply themselves to similar types of arrangement where they do provide some sort of financial literacy.

One of the weaknesses, we believe, is that financial literacy tends to have a component, which is transaction accounts, credit card accounts and the like. But if we are in a rapidly changing climatic condition and these sorts of events are becoming more common—and we have seen over the last half decade that that is the case in Australia—then maybe we need to upsize it and think about general insurance literacy.

CHAIR—We had a discussion earlier from the deputy chair about the Queensland government’s decision to self-insure. They are not the only level of government that has made that choice over time, are they?

Mr Sanchez—I am not aware, but from the press reports—I am not that much of an economic historian—that is the case. But as we said there are products on the market now that allow people to examine the opportunity cost of, in effect, self-insurance.

CHAIR—In 2007 Joe Hockey, I think, was the minister who chose to do exactly the same thing in relation to the Commonwealth for exactly the same reasons. So your point is that it is an issue for government to be looking at generally, isn’t it?

Mr Sanchez—That is right.

Mr CIOBO—[inaudible] self-insure with a very significant budget surplus, do you think?

Mr Sullivan—That is clearly a factor. You have got to look year to year, as a private citizen does, about how much risk they are willing to place with someone else or how much risk they are willing to retain. If you are flush with cash that may change that equation.

Mr CIOBO—It is not a particularly controversial statement. I know it might seem controversial, but it is not a particularly controversial one. In the brief time that Treasury were before the committee they made it very clear that natural disasters cause an erosion in the budget bottom line. They made that very clear. So it is not a controversial statement.

Dr LEIGH—You mentioned before the impact of financial literacy programs on decisions to purchase insurance. Do you see raising financial literacy as being important to ensuring that Australians are properly insured?

Mr Sanchez—Yes, but I think we have a fairly instrumental view of financial literacy. There is an argument that says perhaps we ought to examine more closely how communities understand risk, irrespective of the nature of risk. With financial literacy, far from being as instrumental as I have just described it, how do we provide it, how do we resource it and how do we increase the capability of Australians to understand risk, whether it be retirement risk, property risk, personal injury risk and the like, and how much you ought to bear yourself and how much you are prepared to offload to others.

Dr LEIGH—I take your point about making sure that financial literacy includes risk. If we were to scrap, say, a program that raises financial literacy in schools in order to pay for flood rebuilding, could that have an adverse consequence on what happens in the next crisis? Could it lead to young Australians being less able to take out appropriate private insurance?

Mr Sanchez—I do not want to get into a debate. It is not for me or the insurance industry to debate what programs ought to be cut within government; that is matter for the parliament. Suffice to say, it does not make a lot of sense to educate young people at school about private property risk because at this stage most of their purchases of insurance revolve around the private motor vehicle. How to get them to understand the concept of risk is different. So it is horses for courses. We have done some work on this. We piloted a program with the Smith Family—coincidentally, in South-East Queensland—and we had about 220 people who undertake financial literacy education through the Smith Family programs. We developed a general insurance module and ran a pilot through that. It was very well received. We had it independently reviewed. Like all the financial literacy programs, what is the result three or four years down the track? Researchers are still turning their minds to how to measure behavioural change. We have not got there yet.

Dr LEIGH—Financial literacy is an important part of making sure that people are adequately insured.

Mr Sanchez—Absolutely.

CHAIR—Thank you for your contribution. Hansard has taken a record of the proceedings today, and you will get a copy of that *Hansard*. If there are any errors or omissions, please get them to us as quickly as possible. Thank you again for your contribution today.

Mr Sanchez—Thank you very much.

Proceedings suspended from 12.57 pm to 1.46 pm

PISARSKI, Mr Adrian, Deputy President, Australian Council of Social Service

CHAIR—Welcome. I remind you that the committee does not require you to give evidence under oath and that these hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House or the Senate. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament. Thank you for making yourself available at very short notice. We do appreciate that. Would you like to make an opening statement?

Mr Pisarski—Yes. We think the levy deserves to be supported for a couple of reasons. The first reason is that it is a progressive levy. We like the progressive nature of the levy. It actually has a much greater impact on high-income earners than it has on low-income earners. In fact, low-income earners are exempt, which is a good thing. Secondly, we believe the levy deserves to be supported because it keeps pressure off other cuts that might need to be made if the levy were not available to provide money for flood recovery. One other very serious area of concern we have in relation to the whole package is the cuts to the National Rental Affordability Scheme. We think that those cuts were unnecessary, short-sighted and have undermined confidence in a scheme which is just at this time gaining considerable momentum with the investment community in terms of developing affordable housing options for low-income Australians.

CHAIR—If the government took a different approach and said it was going to find the money from savings, what concerns would you have in terms of cuts to the budget?

Mr Pisarski—We would be particularly concerned about any cuts to income support payments or other welfare programs that support low-income households. Our principal concern is that government may seek to find money from programs that are really essential to support people who are already doing it tough. We do not need to compound the misfortune of people in flood affected areas—and I live in Queensland, so I am very familiar with those—by making other low-income Australians pay for that recovery cost.

CHAIR—Do you have any comments or observations on the way in which Centrelink has responded to the crisis in Queensland?

Mr Pisarski—I think they have done an excellent job in terms of making payments available, in being available at the evacuation centres, in being on the ground and in delivering much-needed assistance as quickly as possible. That has been very good. There have been some issues raised with that, but overall it has been very welcome.

CHAIR—What issues were they?

Mr Pisarski—Some people have complained in the media that they have not received a payment as quickly as they could have. Other people have complained that some people who were not eligible have received payments. But I think to err on the side of generosity at a time like this is the right thing, and I am sure that other processes will track down fraud over time and recover it.

Mr CIOBO—Is it your view that, because of the progressive nature of our tax rates at the moment, people with a higher income already pay a greater proportion of tax?

Mr Pisarski—Sorry, I did not quite hear the last bit of that question. Do you mean they should pay more?

Mr CIOBO—No. Given that we already have a progressive tax system, don't people who already have a higher taxable income pay more tax?

