



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

STANDING COMMITTEE ON ECONOMICS

ESTIMATES

**(Additional Budget Estimates)**

WEDNESDAY, 14 FEBRUARY 2007

CANBERRA

BY AUTHORITY OF THE SENATE



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**SENATE STANDING COMMITTEE ON  
ECONOMICS**

**Wednesday, 14 February 2007**

**Members:** Senator Ronaldson (*Chair*), Senator Stephens (*Deputy Chair*), Senators Bernardi, Chapman, Joyce, Lundy, Murray and Webber

**Senators in attendance:** Senators Bernardi, Eggleston, Fielding, Joyce, Murray, Parry, Ronaldson, Sherry, Stephens, Watson, Webber and Wong

**Committee met at 9.02 am**

**TREASURY PORTFOLIO**

**In Attendance**

Senator Minchin, Minister for Finance and Administration

Senator Coonan, Minister for Communications, Information Technology and the Arts

**Department of the Treasury**

**Outcome 1: Sound Macroeconomic Environment**

**Output Group 1.1: Macroeconomic Group**

Mr David Parker, Executive Director

Dr Steven Kennedy, General Manager, Domestic Economy Division

Ms Nghi Luu, Senior Adviser, Domestic Economy Division

Mr Rob Ewing, Senior Adviser Domestic Economy Division

Mr Paul Gardiner, Manager, International Economy Division

Mr Nathan Dal Bon, Manager, International Economy Division

Mr Roger Brake, General Manager, International Finance Division

Mr Gordon de Brouwer, General Manager, G20 and APEC Secretariat

Dr Paul O'Mara, General Manager, Macroeconomic Policy Division

Mr Graeme Davis, Principal Adviser, Macroeconomic Policy Division

Mr Andrew Thomas, Manager, Macroeconomic Policy Division

Mr Greg Coombs, Manager, Macroeconomic Policy Division

Mr David Turvey, Senior Adviser, Macroeconomic Policy Division

Ms Bernadette Welch, Manager, Operations and Logistics Unit

**Outcome 2: Effective Government Spending Arrangements**

**Output Group 2.1: Fiscal Group**

Mr David Tune, Executive Director

Mr David Martine, General Manager, Budget Policy Division

Mr Jason McDonald, Manager, Budget Policy Division

Mr Rob Heferen, General Manager, Social Policy Division

Mr Peter Robinson, Principal Adviser, Social Policy Division

Mr Michael Willcock, General Manager, Commonwealth-State Relations Division

Ms Maryanne Mrakovcic, General Manager, Industry, Environment and Defence Division

Mr Michael Burton, Chief Financial Officer, Corporate Services Division

Mr Geoff Francis, Principal Adviser, Industry, Environment and Defence Division

**Outcome 3: Effective taxation and retirement income arrangements**

**Output Group 3.1: Revenue Group**

Mr Mike Callaghan, Executive Director

Mr Blair Comley, General Manager, Business Tax Division

Ms Christine Barron, General Manager, Indirect Tax Division

Mr Mark O'Connor, General Manager, Individuals and Exempt Tax Division

Mr Martin Jacobs, Manager, Individuals and Exempt Tax Division

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

Mr John Lonsdale, General Manager, Superannuation, Retirement and Savings Division

Mr Tony Coles, Manager, Superannuation, Retirement and Savings Division

Ms Louise Seeber, Manager, Superannuation, Retirement and Savings Division

Mr Nigel Ray, General Manager, Tax Analysis Division

Mr Damien White, Manager, Tax Analysis Division

Mr Phil Gallagher, Manager, Tax Analysis Division

Mr Colin Brown, Manager, Tax Analysis Division

Mr Paul McCullough, General Manager, Tax System Review Division

Ms Sue Vroombout, General Manager, Board of Taxation

**Outcome 4: Well Functioning Markets**

**Output Group 4.1: Markets Group**

Mr Jim Murphy, Executive Director

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

Mr Chris Legg, General Manager, Financial System Division

Ms Vicki Wilkinson, Manager, Financial System Division

Mr Trevor King, Manager, Financial System Division

Ms Kerstin Wijeyewardene, Manager, Financial System Division

Mr David Love, Manager, Financial System Division

Ms Michelle Calder, Senior Adviser, Financial System Division

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

Ms Marian Kljakovic, Manager, Corporations and Financial Services Division

Mr Matt Brine, Manager, Corporations and Financial Services Division

Ms Ruth Smith, Manager, Corporations and Financial Services Division

Mr Bede Fraser, Manager, Corporations and Financial Services Division

Mr Jorge del Busto, Senior Adviser, Corporations and Financial Services Division

Mr Steve French, General Manager, Competition and Consumer Policy Division

Ms HK Holdaway, Manager, Competition and Consumer Policy Division

Mr Glen McCrea, Senior Adviser, Competition and Consumer Policy Division

Mr Aidan Storer, Senior Adviser, Competition and Consumer Policy Division

Mr Brad Archer, Manager, Competition and Consumer Policy Division

Mr John Karatsoreos, Senior Adviser, Competition and Consumer Policy Division

Mr Michael Johnston, Manager, Competition and Consumer Policy Division

Ms Jane Melanie, Senior Adviser, Competition and Consumer Policy Division

Mr Peter McCray, General Manager, Financial Literacy Foundation

Mr Grahame Crough, Manager, Financial Literacy Foundation

Ms Linda Rosser, Manager Financial Literacy Foundation

Mr Peter Martin, Australian Government Actuary

**Australian Accounting Standards Board**

Professor David Boymal, Chairman

**Australian Bureau of Statistics**

Ms Susan Linacre, Acting Australian Statistician

Mr Peter Harper, Deputy Australian Statistician, Economics Statistics Group

Mr Denis Farrell, Acting Deputy Australian Statistician, Services Group

Mr Garth Bode, Acting First Assistant Statistician, Social and Labour Statistics Division

Mr Mark Whybrow, ABS Chief Financial Officer

Dr Siu-Ming Tam, First Assistant Statistician

Mr Paul Williams, Assistant Statistician

**Australian Competition and Consumer Commission**

Mr Graeme Samuel, Chairman

Mr Brian Cassidy, Chief Executive Officer

Mr Adrian Brocklehurst, Chief Financial Officer

Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division

Mr Mark Pearson, Executive General Manager, Enforcement and Compliance Division

Mr Michael Cosgrave, General Manager, Communications Group

Mr Tim Grimwade, General Manager, Mergers and Assets Sales Branch

Mr Scott Gregson, General Manager, Adjudication Branch

Ms Rose Webb, Acting General Manager, Information Research and Analysis Branch

Ms Lee Hollis, General Manager, Criminal and Cartel Enforcement Branch

Mr Nigel Ridgeway, General Manager, Compliance Strategies Branch

Ms Helen Lu, General Manager, Corporate

**Australian Prudential Regulation Authority**

Dr John Laker, Chairman

Mr Ross Jones, Deputy Chairman

Mr John Trowbridge, Member

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

Mr S G (Ramani) Venkatramani, General Manager, Central Region, Specialised Institutions Division

**Australian Securities and Investment Commission**

Mr Jeremy Cooper, Deputy Chairman

Mr Tony D'Aloisio, Commissioner

**Australian Taxation Office**

Mr Michael D'Ascenzo, Commissioner

Mr Greg Farr, Second Commissioner

Mr Jim Taylor, Acting Chief Finance Officer

Ms Margaret Crawford, Chief Operating Officer

Ms Raelene Vivian, Deputy Commissioner

Mr Mark Jackson, Deputy Commissioner

Mr Mark Konza, Deputy Commissioner

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**Corporations and Markets Advisory Committee**

Mr John Kluver, Executive Director

**Financial Reporting Council**

Mr Charles Macek, Chairman

Mr Jorge del Busto, Secretary

**CHAIR (Senator Ronaldson)**—I declare open this hearing of the Senate Standing Committee on Economics. The Senate has referred to the committee the particulars of proposed additional expenditure for 2006-07 and certain other documents for the portfolios of Industry, Tourism and Resources and Treasury. The committee may also examine the annual reports of the departments and agencies appearing before it. The committee is due to report to the Senate on 21 March 2007 and has fixed Thursday, 5 April 2007 as the date for the return of answers to questions taken on notice. Today the committee will begin its examination of the Treasury portfolio, starting with the Macroeconomic Group of the Treasury and continuing in the order shown on the agenda.