Mr Pisarski—They do, but I would point out that the progressive nature of the tax system has been reduced over time. It has been more progressive in the past and significantly so.

Mr CIOBO—Do you mean tax rates have become flatter?

Mr Pisarski—Yes, indeed; tax rates have become flatter, and therefore the burden has disproportionately fallen on lower-income folks over time as opposed to higher-income people.

Mr CIOBO—When you say that burden has fallen on lower-income taxpayers do you mean they have not enjoyed as much of a tax cut as others have?

Mr Pisarski—Higher income earners have enjoyed greater tax cuts then lower income earners.

Mr CIOBO—In percentage terms or in income terms?

Mr Pisarski—I think in real terms and percentage terms, and I am thinking of the last 15 or more years.

Mr CIOBO—I am probably digressing a little into marginal tax rates, so let me leave it at that. In terms of the impact of an increased tax take from government would you agree that the more tax government takes, the less disposable income there is in the community and therefore the lower the aggregate demand?

Mr Pisarski—Not necessarily.

Mr CIOBO—What is your take on that? Do think there is a way to tax ourselves into prosperity?

Mr Pisarski—Taxes are both taken from people's incomes and distributed to other people as income support, so the distributional aspects can balance and counterbalance the amount of money that is taken from people. I do not think it is true that it necessarily always reduces across the board the level of disposable income at a household level across Australia.

Mr CIOBO—Even though government takes X per cent tax, it loses the impact of some of that as a result of the transaction cost and then pays out a lesser amount. Do you think that is not going to have an impact on aggregate demand?

Mr Pisarski—I am not exactly sure what you are getting at.

Mr CIOBO—If we were to follow the logic that the imposition of tax is not a bad thing, at what point does the imposition of tax become too great and actually impact on aggregate demand? My contention is quite straightforward: the less tax the better. We balance that against social demands for there to be a safety net and a health system and those kinds of things, which of course imposes a base level of tax that is required. But, in my view, every new tax on top of that reduces aggregate demand. I am just wondering whether you agree with that or disagree with that.

Mr Pisarski—I think I would have to say I disagree with it.

Mr CIOBO—In terms of fiscal stimulus and the government's fiscal position, we know that the Reserve Bank has put very clearly on the record its view, which is that, as a consequence of the government's fiscal stimulus, interest rates are higher than they would have been. I am not verballing the governor; he actually said that. Do you think that this new tax is an important way that government can help to reduce the overall level of demand and therefore keep interest rates down?

Mr Pisarski—I see this tax as a means of paying for a recovery effort in flood affected states. I do not perceive a deeper or alternative strategy behind it. I think it is merely a means of saying there is a cost that has been incurred because of the destructive power of the environment, which has to be paid for in some way, and they have sought a potentially simple way of finding that money to pay for that recovery.

Mr CIOBO—But we have had natural disasters before. In 1990 we had floods in Queensland and New South Wales that saw over 2,000 homes inundated; in 2006 we had Cyclone Larry, with a damage bill of around $1.5 billion; and in 2009 we had the tragic situation of Black Saturday, which saw over 2,000 homes destroyed and some 7½ thousand people displaced. We have never imposed a levy—or, rather, a tax—to pay for those recovery efforts in the past. What is different this time?

Mr Pisarski—I am not sure there is a difference but, just because we did not do something previously, does not mean we should not do it now.

Mr CIOBO—Okay, so that is a very good point. This gets back to what I was asking you before about the imposition of a new tax. We could impose myriad new taxes—indeed, the current government plans to impose myriad new taxes. What is it, given that it is only raising somewhere between $1.6 and $1.8 billion, that in ACOSS's view warrants the imposition of this new tax? And why is it ACOSS's view that it could not be funded out of current government expenditure?

Mr Pisarski—ACOSS believes that limiting government's ability to call on expenditure cuts is a good thing at the moment. That is why we support the levy: we do not want those cuts into welfare payments or programs or other things that support low-income Australians. Low-income Australians are doing it tough enough as it is; they do not need to be exposed to the potential of further cuts. So, in that sense, when you need to find money, it is not unreasonable to raise it through applying a levy of this sort.

Mr CIOBO—What if the alternative was just less waste? For example, we have seen the government waste literally billions of dollars on their failed pink batts scheme, on massively bungled projects such as the Building the Education Revolution, on the Green Loans assessors programs et cetera. I think on the last count, actually, under this government we have seen well in excess of $6 billion of money that in no other way, shape or form could be described as anything other than waste.

CHAIR—It is a political statement being made here. I am sure there is a question coming somewhere along the line.

Mr CIOBO—Yes, it is coming right now. My question is this: is it ACOSS's preference that this funding be achieved through reduced wasted spending and not the imposition of a new tax? Or is it your view that there is actually no fat to trim in the budget that does not impact on the poor and therefore we should have this new tax?

Mr Pisarski—ACOSS has been responding to calls from others, like the Business Council of Australia, who have been reported as calling for cuts in welfare programs. So our position is partly to defend against the views of others who believe welfare programs could be cut.

Mr CIOBO—Sure, but I am asking about waste.

Mr Pisarski—It is your assertion about that waste. I do not have that statement in front of me. If you are talking about waste that was historical then presumably that has already happened. We are talking about expenditure going forward, not looking at theoretical waste from the past. We are talking about where we are now and what measures are appropriate from now into the future. We are saying that, to protect low-income earners, we believe the levy is justifiable.

Mr CIOBO—In terms of servicing government debt, which we know is now back at around $80 billion, which costs billions of dollars a year to service, could that have been another alternative? If we were not spending all that money on servicing debt we could have had more money available to respond to this kind of disaster, for example.

Mr Pisarski—You are asking me to speculate on what else government might have done. I am trying to say that we support the levy decision.

Mr CIOBO—So you support the tax regardless?

Mr Pisarski—ACOSS has consistently called for reviews of the Australian tax system that would potentially increase the level of taxation across the board in Australia rather than reduce it. Our general position is that Australia is a low-taxing country. We also have low levels of debt. Therefore we think that it is a supportable proposition that taxes could be increased.

Dr LEIGH—There has been a bit of discussion about debt today. I want to put some of that in context. I wonder if you can talk us through what the impact would have been had the federal government not put in place fiscal stimulus and brought down the unemployment rate by about two per cent over the 2008 to 2009 period. What would have been the human impact of that?

Mr Pisarski—We would have seen much higher levels of hardship, particularly for low-income Australian households. Unemployment would have been much higher. Many more low-income households would be affected earlier than higher income households in that scenario. Homelessness would have increased as a consequence. There would have been, we believe, all sorts of consequences of the government not providing that stimulus over time. That stimulus was essential to keep the Australian economy moving in a positive direction. That view seems to have been borne out by the economic figures over the last couple of years.

Dr LEIGH—When we are talking about who is going to pay the flood levy, we are talking about the share of taxpayers. We have heard this morning that around half of taxpayers will pay the levy. But not all adults are taxpayers. What do we know about the adults who are not taxpayers? Where do they tend to fall in the income distribution?

Mr Pisarski—Adults who are not taxpayers generally have an income below the level of where they should be paying tax or are extremely high income earners who avoid tax through various schemes that are available to high-income earners, such as through family trusts and other measures. We would have also preferred a re-examination of things like family trusts and other trusts that are currently used by predominantly high-income earners to avoid paying tax. I would describe people who do not pay tax as either being too poor to pay it or rich enough to avoid it.

Dr LEIGH—Your point on avoidance is well taken. But in aggregate what would you say about the incomes of non-taxpayers?

Mr Pisarski—In aggregate, they are generally low-income earners. I am not exactly sure where you are trying to go with the point.

Dr LEIGH—Sorry. I take the point that there may well be some high-income tax avoiders. But surely it must be the case that the vast majority of non-taxpayers are low-income earners.

Mr Pisarski—Indeed.

Dr LEIGH—ACOSS represents the poorest people in Australia. From that perspective, can you tell me which strategy you think would be better in terms of paying for rebuilding after the flood: cutting back on doctors, school building expenditure and financial literacy programs for kids or putting in place a progressive levy?

Mr Pisarski—Putting in place a progressive levy is far preferable to cutting programs that affect low-income households.

Mr BUCHHOLZ—With reference to your position on the levy—a position supported by the fact that you do not want to see any cuts to welfare—can you highlight some of the concerns that you have about where those alleged cuts will be?

Mr Pisarski—The concern that we have particularly is around any welfare payments that might be cut, income security payments to low-income households that might be reduced or any cuts to welfare programs that support low-income Australians.

Mr BUCHHOLZ—The Prime Minister put out a statement outlining the bill. I do not recall seeing any areas that have directly led to cuts in welfare. Do you have a conflicting opinion?

Mr Pisarski—There is one area where-low income earners have been affected, and that is the capping of the National Rental Affordability Scheme. The National Rental Affordability Scheme is particularly directed at low-income working households to try and mitigate their inability, I guess, to get rental in the private rental market and to provide a scheme which is available to low- and moderate-income households, which would mean that they rent their properties at 20 per cent below market. There has been a capping of that scheme within the levy package, which we do not support.

Mr BUCHHOLZ—It is very noble that you will bat for your people. It is a good organisation. Could you expand on what your position would be on the carbon tax, on the ETS. Allow me my line of questioning.

CHAIR—I am not sure that is—

Mr BUCHHOLZ—Allow me; otherwise just shut me down again.

CHAIR—Can you tie it somehow to what we are actually doing here today?

Mr BUCHHOLZ—Yes. I will try and phrase it a different way. Can you mention a single occasion when ACOSS may have been in conflict with any Labor policy?

Mr Pisarski—There have been many occasions where ACOSS has been in conflict with Labor policies. We have consistently criticised Labor policies. I do not have a specific example to give you, but there have been many occasions while I have been involved with ACOSS over the last 25 years. There have been various capacities in which ACOSS has been critical of all types of governments, not just coalition governments but, indeed, Labor governments—many occasions. I could go back and find specific examples if you want.

Mr BUCHHOLZ—That is all right, but none come to mind?

Ms O'DWYER—Could I assist. I think I understand the point you are getting to, Scott, in relation to the carbon tax. Your testimony before us today has talked about the impact of cost of living and the impact on low-income Australians. It goes to that evidence to ask you: what is ACOSS's view on imposing a different sort of tax—not a flood tax but a carbon tax—that they will have, potentially, a much more significant direct impact on those low-income earners? It is quite useful for us to understand your opinion on that issue.

Mr Pisarski—I have been on the board of ACOSS for three years. I am not sure that we have a firm position on a carbon tax. We have not seen any formal proposal around a carbon tax. There have been emissions trading schemes proposed, but I have not seen a formal proposal around a carbon tax—

Ms O'DWYER—What is your view on an emissions trading scheme, then?

Mr Pisarski—where I could say that the ACOSS board has formed a position.

Ms O'DWYER—What is your view, then, on an emissions trading scheme, if you have formed a view on that? I am interested in your view because it obviously goes to low-income earners.

Mr Pisarski—The position that ACOSS has consistently promoted around things like the emissions trading scheme is that there would need to be protection of low-income households if there were increased costs for energy, for example. So our position is always about protecting the interests of low-income earners, not necessarily supporting or otherwise government positions. It is about protecting the interests of low-income earners and advocating on their behalf.

Ms O'DWYER—So you would be concerned about a tax that affected low-income earners?

Mr Pisarski—If it were disproportionate on low-income earners, I would be concerned. We are talking about a theoretical tax, which is not really in the scope of the levy.

CHAIR—Has Scott finished?

Ms O'DWYER—I was just pursuing the line of questioning on the carbon tax.

CHAIR—I appreciate the assistance that was given, but we seem to be going a little bit further than that and I am not sure whether you—

Mr BUCHHOLZ—I hope you get the drift of what I am saying: the catalyst of not supporting—

Mr Pisarski—No—you are trying to point out a contradiction in my position and I am saying that there is not one.

Ms O'DWYER—I would like to explore that. I do not think it is actually clear to us that there is not a contradiction. You have said that, if it is disproportionately—

Mr Pisarski—The position in both cases is that we are trying to protect the interests of low-income households. I think that is entirely consistent.