Under standing order 26 the committee must take all evidence in public session. This includes answers to questions on notice. I remind all witnesses that, in giving evidence to the committee, they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. The Senate, by resolution in 1999, endorsed the following test of relevance of questions at estimates hearings:

Any questions going to the operations or financial positions of the departments and agencies which are seeking funds in the estimates are relevant questions for the purpose of estimates hearings.

I remind officers that the Senate has resolved that there are no areas in connection with the expenditure of public funds where any person has discretion to withhold details or explanations from parliament or its committees unless the parliament has expressly provided otherwise.

The Senate has resolved also that an officer of a department of the Commonwealth or of a state should not be asked to give opinions on matters of policy, and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted.

If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer having regard to the ground which is claimed. Any claim that it would be contrary to the public interest to answer a question must be made by the minister and should be accompanied by a statement setting out the basis for the claim.

I welcome Senator Minchin, representing the Treasurer, and officers of the Department of the Treasury. Minister, do you wish to make an opening statement?

**Senator Minchin**—No, Mr Chairman, other than to, on behalf of the government, congratulate you on your election as chairman and wish you well in your new role.

**CHAIR**—Thank you very much.

[9.05 am]

**CHAIR**—We turn to the first Treasury item, output group 1.1, Macroeconomic group.

**Senator WONG**—I had some questions in relation to the water announcement and Treasury's involvement. I wonder to whom that should be addressed.

**Mr Parker**—The water announcement issue should be directed at output 2.1, Fiscal group.

**Senator WONG**—Senator Sherry and I were just discussing whether it would be there or here. I recall when the Welfare to Work package was announced that there was some modelling done of the impacts by Treasury. I have to say I thought that was in a different group; is that not right? There was modelling of the expected or forecast impacts upon labour force participation and so forth. In which group would that kind of economic modelling be undertaken?

**Mr Parker**—That was work that was done jointly between fiscal group and macroeconomic group. It is important to understand the label that is attached to that. That analysis was done in the context of the various parameters which were used to cast and set up and cost the policy. It was not economic modelling in the sense of looking at the whole economy process in a macroeconomic model.

**Senator WONG**—True. Modelling of the impacts was maybe a better way of describing it.

**Mr Parker**—Yes.

**Senator WONG**—Was there any involvement by the macroeconomic group at all in the development of the water announcement?

**Mr Parker**—No.

**Senator WONG**—Which aspects of Treasury to your knowledge were involved?

**Mr Parker**—In the water announcement?

**Senator WONG**—Yes.

**Mr Parker**—Fiscal group had some involvement in that.

**Senator WONG**—No other group?

**Mr Parker**—No, not as far as I am aware.

**Senator WONG**—I will come back to my other questions at outcome 2. Thank you

**Senator SHERRY**—I just wanted to go to a couple of general economic modelling activities, then I will move to some more specific issues within the generality of the matters I raise. I have a few questions about issues relating to economic modelling on resources boom, climate change, industrial relations education—these are general issues at the moment. Has Treasury undertaken modelling of the impact on the economy of commodity prices for Australia's exports returning to their historical levels?

**Mr Parker**—Yes, we have.

**Senator SHERRY**—What aspects of the impact on the economy has that included? For example, has it included impacts on economic growth, national income and other factors?

**Mr Parker**—That is right.

**Senator SHERRY**—What specific areas have been examined in terms of the impact? I mentioned two, but—

**Mr Parker**—A simulation has been run in the Treasury macroeconomic model, TRYM, which looks at the impact of a terms of trade shock. So it was a whole economy simulation.

**Senator SHERRY**—When was that done—approximately? I obviously do not want exact dates, unless you have that sort of detail.

**Mr Parker**—Probably about 1½ years ago.

**Senator SHERRY**—Has there been any ongoing work on an economic impact of a return of commodity prices since then?

**Mr Parker**—That is something we look at on an ongoing basis. As you might be aware, the budget framework for the last several years has included a technical assumption which incorporates a partial unwind of the terms of trade shock. That is regarded as a prudent way to cast fiscal policy in the sense that it seems unlikely that commodity prices would stay at a permanently high level. The budget has been framed on the basis of a partial retrace of the terms of trade shock basically to bring key commodity prices back to a long-run historic average. That has been used in a projection sense such that it means that the nominal economy grows more slowly for a period of time, which is essentially an unwind of the nominal economy growing faster than trend for a period of time, which we have seen in the last several years.

**Senator SHERRY**—I remember discussing this at previous estimates. Is that the two-step approach?

**Mr Parker**—That is correct, yes.

**Senator SHERRY**—Would I be correct in assuming that in terms of preparing for the May budget, and obviously outlining the changes to forecasts where appropriate, this would be an ongoing factor that Treasury are examining?

**Mr Parker**—Correct.

**Senator SHERRY**—I might get to some more detailed questions about that a little later. In terms of general modelling activities, over the last year or 18 months, has Treasury undertaken any modelling of the impact of climate change on the Australian economy?

**Mr Parker**—Do you mean in terms of the economic effect?

**Senator SHERRY**—The impact on economic growth, living standards, employment, possible restructuring, shifts in the economy as a result of climate changes.

**Mr Parker**—We have not done that in the context of a full macroeconomic simulation. Climate change is obviously an issue which we do considerable work on, at the policy level and thinking about the potential economic impacts of that. If you want to get into the issue of climate change effects on policy, again it would be the fiscal group to whom those questions should be mainly directed.

**Senator SHERRY**—When you say considerable work has been done, what do you mean by ‘considerable work’?

**Mr Parker**—As you would be aware, there has been a policy debate going on over climate change for a considerable period of time.

**Senator SHERRY**—It has been a long-term debate. I am not sure to what degree Treasury has treated it as a long-term debate in the context of examining its impact. Does Treasury have a special unit in this area?

**Mr Parker**—Yes, it does.

**Senator SHERRY**—Again I seem to recall a conversation about this at a previous estimates hearing. Can you refresh my memory for the record?

**Mr Parker**—Yes, there is an environment and industry policy unit in the fiscal group.

**Senator SHERRY**—How does that interface in terms of the domestic policy economic advice and forecasting? Presumably there would be an exchange between those officers in fiscal group and the officers preparing macroeconomic impact indicators for the budget. Is that right? How does the relationship work?

**Mr Parker**—In principle that is right, and there is a dialogue which goes on between the unit and ourselves. But in terms of specifically factoring environmental issues into the macroeconomic forecasts which we prepare, it would be fair to say that to date the environmental greenhouse issues—if we are talking specifically about greenhouse issues as opposed to broader issues like the drought, issues which impact, very importantly, obviously, on the rural sector—have not been, in a sense, sufficiently large as to have an obvious macroeconomic impact.

**Senator SHERRY**—Just taking you up on that, why does Treasury believe they have not been sufficiently large to date?

**Mr Parker**—In order to have a macroeconomic impact, you need to be talking about substantial structural change to the economy. Obviously this is an issue of potential relevance in the future, but hitherto it has not been something which has been a large feature of macroeconomic developments.

**Senator SHERRY**—I might come back to some aspects of that a little later before we get to fiscal group. As to industrial relations changes, is Treasury undertaking modelling of the link between industrial relations laws, recent changes, and productivity?

**Mr Parker**—Yes, we have had a look at that.

**Senator SHERRY**—When have you examined that?

**Mr Parker**—Over the last year or so.

**Senator SHERRY**—That is a pretty broad time frame; can you be a bit more specific than ‘over the last year or so’?

**Mr Parker**—As you would know, industrial relations policy development has been going on for some considerable period of time. We are now in the early stages of the new regime. We are looking at productivity writ large in the economy on an ongoing basis. The new

industrial relations policy framework is one potential influence on aggregate productivity development, so it is something that we keep an eye on.

**Senator SHERRY**—In what way do you model the impacts of industrial relations changes?

**Mr Parker**—It is not an easy exercise to do that. It would be possible to do it on the basis of assumed changes to productivity levels in particular areas. The other thing which is important is the path of wages growth which comes out of that and whether that might lead to faster or slower employment growth or substitutions of employment or, more particularly, for labour for capital. It needs to be considered in a whole economy context.

**Senator SHERRY**—The industrial relations changes are relatively recent. Has Treasury done any specific examination, modelling, on impacts since the changes to law occurred?

**Mr Parker**—I think it is much too early to have a definitive view about the specific productivity effects of the changed industrial relations area. To give you some broader context, research into productivity is an inherently difficult area. Productivity is in a sense a measure of our ignorance. It is the growth in a sense that we cannot explain by increased inputs into the economy. So it is a residual number. It is measured residually. And like anything which is measured residually, it incorporates all of the errors in measurements anywhere else in the national accounts. So what you tend to find is that productivity is inherently volatile from year to year. It will go up strongly in one year and not so strongly in the next. It is also subject to significant revision. So that means that, as a simple matter of econometrics, if you have a lot of things moving around and a lot of potential influences, you need a lot of data to try to untangle that, and we do not have a lot of data yet.

**Senator SHERRY**—You answered my question before I asked it. The quantity of data to date must be very limited?

**Mr Parker**—Correct.

**Senator SHERRY**—And that is because of the time frames?

**Mr Parker**—That is right.

**Senator SHERRY**—I am actually going to go to issues relating to productivity in a little bit more detail later. Do you draw a distinction between productivity and efficiency? They seem to be used interchangeably in this debate and others, and I am not sure that they are actually the same thing.

**Mr Parker**—No, they are not. Productivity basically measures the amount of output that you get for a given amount of input. So, if you have the same amount of labour input and, over time, you get higher output, GDP, as it is measured, then labour productivity will rise. There are various concepts of efficiency. One is the so-called allocative efficiency. This is the idea that resources in the economy are allocated to their most productive use. So issues of allocative efficiency arise with respect to the structure of the economy: do we do the right things? Then there is an issue of productive efficiency—that is, in the production of particular things, is that done in an efficient way? So it is possible that if efficiency improves in the economy then you will get a higher measure of productivity. But, formally, they are not exactly the same thing.

**Senator SHERRY**—When you say it is possible to get higher productivity, you do not necessarily get higher productivity as a consequence of increased efficiency.

**Mr Parker**—I think you probably would.

**Dr Kennedy**—You will get higher measured productivity growth, but what most economists are thinking about with productivity are movements out in the technological frontier, not to get too jargon based. So the idea that it is our technological capacity to produce things has moved out.

But you are right. If, on average, all of the firms got closer to that frontier, which would be an increase in technical efficiency for example, that would still show up as an increase in measured productivity in the ABS national accounts. But economists tend to distinguish between the notions because they want to see if, on average, firms are mostly technically efficient or, as Mr Parker said, the resources are well allocated. But the measurement of productivity, unless you go to quite sophisticated techniques, just soaks all of that up in one measure.

**Senator SHERRY**—I will explore a few more issues on productivity a bit later. I just want to conclude some general questions on industrial relations. Given your earlier comments, Mr Parker, to date the quantity of evidence of individual contracts generating productivity gains—I assume it is too early to make any conclusions about that?

**Mr Parker**—I do not have any particular evidence on that.

**Senator SHERRY**—Do any of the other officers have any observed quantified evidence to date?

**Mr Parker**—No.

**Senator SHERRY**—I take it silence is agreement with your general conclusion, Mr Parker.

**Mr Parker**—This may simply be a point of ignorance on our part rather than—

**Senator SHERRY**—I would never suggest that; I would never suggest you are ignorant. Has Treasury undertaken any modelling of the link between employment protection legislation and unemployment?

**Mr Parker**—I am not certain whether Treasury has looked at this in the context of the Australian data. There is a well-established body of international research which has looked at this issue. The reason it is generally done in the international context—the OECD has done a whole lot of work—is again an econometric issue. You need some data which incorporates some difference. We have not had major changes in the employment protection legislation in Australia until recently. Conceptually, you can look at this in two ways. You can look at how things have changed in Australia over a number of years and see if you can pick up an effect. That has proved to be quite difficult both in Australia and in other countries because the employment protection legislation does not change very much. The other way is to look at it across countries that have different employment protection regimes and see if you can pick up a difference that flows from that. Most of the research has been done in the context of cross-country analysis.

**Senator SHERRY**—I am sure you will respond, but there might be other officers who have a greater detailed knowledge and I respect the limitations on the level of detail that you get. What would you understand as employment protection legislation? What issues does it encompass? Are we talking about minimum wages? Are we talking about statutory rights to appeal with respect to dismissals? What are the policy issues within that definition of employment protection legislation?

**Mr Parker**—It is essentially limitations on termination of employees. Across different countries that might encompass a whole range of issues. Obviously, in the Australian context, there are procedural matters around the fairness of termination. In other cases, there is more stringent employment protection legislation relating to the inability to terminate employees.

**Senator SHERRY**—But, as a general observation, the limitations on the ability of employers to employ labour have always been quite minimal in Australia, haven't they, other than perhaps in the public sector?

**Mr Parker**—I would not say minimal.

**Senator SHERRY**—Minimal compared to some other jurisdictions I am aware of.

**Mr Parker**—It is lower than some other jurisdictions, but it is higher than some others as well.

**Senator SHERRY**—So lower than which particular jurisdictions? Which would come to mind, in your observation?

**Mr Parker**—It basically is a suite, although there is some differentiation in that. Many of the European countries have more stringent employee protection legislation. Within the European context, Denmark is looked at quite closely as a country which has relatively high employee protection legislation. So that is at one end of the spectrum. At the other end of the spectrum is the United States, which has relatively low employee protection legislation.

**Senator SHERRY**—But at the present time, recently, there has been no modelling of that link between employee protection legislation and unemployment—in the context of the recent industrial changes to law?