Ms O'DWYER—Sure. So you would not want to see a tax imposed on low-income earners? That is not a hard question to answer.

Mr Pisarski—It is a theoretical proposition. I would always want to wait and see the detail of any carbon tax or other tax that was going to be imposed and what the range of it was. It might be an extremely progressive tax, for example, which we could potentially support. It might be a regressive tax which we would probably generally oppose. Until I know the detail of it, it is impossible to comment.

Ms OWENS—Can I talk a bit about the impact of the flood and the way people are handling the rebuilding process, particularly people who did not have as much stored capacity to deal with adversity as others—people for whom a couple of weeks off work was devastating, people who did not have insurance, people who were renting in flood areas et cetera. Apart from the rebuilding cost, which is what we are essentially talking about at the moment, there are other forms of rebuilding. Would you like to talk about the impact, the process and the duration of some of those?

Mr Pisarski—Some of this will have an effect on people that lasts many years. Even though the flood itself was relatively short in duration, if your house and all your household possessions were destroyed—family records were often completely lost—that may have all sorts of impacts, material, emotional and psychological. In many cases it will take many years for people to rebuild their lives to the point they were at before the flooding.

The immediate efforts, the evacuation centres and the processes put in place by governments at all levels, were extremely welcome, in Queensland and Brisbane in particular. What we really need to see now is a long-term commitment to help those people affected to rebuild their lives, because we are not exactly sure how the impacts will manifest over time. They will affect different people and households in very different ways. Some people will get over them very quickly; others will take a long time.

It is difficult to comment further than that except to say that the supports that have been provided to now have been very welcome. The processes that have been put in place have been good so far. The only comment coming from the community sector in Queensland is that there could have been a greater engagement of the community sector in the immediate effort. I know a lot of organisations feel there could have been better engagement of them by government, but I do not think that is as much a criticism as a wish to be involved in helping people reconstruct their lives and helping with the general recovery effort.

Ms OWENS—Does ACOSS have a view on the coming debate—I guess there will be one—on insurance, on improving our take-up of insurance and the broader insurance issues?

Mr Pisarski—It is not something that we as a board have had a discussion about yet. We have a meeting tomorrow, in fact, where these issues may be brought up and a position formed. I can say as an individual and someone who has been a part of the community sector for 30 or more years that I think the biggest problem with insurance is the lack of clarity around the definitions of what constitutes, for example, a flood, or damage from stormwater. Those sorts of things are critical to people having a transparent understanding of where they stand with their insurance policy. My sister lost her property and she is not yet sure, some weeks afterwards, whether or not she is insured for the damage that was done to her property. So I would be looking for much better clarity and standardisation of those clauses and descriptions so that people have certainty when something happens about whether or not they are covered.

Ms OWENS—Is there an issue with people being able to afford insurance?

Mr Pisarski—That is certainly an issue for low-income people, and there is sometimes an issue about the level of insurance people have taken out. Just as a personal anecdote, when I bought a house and took out an insurance policy it was partly guesswork as to how much I should insure the house for. It was not necessarily an exact valuation of what it would cost to reconstruct the place. I think there is far too much guesswork involved and I am sure that many low-income people, if they are insured, would be very underinsured.

Ms O'DWYER—Earlier we talked more broadly about cuts and the importance of the country having a very strong fiscal position. I am interested in your views. For your membership, the people that you represent, would it be your view that it is important for Australia to be in a strong and sound financial position?

Mr Pisarski—Yes.

Ms O'DWYER—Would you or your membership have concerns about the government debt that we were told today is around $80 billion at this point in time?

Mr Pisarski—Debt is always a relative concept. I was at a luncheon last week for the Urban Development Institute of Australia at which Saul Eslake was the presenter and he described Australia's debt as extremely low by international comparisons. When I look at Australia's debt levels I do not think Australia necessarily carries a level of debt that it cannot afford to repay. Debt is always a function of what is repayable rather than the total amount.

Ms O'DWYER—Would there be a level of debt, though, that you would be concerned about?

Mr Pisarski—Again, that is a hypothetical question. There is always going to be a level of debt. I would be extremely concerned if Australia had debt levels at the magnitude of Ireland or Greece. I think that would be a significant concern. But, given that Australia has a debt level far lower than those countries, I do not think our level of debt is a concern at this point.

CHAIR—Thank you for your attendance here today.

[2.16 pm]

KEARNEY, Ms Gerardine (Ged), President, Australian Council of Trade Unions

CHAIR—On behalf of the committee I welcome the representative from the Australian Council of Trade Unions to the hearing. I remind you that although the committee does not require you to give evidence under oath the hearings are legal proceedings of the parliament and warrant the same respect as proceedings of the House or the Senate. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament. Thank you for making yourself available. Are there any opening comments that you would like to make in relation to the issues that we are considering here today?

Ms Kearney—I do have a short statement. I thank you very much for the invitation to come here today to address the committee. This is an important issue for us and we are very grateful for the opportunity to present here today. It is important for us to know that working people have a voice in these major debates, and the ACTU represents over two million working people.

We come to this inquiry to support the government’s plan for a progressive one-off levy, which exempts flood victims and the majority of workers, to help cover the costs of the devastating floods. Like all Australians we watched the night with numb shock and disbelief as the floods tore through regional Queensland and various other parts of the country. Many of our members were some of those who tragically lost their lives and their homes and were affected by the floods.

As a short aside I acknowledge that the Australian labour movement did respond very, very well to the floods. We raised over half a million dollars in direct donations to the Queensland flood appeal and we contributed in countless other ways by coordinating workers, helpers and volunteers. It was immediately clear that this was a natural disaster of almost unprecedented proportions and that it would require a highly significant response on a national level and that it would require considerable Commonwealth government funding.