**Mr Parker**—No, we have not modelled it specifically. There are too many things going on to untangle the effects. Given that we have had strong employment growth over the last period, particularly through some parts of 2006, if you constructed an estimation equation and looked at the effect, you would probably just naturally drop out a result which said that the change to the employee protection legislation had boosted employment growth. Whether that is a real effect is a technical economic question. There may be other things going on.

**Senator SHERRY**—Isn't employment a lag impact as a consequence of economic productivity growth?

**Mr Parker**—It tends to be lagged variable to GDP growth, yes.

**Senator SHERRY**—Yes. So, at the current time, wouldn't employment growth be a consequence of other economic factors prior to changes to industrial laws, given their relatively recent introduction?

**Mr Parker**—That would be one of the other things which is influencing it, yes.

**Senator SHERRY**—And a significant influence?

**Mr Parker**—We have had relatively slower economic growth over recent times. This gets us into the conundrum, as some people have labelled it, as to why we have such strong employment growth, given that we have had relatively weak GDP growth. There are issues about whether there are errors in the data—measurement errors. There are issues around the consequentially low rate of productivity growth that we have had in recent times. There is a long lag between GDP and employment growth. It is one of these variable lags as well. So it is difficult to be definitive about precisely what is driving employment growth at any particular point in time. It is also a noisy series.

**Senator SHERRY**—What do you mean by that? I think I understand what you mean but, for the record, and I am sure for all those aficionados who follow your words, could you explain that?

**Mr Parker**—It is a scientific description of a series which is volatile. The issue of signal to noise is the primary question. How much information is there? In a sense you can imagine that, if you have a series which is, say, trending up, then a noisy series which is trending up will have a zigzagged structure around the trend. The more noise there is—the volatility vis-a-vis the trend—the harder it is at any particular point in time to discern the trend.

**Senator SHERRY**—Again, I may return to some more detailed questions in this area a little later. I want to move to the issue of education and training.

**Senator MURRAY**—Before you move on, could you amplify a little for us the question of such low GDP growth relative to such strong performance in the economy? To me, there is a dissonance between the two. It defies what I would normally expect, and there is the matter of whether your commentary on possible data error is one to worry about. One of the possibilities of course is that GDP is not picking up sufficient of the cash economy and that growth is much faster in real terms than is being measured. Another possibility is that the activity being recorded is not being properly reported by those from whom it is gathered. That is an endemic problem for the ABS. But you may have other views. I find our growth very modest and the restraints on our growth somewhat unfortunate. Yet the economy does appear to be doing well.

**Mr Parker**—I would be happy to elaborate on that. It is a very interesting issue and it is an issue which we have done considerable work on. It is an issue which bears importantly on the macroeconomic policy settings and the broader macroeconomic policy debate. So it is something that we have been very actively working on. As a consequence of the relatively slow growth in GDP and high employment growth, there is an apparent slowing in the aggregate level of productivity in the economy. As I said earlier, productivity is in a sense a measure of our ignorance. So trying to actually work out why—

**Senator SHERRY**—That is a very brave admission for an economist.

**Mr Parker**—I am a fairly modest economist, Senator. I am actually quoting from a rather famous economist who said that—I am not sure who it was.

**Dr Kennedy**—I am not sure whether it was Robert Solow.

**Mr Parker**—It might have been Robert Solow, who basically set up the whole growth structure in economic theory. So, given that it is in a sense a measure of our ignorance, it is difficult to actually unpick why this is occurring. Certainly we had an acceleration in productivity growth in the 1990s, particularly in the latter part of the 1990s. The accepted wisdom is that that was an economic pay-off from long and sequential economic reform. If you look at the more recent data, we have looked very carefully at what might be the explanations for this. Let me preface all of this by saying that one of my bosses many years ago in Treasury, when I was just a young starter, said, ‘If you are doing any work in this area, David, what you should do is throw out the last two years of data,’ because the last two years are subject to revisions, measurement errors and so forth, and looking at those last two years can actually throw out the analysis. Unfortunately, we do not have the luxury of always throwing out the last two years of data and coming along and saying to you, ‘We will tell you the answers to these questions in two years.’

**Senator SHERRY**—I must say that it would be very difficult, I suspect, when you received data inputted from the ABS, to say, ‘I am going to put it in the drawer for two years and not worry about it.’

**Mr Parker**—Correct. We know the data will change, so we have to take that reality. The fact is that policy decisions have to be taken in real-time based on all the information that you have. Unfortunately, we do not have the luxury of throwing out the last two years, so we look at it quite closely.

There are some quite particular things going on in the Australian economy at the moment. The terms of trade shock is causing very substantial structural change in the economy. One way of trying to unpick the productivity story is to look at productivity data sector by sector, see what is happening in mining, manufacturing and so forth. Again, I need to preface this by saying that productivity data at the sectoral level is less reliable than productivity data at the aggregate level. The reason is that, if you are looking at output at a sectoral level, you can measure the output reasonably well, but measuring the labour input is rather more difficult.

Let me just give you an example—and I will get onto mining in a minute. Basically, labour import measures come from the Labour Force Survey, a household survey where the ABS goes around and asks households, on a sampling basis, questions like ‘are you employed’, ‘where do you work’ and so forth. It is not always the case that people know what sector they work in. Now, that might sound a bit strange, but it is nevertheless the case. When the ABS previously used to survey employers, in the so-called Survey of Employment and Earnings, there used to be considerable differences between what the employers said people were working on and which industries people said they were working in. To give you a simple example of this—and this leads into the mining story—if you ask someone where they are working, they might say they are in mining but they could actually be in construction. They might be working on infrastructure around the mining industry, such as railways, roads, plants and equipment et cetera, but they are not actually working in the mining sector, which is the extractive bit of the economy.

Now, you would expect that, when there is substantial structural change going on in the economy, that might lead to temporarily lowered productivity growth. I will give you one particular example of that, and this is a regularity that we have observed: the level of

productivity in the mining sector has been falling through this mining boom. We have seen massive increases in employment in the mining sector, but so far increases in output are relatively muted compared to the employment growth. We are seeing increases in output; that is starting to come through. We published a paper on this last year—David Gruen was the author—which looked at the evolution of mining investment and output in this mining boom compared to the last. It shows that there are very long lags between when you start to invest in the mining sector and when you get the output. It is three, four, five years before something starts to come through.

So in the mining sector what we have seen is a very big lift in the level of investment and a very big lift in the level of employment—the mining sector accounts for a substantial share of the employment growth that we have seen, although it is a very small part of employment in the economy—but that just comes out in the form of a decline in measured productivity in that sector. If you look at how this boom has evolved, you will see that over the past four to five years the productivity level in the mining sector has fallen by 40 per cent. In macroeconomic terms that is a massive fall.

**Senator SHERRY**—Over what period did you say?

**Mr Parker**—Over the last four or five years.

**Senator MURRAY**—And it's untrue.

**Mr Parker**—Pardon?

**Senator MURRAY**—And it's untrue, in real terms.

**Mr Parker**—It is a timing issue. We are seeing increased labour and capital go into the sector. There is a measurement issue as to whether the input has been measured properly—when people say they work in mining, are they really working in construction? But over time, as the investment and new mining capacity comes on stream, then you will get a lift in output but with actually a lower labour input. So part of the slowdown in productivity that we have seen in the last several years is in fact due to that shock. The economy is adjusting, and you would expect over time that that shock would unwind and we would run at a higher rate of productivity.