Let us not be in any doubt that we are quite aware of the fiscal context for the government’s response to these floods. Notwithstanding the impact of the floods—and we know that there will be an impact particularly in the agricultural and industry areas—Australia’s economy is strong. I noted the conversation before with the previous presenter. We are currently out-performing all peers around the world, in the developed world particularly, following the global financial crisis. Equally the Commonwealth budget position is very strong and we note the context of that. Prior to the floods it was projected that the deficit would be just 0.8 per cent of GDP in 2011 and 2012, and no other major economy is planning to return to surplus as quickly as Australia. It certainly has not any impact that we can see or put any strain at all on the private sector or the private economy.

However, we also note that a range of economists and interest groups have suggested that deferring the deficit reduction plan and returning to a surplus a bit later would have had a negligible impact on the economy and that Australians overall understand that a modest deficit is an entirely reasonable way of funding nation-building infrastructure—and much of our nation's infrastructure has been funded in that way in the past. However, we do accept and note that the government has made a concrete commitment to a fiscal strategy that will see the federal budget record a surplus in 2012-13.

We also believe it would be detrimental to Australia's long-term prosperity for the extra cost of the floods to result in a substantial reprioritising of important government spending initiatives, including investment in infrastructure or cutbacks to recurrent expenditure on health, education and community services—as we heard previously. As a nation, the ACTU believes that we need to take collective responsibility for each other's welfare. Times of natural disaster highlight this basic principle even more.

A progressive levy that exempts low-income earners was an option that the ACTU supported and asked the government to consider in late January. In this context, we offer our support to the plan for a progressive one-off levy. We support it for the following reasons. No. 1, it is temporary and one-off. As I have already outlined, it is a far better alternative to deep and far-reaching spending cuts, as the coalition has suggested. If we are going to have a debate about spending cuts, we believe it must be in a carefully considered process. There are areas, as we have highlighted, of middle-class welfare, where programs need to be reviewed—for instance, superannuation tax concessions for high-income earners. Savings could be made by taxing super contributions at an individual's marginal tax rate rather than the current flat tax of 15 per cent for everyone earning over $37,000—which delivered massive benefits to high-income earners. Another area is the 30 per cent private health insurance rebate.

The second reason we support the levy is that it is fair. Not only are recipients of flood-related payments exempted but it applies only to people earning more than $50,000, those who can most afford it, which immediately means that about 50 per cent of workers are exempt from having to pay the levy. The progressive structure means that even high-income earners will not pay one per cent of their total income. It only applies on the portion of their income that exceeds $100,000. That affects less than 10 per cent of workers. This means that a full-time worker earning average wages of $65,000 will be liable of a levy payment, as I am sure you know, of just $1.45 a week, while some on double that will pay $10.61 a week.

Thirdly, we support the levy because it will raise funds for important infrastructure programs, such as the replacement of roads and rail lines that must be built in any case, but will also drive future economic and productivity growth in affected regions. The funds raised will not be frittered away.

There are two other points that we would like to make with regard to the recovery program. As I said earlier, as a nation, we believe we need to take collective responsibility for each other's welfare, particularly in times of disaster, and a progressive levy on wage and salary earners is consistent with this principle. But it should also apply, we believe, to the corporate sector. The costs of the post-flood reconstruction need to be shared by all sectors of the Australian economy and not solely borne by households. We have heard just today that BHP Billiton has announced a super profit of more than $10 billion for the first half of this financial year. They are earnings from iron ore, earnings from Australia's natural resources—and it has tripled. With companies like BHP Billiton reaping super profits of more than $10 billion in half a year, there is no doubt, we believe, that corporate Australia can afford to contribute its share.

The second point I would like to make is a point of caution with the concept of fast-tracking and the utilisation of 457 visa workers for the reconstruction program. Whilst the ACTU supports immigration, we just ask that caution be taken with rushing into importing labour, which we too often see drives down wages and working conditions of Australians. That is my opening statement, I am happy to take some questions.

CHAIR—Thank you for that. Ms Owens is going to start questions.

Ms OWENS—I think you have answered most of my questions, but I will continue where you finished talking about capacity constraints we will be facing. Clearly there will be a great need for workers, not just because of the flood rebuild in Queensland but also because of quite a few other very large-scale projects which we will be building, with the potential to suck workers out and place strain on other sections of the economy, particularly on manufacturing. Do you have a crystal ball? Do you have any answers there?

Ms Kearney—We have had throughout the movement discussions about that very thing. Right now the construction union tells us that, with the number of projects that are about to close in the very near future and the projects that have closed, there will be about 30,000 construction workers looking for work in the next few months and coming weeks. We think that this will certainly help.

CHAIR—That is across Australia.

Ms Kearney—My understanding is that that is in Queensland in the flood affected areas, but I may be wrong on that. We believe that there will be plenty of workers available for the reconstruction program. We are urging the government to use the reconstruction program as a way to help build skills and encourage employment in areas where there has been long-term unemployment, particularly amongst younger people. We know on the Central Coast and North Coast of New South Wales—and even on the South Coast—there are high levels of youth unemployment and we are hoping that the reconstruction program, with a bit of thought, can be used to encourage younger workers into the workforce as well. Certainly we recognise that ultimately there may be a need for some short-term importing of labour. All we ask is that it is done carefully where there are very well-considered shortages and skill shortages and that it is done in consultation with the relevant stakeholders.

Ms OWENS—I guess a large number of those projects ending up in Queensland would be stimulus projects coming to an end.

Ms Kearney—They may well be. I do not have the details, but I am happy to get those for you if you would like them.

Ms OWENS—That would be good, thanks.

Mr CIOBO—Ms Kearney, are you a member of the Labor Party?

Ms Kearney—I am.

Mr CIOBO—I just wanted to ask that so I had some understanding about where you sat vis-a-vis this flood tax that is being imposed. The ACTU is an affiliate of the Labor Party?

Ms Kearney—No.

Mr CIOBO—You pay membership to the Labor Party or in some way contributions to the Labor Party?

Ms Kearney—No.

Mr CIOBO—The ACTU has never paid a contribution to the Labor Party?

Ms Kearney—The ACTU is not an affiliate and does not pay affiliation fees to the Labor Party. I do not understand why you are asking that question.

Mr CIOBO—Because I am trying to ascertain how independent a witness you are.