There is also some stuff going on in the non-market sector—education, health, public administration and so forth. It appears that productivity numbers in the non-market sector have been quite weak for the last several years. Measuring productivity in the non-market sector is really fraught. Productivity is output over input; you need to measure both output and inputs. In the non-market sector you can measure the inputs quite well—you can count the number of public servants, the number of teachers, the number of doctors, how many hospital beds there are—but measuring the output is very problematic because there aren't market transactions that value and quantify them.

**Senator MURRAY**—That is right, and that is reinforced, I might say, by the fact that there has been a substantial shift from the public sector—which tended to measure its activities reasonably well—to the not-for-profit sector, who are now carrying out many government functions, and they do not measure their activities very well and you therefore get a data weakness from that sector.

**Mr Parker**—Just as a particular example, if you increase the number of teachers and reduce class sizes then the output per teacher in terms of number of student years taught will actually decline. Whereas, as a parent, I am quite interested in class sizes because I think that goes to the quality of the education, and we are not measuring in a sense quality in that productivity measure.

**Senator SHERRY**—While we are on education and training in the generality, has Treasury undertaken any modelling of the link between investment in education and training and productivity?

**Senator MURRAY**—I want to give the call back to Senator Sherry; I think he has a whole lot in this area. But before you answer that, can you conclude on the GDP growth side versus what is happening? I have to be careful as a West Australian, because obviously I have a sense of wellbeing for what is happening in my state. My sense of things—I want you to summarise for us—is that GDP growth is likely to be higher than the figures are showing us. That is my instinct. I cannot compute what I am seeing and hearing about bottlenecks, market stress, higher interest rates, obviously attempts to constrain matters, employment growth—all those sorts of things—and of course a general sense of what I describe as wellbeing in many sectors of Australia with the GDP growth figures that I am seeing.

**Mr Parker**—Let me continue a little bit on the productivity story, because that is in a sense the conjunction of the question that you have asked.

**Senator MURRAY**—Then if you could come back to Senator Sherry.

**Mr Parker**—Yes. If you look at productivity, on a whole economy basis it has been relatively weak over the last couple of years. You can strip out those bits that you in a sense understand the weakness of—the mining sector being an example—and look at those bits of the economy that you can measure productivity well in; so we are now looking here at the market sector. So we have stripped out mining and the non-market sector, which we cannot measure properly. Productivity growth in the non-mining market sector last year was 2.3 per cent, from memory. So the bit of the economy where we really would think that most of the productivity growth would come from is actually travelling along normally, in the sense that there is no story to tell about that. So I think that is quite interesting.

**Senator SHERRY**—Just before you go on, I was looking at some figures last night and I have got some here today in relation to labour productivity growth value-added per hour. Just to pick up your comment about the non-mining sector, how would you explain the trend annual growth, for example, in electricity, gas and water supply, which is minus 4.4—clearly not the mining sector; and I am sure it is well measured—or in health and community services, where it is only 0.6? How would you explain those low annual growth trend rates, given your earlier comments?

**Mr Parker**—I do not think that it is actually productive for me to try to explain what is going on in every sector. As I said, the data down at the sectoral level is difficult because of measurement issues. We can tell stories that we can understand in economic terms about particular large structural shifts like those happening in the mining sector. For the electricity, gas and water sector, if you were to ask me to speculate about what that would be, my speculation would be that we are seeing pretty significant investment in that sector, making

networks more resilient and so forth. So you might not be getting additional output, but you are getting additional reliability and so forth from that. Again, there are measurement issues buried in that. Those numbers are quite volatile. We saw very high growth in that sector—electricity, gas and water—as we went through the corporatisation and competition reforms in that sector.

**Senator SHERRY**—Looking at another sector, finance and insurance—which actually surprised me a little—again, there was very low long-term trend productivity growth, almost the lowest.

**Mr Parker**—And, again, that is extremely difficult to measure.

**CHAIR**—In relation to the reliability question and productivity growth in the mining sector, do you find where you have rapid employment growth, as you have in the mining sector, that there is a requirement for a skill increase to drive that productivity—the large influx of new employees requires a skill development that will then lead to greater productivity? Is there a lag between that growth and the acquisition of skills and the reliability you referred to?

**Mr Parker**—It would be reasonable to expect that. Just to finish off on Senator Murray's question: are the GDP numbers wrong? This has been an area of debate for some time. The ABS measures GDP in three ways. It measures it by counting up the number of things produced—shiploads of coal, the number of cars and so forth. It also measures it by the incomes that are generated by that production process: it counts up everybody's wages and salaries and profits. It also measures it by the amount which is spent on these things—the expenditure on consumption, investment and so forth. They are all telling broadly the same story. So it is not with one of these things that there is an obvious error in the data. It may well be that there could be some small revisions; there are always small revisions. Historically, over the last several years, there has been a slight upward bias in the revisions by the ABS to GDP, and it is a relatively small number.

**Senator MURRAY**—Intuitively, an economist would say that where you have GDP growth between two and three per cent you are unlikely to get full employment effects, you are unlikely to get capacity effects—obviously you can get them sectorally—across the economy. You are unlikely to show signs of an economy overheating, to use the old phrase. Yet, in the commentary, there is a sense of those strains and pressures. It does not equate to me to a growth rate of between two and three per cent, traditionally. And that is why I have asked the question.

**Mr Parker**—I think the answer to that puzzle is that not all of the economy is growing at two to three per cent. The bits of the economy which are experiencing the pressures and the capacity constraints that you have talked about are growing at much faster rates than two or three per cent.

**Senator SHERRY**—Although, for example, let us take up the earlier issue of employment growth in the mining sector. Presumably in the main there is a transfer of employees from other sectors into the mining sector. Doesn't that indirectly lead to flow-on consequences for those sectors from which that labour is being transferred?

**Mr Parker**—It is difficult to be definitive about this. If you decompose employment growth in the regions which are growing most rapidly—so WA and Queensland—the employment growth comes about basically from three things. First is the underlying population growth, which tends to be relatively stable. Second, it is changes in the unemployment rates—that is, the proportion of the workforce that is in employment. The third thing which drives it is the participation rate—that is, the proportion of the population in the workforce. It so happens that most of the rapid growth that we saw in WA and Queensland over the last year or so has been accounted for by an increase in the participation rate in those sectoral economies. That is, in a sense, new entrants into the labour market so that is the aggregate data. It might be that someone has newly entered the labour market and gone into a job which has been vacated by someone who has gone to the mining sector. So there may be underlying shifts there, but at the aggregate level it looks as if the participation rate is the thing which has been driving or has accommodated that increase in labour demand in those economies.

At the aggregate level, it is not clear from the interstate migration data that we are seeing a lot of people moving to the different states. One of the reasons—again, this is a data issue—is that a lot of this employment surge in this sector is done on a fly-in fly-out basis and they do not necessarily fly-in fly-out from the same state.

**Senator SHERRY**—I was sitting next to a North West Shelf employee on the plane to Devonport the other day, and he is a fly-in fly-out from Devonport in Tasmania to the North West Shelf. There are those sorts of changes that have occurred in terms of location of employment. I must say I was a bit taken aback, but that is not an unusual case apparently.

**Mr Parker**—Yes. I may be wrong about this, but my understanding is that if he was asked, ‘Are you employed?’ then the labour force survey would measure him as being employed in Tasmania.

**Senator SHERRY**—I want to go back to the general issues of modelling. There was an earlier question about the link between investment in education and training and productivity. Has Treasury undertaken any recent modelling in this area?