Ms Kearney—Sir, I represent over two million workers who are a very broad church. I come from the Australian Nursing Federation. I was general secretary of the Australian Nursing Federation where I can very confidently say that at least 47 per cent of our membership were conservative voters.

Mr CIOBO—Sure, but you are here representing the ACTU today?

Ms Kearney—I am representing the ACTU, but the ANF is a very large affiliate. In fact, right now, it is the second largest affiliate of the ACTU, with over 200,000 members, with the largest growth in membership. The ACTU are a very broad church and our members vote in many varied and different ways. So I am not quite sure what your point is. I represent those workers and they elected me democratically.

Mr CIOBO—Great. So just to clarify, the ACTU has never paid the Labor Party any funding?

Ms Kearney—Not any affiliation fees. We do not pay any money directly to the Labor Party.

Mr CIOBO—You pay no money to the Labor Party?

Ms Kearney—Nothing directly to the Labor Party.

Ms O'DWYER—Can I just clarify a point, because in the AEC returns you do actually make payments—donations—to the Labor Party.

Ms Kearney—No, we do not.

Ms O'DWYER—Well, I can pull out AEC returns that say that you do and that you contribute to associated campaigns.

Ms Kearney—Third party campaigning is a different issue. We do not donate to the Labor Party and it is incorrect to say that.

Ms O'DWYER—So the reports that were in the *Australian* about the $30 million that the ACTU apparently spent on the campaign regarding Work Choices are not accurate?

Ms Kearney—It is not a donation to the Labor Party, no.

Ms O'DWYER—It is clearly in line with Labor Party policy. It manages to be exactly the same as the Labor Party policy. I am similarly just trying to understand your perspective in coming before us today.

CHAIR—You will find there were a lot of Your Rights at Work people handing out for the Greens as well.

Ms Kearney—Can I just clarify: Your Rights at Work was about policies that protect working people. I am absolutely positive that in putting our own agenda we were campaigning for our own agenda, with a response from several independent people, several other parties, including the Labor Party.

Ms O'DWYER—There was no contribution to the Liberal Party.

Ms Kearney—It is our right to campaign on the rights of our members, just as it is the right for the mining companies to get together and campaign for their interests.

Ms O'DWYER—They are not sitting before us today; you are. That is why we are asking you the questions.

Ms Kearney—The ACTU does not donate directly to the Labor Party.

Ms O'DWYER—Indirectly then. We will leave it at that.

CHAIR—That is not what the witness said. You cannot put words in her mouth.

Ms Kearney—That is right. I did not say that. We campaigned for our members' interests with our own agenda.

Mr CIOBO—You made some additional points to the inquiry. You said earlier that you are confident that 'the funds won't be frittered away'. They were your words. On what basis are you confident that the funds will not be frittered away? I have concerns. We have seen billions of dollars that I would describe as being frittered away through failed programs—and just to name one of them off the top of my head, the so-called FuelWatch initiative. Here we saw the expenditure of tens of millions of dollars and it came to nought. How can you be confident that the funds will not be frittered away? Is it because John Fahey has oversight of the committee? Is that the check-balance?

Ms Kearney—I am not familiar with the funding of the specifics of FuelWatch, but I am confident that the projects will be very specific in Queensland. Some of those projects, as I said, were going to be funded anyway. They are projects that will create work, rebuild homes, rebuild roads and rebuild infrastructure. They are important projects, and I do not see how you could think that would be wasteful or 'frittering away'.

Mr CIOBO—That is not what I am saying. People would say that the school halls program and the broad Building the Education Revolution program were important as well. Yet we saw government paying top dollar rates—well and above market rates—to such an extent that we saw literally billions of dollars being frittered away. Given this government's track record of wasting so much money, how can you be confident that we will not see money wasted this time? Is it because of John Fahey's oversight and his appointment? Is that what brings you the confidence? What is it that brings you confidence that you will not see funds wasted?

Ms Kearney—Because I am confident the projects that will be built will be necessary and that they will be well managed. Perhaps you could say from lessons learnt, I am not confident that the BER is the disaster that you are saying it is.

Mr CIOBO—I never said it was a disaster. I said funds have been wasted.

Ms Kearney—From our members' point of view, the BER has been very successful in keeping people in meaningful work, keeping the industry afloat and building really good community infrastructure. So I am confident—

Mr CIOBO—Surely you can see that funds were wasted.

Ms Kearney—You cannot not do something as important as rebuild homes, roads and schools on the very basis that it might be done inefficiently. One has to assume that these are worthwhile projects. The money is being put aside to build them. It is very important for the wellbeing of the people who have lost their homes, lost their communities and lost their jobs to rebuild the economy of a devastated state. That is worth while and that is what we are supporting.

Mr CIOBO—In your pre-budget submission to government, does the ACTU have a view on the Medicare levy?

Ms Kearney—Can you give me more detail?

Mr CIOBO—I understand that the ACTU has already lodged a pre-budget submission this year. Does it include commentary about the efficacy or otherwise of the Medicare levy?

Ms Kearney—I think we support the Medicare levy.

Mr CIOBO—My interpretation was that the ACTU effectively advocates the abolition of the Medicare levy.

Ms Kearney—No.

Mr CIOBO—So you think it is an efficient form of taxation?

Ms Kearney—Yes. I am sure that that is not what we would have said.

Mr CIOBO—Are you unfamiliar with the submission?

Ms Kearney—I am familiar with it, but it is some time now since we submitted it so I am not sure exactly what the detail was on the Medicare levy. We support levies. Progressive levies are a legitimate way of raising money for hypothecated reasons such as health care. A one-off levy, as I said, for rebuilding infrastructure that is progressive so that those who can afford it can pay it, we support.

Mr CIOBO—How crucial is this notion of being supportive of this levy because it is a one-off and temporary? As a nation, unfortunately, we are prone to natural disasters. We have had many over the years. We have not previously raised a new tax to pay for reconstruction. On this occasion we are. From your evidence, if there were another unfortunate natural disaster next year, it sounds as if you would not support a new tax being rolled out or, indeed, the continuation of this tax. I am trying to ascertain whether your support of it is because it is temporary. How important is that?

Ms Kearney—I cannot predict what is going to happen in the future as far as natural disasters go but I do know that, right now, we have had one mighty big disaster that needs to fixed, and it needs to be fixed efficiently and quickly and with as least pain as we possibly can. Hopefully, it will be fixed in a way that will have some decent benefits as far as giving people good jobs, creating skills and rebuilding roads and infrastructure that communities need. We are facing a big disaster right at this point in time and a very efficient and legitimate way to fund the fixing up of the results of such a disaster is a levy. So we support that.

Mr CIOBO—I know this is a hypothetical but, if we saw another disaster next year and the government said, ‘We’re going to have another tax next year,’ I presume you would be supportive?

Ms Kearney—If it were necessary; if it were of equal proportion. Just as the Howard government used one-off levies on a number of occasions for various things, I suspect we would have to revisit.

Mr CIOBO—You made the point that it was your view that corporate Australia could afford to pay more, afford to pay its share. When you say corporate Australia, are you referring just to publicly listed companies or are you referring to all companies that pay company tax? What are you referring to?

Ms Kearney—I think it should be those companies that make super profits, as I said. One could even ask the question whether, if we had the super profits tax in place right now, we would need any of the budget cuts that have come with the levy program. I do not think there is any problem in taxing companies that make super profits, and the definition of a super profit I will leave up to the experts. I am not exactly sure, but I am pretty sure that $10 billion in the first half of a year would be seen as a super profit. I think that corporate Australia can well afford to help rebuild Australia’s infrastructure in times of disaster like this.

Mr CIOBO—So the kind of new tax you would like to see imposed on corporate Australia you do not have a view on, a view as to what constitutes a super profit.

Ms Kearney—Do I have a view? I just said that—

Mr CIOBO—I am saying that you do not have a view as to what constitutes a super profit.

Ms Kearney—Not in dollar terms, but I am sure there are people out there who can work that out for the Treasury or whoever would impose the tax. But we would support a super profits tax, and I would suspect that $10 billion would fall into that category.

Mr CIOBO—Well, I would suspect it would depend on return on equity, but that is a separate thing. With respect to your preferred model, would it be the flood tax as it is currently imposed or would it be for an equal amount imposed on corporate Australia for those earning a super tax?

Ms Kearney—I am not proposing a model. As I said, I am not an economist. I am saying that there is a principle that those who can afford to pay for the rebuilding of Australia should, and I think companies that make a lot of money and reap a lot of profit should have a part in paying for the rebuild after such a disaster. I am not saying I am an economist and I am not saying that I am putting a model forward. I am saying that, as a broad principle, I think it is very sound.

Mr CIOBO—So the ACTU thinks it is an omission to not have super profits of companies in some way contributing to this relief and recovery effort?

Ms Kearney—I think it would be appropriate.

Mr CIOBO—So, if you were designing it, you would broaden it out so that we would have a greater contribution flowing from the super profits of corporate Australia?

Ms Kearney—Yes, I would.

Dr LEIGH—I cannot resist briefly correcting the record on one of Mr Ciobo's flights of fancy: the FuelWatch scheme was defeated by a tied vote in the Senate in 2008. Ms Kearney, there have been some discussions about your credibility here as a witness. I do not want to trawl through some of the issues raised by my colleagues but, on the issue of levies, did the ACTU support the Howard government's gun levy and East Timor levy?

Ms Kearney—That is a very good question. I think we would have, yes.

Dr LEIGH—In terms of the impact on the workers you represent, which strategy do you think would be most effective: to cut back on doctors, cut back on school buildings and scrap financial literacy programs or to impose a modest, progressive levy?

Ms Kearney—The latter, definitely. To cut back on those things, as you suggested just then, would certainly have the net impact of lowering people's wages—health care, community services, all of those things, are incorporated in what we call a social wage and are an incredibly important part, particularly of low-income earners' livelihoods.

Dr LEIGH—You said in your opening statement that the ACTU had done a lot to raise individual charitable donations to assist flood victims in Queensland. What do you make of the argument that the imposition of a flood levy causes people to stop giving?

Ms Kearney—That is an interesting question. It certainly has not been the case within the labour movement. People have continued to donate. It has been made very clear that the levy is there for the rebuilding of infrastructure such as roads, bridges, houses et cetera, whereas the donations, as we know, will hopefully go directly to victims and help them with their personal wellbeing.

Ms O'DWYER—I just want to clarify some of the comments that you made earlier, and thank you very much for appearing today. You mentioned before that the cost should really be borne by the people who could most afford it, so I would like to understand whether you think that people who earn over $50,000 are wealthy.

Ms Kearney—No, I do not think that they are wealthy, but I think they could afford $1.45 a week.

Ms O'DWYER—I think you mentioned before, and correct me if I misheard you, that the average worker's wage, or your membership's wage, was $65,000 a year. Did I mishear what you said in your opening statement?

Ms Kearney—Did I actually state that? I have some figures here so I can help you with that.

Ms O'DWYER—I do not want to misquote you.

Ms Kearney—I am not sure if I actually stated that. I do not think I mentioned a wage level at all.

Ms O'DWYER—What would be the average wage?

Ms Kearney—An average wage is around $65,000.

Ms O'DWYER—Yes. So this $50,000 is less than the average wage.

Ms Kearney—Yes.

Ms O'DWYER—In terms of your membership, you said you represented over—

Ms Kearney—Around two million.

Ms O'DWYER—Of those two million people, how many do you think would be impacted by the imposition of this flood tax?

Ms Kearney—I would have to hazard a guess and say that our membership is probably reflective of the general population so it is probably around 50 per cent, the same as the general working population.

Ms O'DWYER—One of the things that we heard earlier today from Treasury officials was that part of the reason for coming up with a $1.8 billion levy was based on the estimates of the cost of reconstruction. What is the ACTU's view on whether, if that cost is higher, the levy should be greater than the $1.8 billion or, if we discover later on that in fact there is still a lot more work to do, whether it should be increased beyond the 12-month period?