**Mr Parker**—Not that I am aware of. We have done some analysis. We published an article in the *Roundup* perhaps a year ago by Gene Tunny, which looked at some cross-country evidence, and we looked at this at a previous Senate estimates hearing. I can rehearse that discussion, if you would like.

**Senator SHERRY**—No, I can recall that discussion. I do not think I was leading the question towards that. I am just interested in anything over the last year that has been new activity by Treasury in this area.

**Mr Parker**—Graeme, do you have anything to add to that?

**Mr Davis**—No.

**Senator SHERRY**—Is there a link between the nation’s education and training performance and its international competitiveness?

**Mr Parker**—In a sense this goes to the article which we published in the *Roundup*. Yes, we believe that there is, but what that data showed in the study was that it is very easy to

show a strong link between productivity or output and education levels. As you look at the large changes in education levels across lower income countries, there is quite a strong relationship there—that is, that very low-income countries tend to have relatively low education levels. Once you get up into the developed countries—the OECD, for example—that relationship is just swamped by the other effects. We would believe that education is very important, but once you get up to the point where most countries have education attainments in the OECD at a relatively high level, there simply is not enough variation in that data to pick up an effect.

**Senator SHERRY**—The impacts of change in education and training would be fairly long term, wouldn't they?

**Mr Parker**—Correct. They are also difficult to measure. What you really want to measure in economic concept is the skills that are in people's heads. That is very difficult.

**Senator SHERRY**—And the earlier reference that you made about class sizes and whether that would lead to a long-term improvement in what is in a person's head would be a very long-term impact in terms of that individual entering the workforce perhaps 10, 15 or 20 years later.

**Mr Parker**—That is right. There is no doubt that it is fundamentally important.

**Senator SHERRY**—What about the general issue of physical infrastructure. Has Treasury undertaken modelling of the impact of infrastructure bottlenecks on productivity exports in economic growth?

**Mr Parker**—I am not aware that we have done anything specific on that.

**Dr Kennedy**—We have not done any modelling as such, but we have looked at the question and qualitatively analysed whether we think there are substantial issues.

**Senator SHERRY**—When did you undertake that?

**Dr Kennedy**—It is a bit like the terms of the trade issue; it is an ongoing issue.

**Senator SHERRY**—But no specific modelling in recent times that you could point me to?

**Senator MURRAY**—The *Economic Roundup* would have a series of articles on infrastructure, wouldn't it?

**Dr Kennedy**—Yes, certainly.

**Senator SHERRY**—What about the link between public investment in national infrastructure and productivity exports in economic growth?

**Mr Parker**—Public investment in infrastructure has been on a declining trend. That is basically the data, although there has been a pick-up in recent times. Most of that is done at the state level rather than at the federal level. It is also significantly affected by measurement and compositional issues. For example, the privatisation of Telstra is going to have a very significant effect on the split between measured private and measured public investment.

**Senator SHERRY**—With the increasing trend towards, for example, public-private partnerships, that would presumably be measured in the private sector because the asset is often owned by the private venture as distinct from the public sector?

**Mr Parker**—Yes, I believe that would be the case, although it would depend on the structure of the particular deal.

**CHAIR**—Senator Sherry, I do not want to interrupt your flow, but Senator Parry has a question in relation to an answer that Mr Parker gave you. If you do not mind, I will go to him and then come straight back to you.

**Senator PARRY**—My question is in response to Senator Sherry's mine example, which I have had similar experiences with—miners working in other states. Your response was, interestingly, that the statistic of employment would be recorded in the state of home base, not the state of employment.

**Mr Parker**—I think that is the case. Am I correct in that?

**Dr Kennedy**—I think so, but that would be worth confirming with the ABS.

**Senator PARRY**—If it was, that would not necessarily be an issue because presumably the disposable income would be spent in the home state.

**Mr Parker**—Exactly.

**Senator PARRY**—I was just concerned that you might have thought that was an issue. It is not an issue as far as you are concerned?

**Mr Parker**—I do not think it is an insurmountable statistical problem.

**Senator PARRY**—I do not think it distorts the employment statistics; it would just be unusual if you were working in another state.

**Dr Kennedy**—It is more a question of seeing where employment demand and growth is occurring. If it has been recorded that it is occurring in Tasmania when it is actually happening in Western Australia, we need to disentangle that effect. But it is certainly true that that person would presumably be spending most of their money in Tasmania. So the spending effect would go through Tasmania.

**Senator PARRY**—And equally, I am familiar with people moving to Tasmania on a weekly basis for employment, so there might be a balancing or a net effect.

**Senator SHERRY**—On that issue: it would be incredibly difficult to disaggregate some of the impacts, because presumably the individual I referred to earlier would be spending some proportion of their income in Western Australia, where he is working for four weeks before he then has the two weeks off in Tasmania—probably a greater proportion of the expenditure, I suspect, is spent in Tasmania, fortunately. I would have thought it would be very difficult to disaggregate those sorts of consumption impacts, on a regional basis, for example. In fact, I would have thought it would be very difficult to even attempt it.

**Mr Parker**—And we have not tried to.

**Dr Kennedy**—And mining employment is still less than about two per cent of total employment, so we are still talking about a relatively small portion of total employment that is out there.

**Senator SHERRY**—True in terms of employment. I have not got or looked at the recent average wages, but I suspect its average wage levels is probably one of the highest average

wage levels in the economy. So presumably the impact would be greater than the pure employment numbers.

**Dr Kennedy**—Certainly, and mining wages are growing up around five or six per cent compared to retail wages, which are down in the threes.

**Senator Minchin**—It is AWAs; there are some good outcomes.

**Senator MURRAY**—You both indicated the importance of measuring labour mobility as part of the flexibility you want in the economy, and that translates across to the transport sector and the importance of issues such as Qantas and the regional airlines and so on. I have been a fly-in fly-out worker for years now coming here.

**CHAIR**—Where are you spending most of your money?

**Senator MURRAY**—You mean where are they spending most of my money? They spend it in Perth. That is a growing phenomenon, if you watch the capacity constraints developing at a number of our airports, for instance. Labour mobility in this sense is a key economic factor which has been underreported and underanalysed.

**Mr Parker**—It is certainly an important issue and it is macroeconomically important in the sense that, because we have had this flexibility, we have seen real wages grow more quickly in the sectors which have been positively impacted by the terms of trade shock. But unlike some earlier episodes where commodity prices have gone up substantially, we have not seen that sectoral change in wages, a relative change in wages, which is attracting resources into those sectors. We have not seen those wage changes spread more broadly across the economy and become a large cost based shock to the economy, which has caused inflation and the macroeconomic brakes have had to be applied.

If you compare the response to this terms of trade shock to that which occurred in 1974, it is a chalk and cheese difference in terms of the inflation impact and the output story and so forth. It was a rather sad experience that we had after the 1974 terms of trade shock, which was brought to a rapid end by the subsequent oil price shock, and we ended up with what was called stagflation for a long period of time. This time the degree to which the authorities have had to apply restrictive macroeconomic policy has been much less.

**Senator SHERRY**—I want to conclude with some general questioning on modelling, and then I will go into some more specific questions, some of which you have already started to develop. I want to talk about federalism, the structure of our federal system—Commonwealth, state and local government, but Commonwealth-state in particular. Has Treasury undertaken any modelling recently of the financial and economic cost inefficiencies of a federal system of government in Australia?