Ms Kearney—I would not like to project into the future but I guess you make all decisions based on what is happening at the time. I would hope there would be consultation around that. It would depend on how much more money needed to be spent and what the magnitude of the problem was. As I said, levies are a legitimate way to raise federal funds. We also made it quite public that we would support a delaying of the surplus target if that was necessary, but we recognised the government's commitment to reaching a surplus again. There are several ways that we could approach that problem.

Ms O'DWYER—But you would not have a fundamental in-principle objection to either an increase or an extension.

Ms Kearney—Of the levy?

Ms O'DWYER—Yes.

Ms Kearney—It would depend, as I said, on the magnitude of the problem.

Ms O'DWYER—It would depend, but in principle there is no blanket fundamental objection?

CHAIR—I think she has answered twice.

Ms O'DWYER—I just want to clarify, so I understand it correctly.

CHAIR—I think she has answered twice as to what her position is.

Ms O'DWYER—All right. Well, I will understand that then to be as I understand it, which is no in-principle objection to it, but I do not want to misconstrue what you say so I am giving you the opportunity to respond.

Ms OWENS—I think you just did.

Ms O'DWYER—I am interested to also understand this from your perspective. We have talked with a number of witnesses throughout today about the fiscal position. Obviously the government, in bringing forward this levy, have said that there is a need to bring it forward given the fiscal position of the government. Would it be your view and the ACTU's view that there has been government waste and mismanagement?

Ms Kearney—I think that the economy, as I said in my opening statement, is incredibly robust. I think it is an absolute credit to the current government that they brought us through the global financial crisis in the way they did. I believe the stimulus package was the right thing to do. I believe that we have very robust regulations around our finance industry that helped us. I think that Australia is faring incredibly well with a very small deficit. Overall, if you look at government management—

Ms O'DWYER—There have now been several audits and I just want to understand your perspective. It goes to the need for this levy and the explanation by the government for bringing it forward. Do you think there has been government waste and mismanagement?

Ms Kearney—As I say, overall I think that government is managing the economy incredibly well and I think they deserve a great deal of credit for that given the position we are in right now particularly in comparison with the rest of the world.

Ms O'DWYER—But that is not the question I asked. I did not ask about the management of the economy. I had actually—

CHAIR—That is how she answered it though.

Ms O'DWYER—If you allow me, I am asking a very specific question about government waste and mismanagement. Let me give you an example—the school hall program. There has been an audit into the school hall program and we understand that an extra $2.6 billion has been spent on that program. Given the way that it has been structured, it is clear that that money would not have needed to be spent—when you do a comparison—if the program had been handed to the independent school sector. Let us use that as an example if that helps clarify my question. Do you think that there has been waste and mismanagement?

Ms Kearney—If you take isolated programs that have had budget blowouts, that is not an unusual thing—

Ms O'DWYER—I think the scale of it is very unusual.

Ms Kearney—I do not think so given the incredibly stable situation of our economy. I know that the government has come out and said that they have learned lessons from the pink batts program, for example, and that those instances will not be repeated. So I am quite confident that this government has a strong hold on the management of this economy.

Ms O'DWYER—So you would rather not acknowledge the waste and mismanagement of the government—

Ms Kearney—I just said that the government itself has acknowledged the problems there were with the pink batts, and I take that—

Ms O'DWYER—You are not representing the government; you represent the ACTU, and so I am asking for the ACTU's interpretation.

Ms Kearney—In isolated projects you could find areas where there could have been more efficiency. Whether that constitutes gross negligence and massive waste is another issue. To determine whether that is the case, one can look at the economy overall and see the position that we are in and I would have to say that I think this government has managed the economy very well.

Ms O'DWYER—We talked just before—and you touched on the issue—about bringing in, let us say, overseas workers to help with the reconstruction effort. We spoke to the Reserve Bank governor last week and there was quite a bit of discussion about capacity constraints. Obviously your membership has very strong views about bringing in non-unionised workers to work on construction, so in circumstances where there is a conflict between actually getting, as you put it, very important infrastructure projects built, vis-a-vis the interests of your unionised members, would you take the view that it is more important to build and build as quickly as possible?

Ms Kearney—Could I just make a clarification? I have never said that we have an objection to 457 workers based on the fact that they are non-unionised. I would like to make that quite clear. That is not true. The second thing is that the ACTU supports immigration absolutely. We do not have a problem with immigration. We recognise that people coming in on temporary visas are an important part of managing the economy. They are three very important points that I would like to make.

However having said that, I think that we need to be very careful about rushing or bringing in people on 457 visas when there are hardworking Australians out there who could do the job equally well. So we are asking for a very well-planned, well-structured and well-implemented program of immigrant labour that takes into consideration the appropriate level of skill shortages, proper market testing, ensuring that the 457 visa workers are not exploited and that they do not work here below our own market labour conditions. I do not think that that is an unreasonable position.

CHAIR—Thank you for your attendance here today at short notice. There was one issue on which you said you would get back to us in relation to the construction workers.

Ms Kearney—Yes.

CHAIR—Could you do that tomorrow? We have a very tight timeline in relation to this inquiry.

Ms Kearney—I will make a phone call as I leave.

CHAIR—Fantastic. Thank you. There will be a *Hansard* transcript of your contribution here today. Have a look at that and, if there are any errors or omissions, please get back to us as quickly as you can.

Ms Kearney—Certainly.

CHAIR—Thank you again for your attendance here today.

Ms Kearney—You are welcome.

Mr CIOBO—I am just aware of the tight time frame for the turnaround of this report, and there may be a dissenting report—who knows. When are we likely to get the *Hansard*?

CHAIR—The question is as to when the *Hansard* will be available, given the tight timeline that we have. The secretary tells me it will be ready at about nine or 10 o'clock tomorrow morning; it is a high priority.

Mr CIOBO—That is good, because it will be important for all of us.

Dr LEIGH—That is a tight turnaround. We appreciate it.

Mr CIOBO—Thank you, Hansard.

Resolved (on motion by **Mr Ciobo**):

That this committee authorises publication of the transcript of the evidence given before it at public hearing this day.

Committee adjourned at 2.51 pm