**Mr Parker**—That would be a question which you should direct to the fiscal group.

**Senator SHERRY**—I want to expand on some of the earlier discussions that we had on productivity growth. Could you outline to me what is meant by labour productivity and multifactor productivity?

**Mr Parker**—Labour productivity is a measure of output per hour worked. You can also measure it in terms of output per head. It is a measure which is derived by taking aggregate

output and dividing it by aggregate input. That is labour productivity. You can measure that at an economy-wide level or you can measure it at a sectoral level, which we have talked about.

The multifactor productivity is meant to then account for the fact that labour is not the only input to the economy. If you have what we call capital deepening in a firm or industry or a sector—that is, labour has more capital to work with: better machines and so forth—then labour productivity will rise as a result of that. The fact that we now work with computers rather than a pencil and a sheet of paper means we can do a whole lot more stuff than we could do previously in the same time. That said, of course our output is very difficult to measure. But putting that point aside, so-called capital deepening can explain part of labour productivity.

What multifactor productivity says is: how much of labour productivity is unexplained by the capital deepening? So it basically takes aggregate output, subtracts the labour input, subtracts the additional capital input, and you are left with the true residual—the unexplained, multifactor productivity growth. This measures things like technical progress, our ability to work smarter over time. So that is the distinction.

**Senator SHERRY**—Thank you for that. Again, we touched on this to some extent earlier: what is your evaluation of the role of productivity and its importance in Australia's prosperity in the long-term?

**Mr Parker**—You can look at that in the context of what we call the three Ps framework—population, participation and productivity. The simplest but by no means complete measure of welfare tends to be GDP per head. So population growth does not feature in that as a substantial driver, although issues of population structure, age structure and the like, can. Of course, that is the topic of the debate around the *Intergenerational report* and long-run fiscal pressures and so forth.

**Senator SHERRY**—Before you go on, if you have a declining total population—and I think Japan and Italy will be the first countries to experience this, if they are not already experiencing it—presumably then you could have an outcome of GDP growth per head increasing as a consequence of total population decline.

**Mr Parker**—Yes, if there were underlying productivity growth, then you would have to ask where that is coming from: is it capital deepening or multifactor productivity? In the case of populations which are ageing, as Japan's is, you may well find that the workforce—that is, the productive part of the population as measured in the economic data—is actually declining as a proportion of the total population, in which case there is a driver going the other way.

**CHAIR**—Is that the more normal scenario?

**Mr Parker**—I think that would be right. The next thing is the participation story. Over the last 15 years or so we have seen a substantial decline in the rate of unemployment and a lift in the participation rate, so we are getting a much higher labour input into the economy. That drives an improvement in output per head. Then of course the last thing which impacts on this is productivity. Over the very long term, the main driver of the level of prosperity is productivity. All of the other things over the very long term tend to be second-order influences. But that is not to say that getting the unemployment rate down over the last 15

years was not very important. But if you are thinking about it over a 40-year period, then it is productivity which drives it.

**Senator SHERRY**—And the consequential flow-on to living standards, employment, wage levels—all of those issues are fundamentally driven by long-term productivity growth?

**Mr Parker**—Productivity is not everything, but it is almost everything.

**Senator SHERRY**—I accept it is not everything, but it is very significant.

**Mr Parker**—Correct.

**Senator SHERRY**—What are the implications of poor productivity growth for inflation?

**Mr Parker**—That depends on the extent to which the slowdown in productivity growth is in a sense factored into decisions which are taken in the economy. If you have a secular slowdown in productivity growth and that is not factored into slower growth in nominal wages, then other things being equal you will have a higher growth in unit labour costs, and other things being equal you will then tend to have higher inflation, unless the profit share declines. One of the reasons that we had a very nasty shock in the 1970s—there were various other reasons—was that productivity declined in a secular sense. We had very high productivity growth through the sixties and then for some reason in the early seventies it slowed right down. It took quite some time for that constraint in a sense to get factored into wage decisions.

**Senator SHERRY**—Then we had the massive external shock of the oil.

**Mr Parker**—We had the massive external shock. We also did not serve ourselves well by having massive increases in nominal wages. That is how we got into the so-called real wage overhang story.

**Senator SHERRY**—Again, we have touched on this to some extent. The recent productivity performance: do you have any additional observations to make about that, other than the discussion we had earlier?

**Mr Parker**—Not at a sectoral level. If I wanted to connect your last question with this one, which is, I imagine, where you were heading, it is to say that it is just much too early to really unpick the macroeconomic consequences in terms of inflation and in terms of macroeconomic policy settings from the slowdown in productivity that we have seen. There are all the measurement issues that we have talked about. There is the likelihood as we come out of the mining sector boom that productivity growth will accelerate out of that. As I said, this data is volatile, noisy, impossible to forecast, and so we do not get too fussed about it. It is something where we have to sit back and wait until the data is in.

**Senator SHERRY**—Notwithstanding your concerns about data and I think your earlier comment about putting it aside for two years, we have to make a call about productivity performance and long-term trend. What call do you make about it at the present time?

**Mr Parker**—We are not making a call about it at the present time.

**Senator SHERRY**—For the reasons you referred to earlier?

**Mr Parker**—For the reasons we referred to earlier. I think it would be much too soon to say that we have somehow or other dropped below average productivity growth over the last

period. If you look at productivity cycles, the previous productivity cycle ended in 1999, from memory. That was a very high average. The one after that ended in about 2004. When I talk about productivity cycle, the idea is to identify parts of the economic cycle so that you take out the cyclical influence from productivity, because it is a very cyclical thing as well. The productivity growth in the last cycle, which ended in 2004, was about average. Productivity was weak in the next couple of years. But I think it is much too early to start saying that we have somehow or other dropped below trend productivity.

**Senator MURRAY**—May I ask a quick question. With respect to the *Intergenerational report*, will there be any attempt by Treasury to model productivity trends for the long-term and indicate what needs to be done with respect to that area?

**Mr Parker**—We have to strike an assumption for productivity over the long term. We did that in the last *IGR*, at 1¾ percentage points. At the time a number of people thought that might be too conservative, because we had just been through the accelerated productivity phase of the late nineties. That average rate basically has pertained since then. We will need to strike an assumption for the period going ahead 40 years. It is an assumption.

**Senator MURRAY**—The reason I ask is that Senator Sherry asked whether you are going to have to make a call. As I understand it, that report is coming out this year, which means you have to be making a call, long term at least, and that would imply a sense of whether policy settings now and over the period that matters in the past will contribute to a lift in productivity. To use your language earlier, if you put more in the heads of kids with respect to maths and science, skills and abilities and so on, it will affect your long-term productivity thoughts. That is accurate, isn't it?

**Mr Parker**—That is right. What we did in the last *IGR* was assume a rate of productivity growth that was equivalent to the average which had pertained over the last 30 years. That happens to drop out at 1¾ per cent. That happens to also be the average growth in the last productivity cycle as well, to a point here or there. When you are doing very long-term projections it is a fraught exercise to say, 'That is our history, but we are going to deviate from our history in the future because of a whole range of policy moves yet to be announced or to flow through from other things.' The data is simply not there to support that. You are much more soundly based just to in a sense take a long run average. But that then leads into a policy debate: if you think we can do better than 1¾ per cent then what do you need to do?

**Senator MURRAY**—Yes, except that, if the combination of state, federal and territory governments' policies with respect to a prime driver of productivity, and that is the skills of people, have been effective over the last, say, five to 10 years, that should influence positively productivity outcomes, all things being equal. That is why I put the question to you, because, with respect to the nation state, the two prime areas where you have to attend to productivity are your land and your people. If government policies do not produce a lift in productivity expectations given everything else that is going on in the world, you are going to see a long-term decline in Australia's ability to create wealth for its people. I am not a pessimist in this area, I might say, but I am uninclined to just say, 'This is what we've done for 30 years back, so this is what we must do for 30 years forward.' That is not what I thought you have said. That is why this *Intergenerational report* is a signal to me as to whether Treasury thinks,

broadly speaking, the market and the governments of Australia are maintaining our momentum.

**Senator Minchin**—The Treasury will obviously have to have an assumption and an explanation has been given as to what that assumption would be based on. It will not be presented as an official forecast of productivity, but it will present all of the data that enables us to discuss what policy implications it has and what policy measures might be available to enhance that long-run average productivity if we believe that is important. It will not be an official forecast, I presume.

**Mr Parker**—The purpose of the IGR is to make a projection which then exposes a range of policy issues which flow from that. It is not trying to predict what the economy will do over the next 40 years. There are different bits that you can be more or less confident about. You can be pretty confident about the population dimensions of the IGR because a lot of the population and the demography stuff is just locked in. The fact that total fertility fell precipitously after the baby boom still has effects. There is nothing that can be done about that. The fact that total fertility is now rising a little bit will continue to have quite significant effects over the next little period.

**Senator JOYCE**—How do we monitor that?

**Mr Parker**—Total fertility?

**Senator JOYCE**—Babies per—

**Senator Minchin**—Birth rate.

**Senator JOYCE**—Yes.

**Mr Parker**—Total fertility is a measure of how many children a woman would have if that woman had as many children at each age through her lifetime as are presently being born in Australia. You look at the fertility rate for each year—how many women aged 21 are having babies, how many women aged 22 are having babies, and so forth—and expand that across the total lifespan, and you get to an answer of how many babies an average woman, in a sense, would have in her lifespan.

**Senator JOYCE**—So, in lay terms, you are basically saying that slightly more younger women are having babies now?

**Mr Parker**—In fact it is more older women who are having babies.

**Senator SHERRY**—I have to say that I did not expect to get into this area of questioning, despite my deep interest in all issues relating to productivity and macromodelling. Can I come back to the earlier discussion on productivity performance. In your earlier comments I think you identified ‘weak’ productivity growth. Is that from 2004 onwards?

**Mr Parker**—That is about right.

**Dr Kennedy**—If we look at productivity growth, it did slow in the 2000s in general, compared particularly to the late 1990s, but the weak economy-wide productivity growth has particularly been the case in the last two years, 2005-06 and 2004-05. But, as Dr Parker said earlier, in the market sector in 2005-06 productivity growth was around 2.2 per cent, which is

about its long-run average. That is the part of the economy where we are most confident we are measuring productivity accurately.

**Senator SHERRY**—Again, earlier we touched on productivity in the mining sector and, to some extent, in some of the other sectors. In relation to the discussion earlier about productivity—as I think you predicted—starting to increase in the mining sector, the fall has been quite dramatic, looking at the sectoral figures that I touched on earlier compared to other sectors. Is Treasury confident that the productivity growth in that sector will increase, or start to increase, based on the evidence that it has examined?

**Mr Parker**—That is certainly what we saw through the last mining boom in the early eighties, and we would expect that to be repeated this time. As to the precise timing and the precise amount, it is open to conjecture.

**Dr Kennedy**—There is an additional factor at play in the mining sector, and that is that there has been a fairly steep decline in oil production over the last four to five years in Australia, which has contributed to that decline in mining productivity. We are expecting that decline largely to have run its course. It is quite a significant part of the overall fall in mining productivity.

**Mr Parker**—The productivity point there is that you need the same number of people to man the oil facilities. They just pump less per head.

**Senator JOYCE**—That relates to a question that I was going to ask later on. Do you mind if I ask it now?

**CHAIR**—The non-government senators have had a pretty fair go for the last hour and a half and I thought I would throw to the government senators. I know that Senator Joyce has a question in relation to the coal industry and I think Senator Watson has—

**Senator SHERRY**—Chair, I think it is probably easier if we deal with it sector by sector. I am quite relaxed about government senators coming in at an appropriate time.

**CHAIR**—I think we will have Senator Joyce and then we will have a break for morning tea.

**Senator JOYCE**—As a separate issue, you said that there is a strong correlation between the cost of oil as an input and our productivity from mining. Is that correct—is that what you said?

**Mr Parker**—No, what we said is that when we measure productivity in the mining sector, the mining sector also includes oil extraction.

**Senator JOYCE**—Oil infrastructure?

**Mr Parker**—Oil extraction. So, for the purposes of the statistics, all of the platforms out in Bass Strait and the North West Shelf are part of the mining sector. As oilfields deplete it gets harder and harder to pump oil out of them. So the amount of oil that is produced per platform has been declining in Bass Strait and other places. But the productivity story comes about because you still need the same number of people, helicopter pilots and so forth to run each platform.

**Senator JOYCE**—So basically you are saying that we still need the same attention to the production of oil but we are not producing as much and it is increasingly going to fall away over time. But that is a different issue.

**Mr Parker**—Yes. As new fields replace the North West Shelf, it could go up again.

**Senator JOYCE**—That is a different issue.

**Senator SHERRY**—The cost of the operation is relatively fixed.

**Mr Parker**—Pretty much, yes.

**Senator SHERRY**—But the production inevitably will decline because of the nature of the oil industry.

**Mr Parker**—That is right.

**Senator SHERRY**—Unless, of course, as you indicated, new oilfields come on line. Some are, but they may not necessarily be of a size to replace the sector that is in decline in terms of production.

**Mr Parker**—That is right. I mentioned previously that the level of productivity in the mining sector had fallen by about 40 per cent. About one-quarter of that decline is this oil effect.

#### **Proceedings suspended from 10.26 am to 10.46 am**

**CHAIR**—Dr Kennedy, there is a matter you want to bring to the committee's attention resulting from some answers this morning; is that correct?

**Dr Kennedy**—I will confirm how a person's employment will be recorded in the labour force survey. We were discussing before whether, if you were in Tasmania and flying out for a job and flying back, your employment would be recorded in Tasmania. Apparently the rule is that, if you are away for six weeks or more, your employment will be recorded in the place you have flown to—WA. If you are going to be away for less than six weeks, your employment is recorded at your place of residence, which would be, in your example, Senator Sherry, Tasmania. So it depends how long you are away for.

**CHAIR**—I think that is very helpful.

**Senator SHERRY**—I am not sure how you would apply that in any detailed survey. You are working for four weeks in WA and you are then back home in Tassie for two—four on and two off. Continuing the discussion on productivity, to what extent have the declines in productivity in the mining sector that we discussed earlier—albeit you argue that there is to be a shift in improvement—been offset by compositional shifts away from lower productivity sectors to mining?

**Mr Parker**—That is difficult to answer, in the sense that we do not have good data on where the resources that have gone into mining—particularly labour resources—have come from. Anecdotal evidence is that there has been a substantial outflow of labour from the rural sector, in part because of the drought, into the mining sector. Anecdotally it is the case that, because the mining sector has had this substantial boom, it has made the adjustment for the rural sector a little easier because there are alternative employment opportunities and alternative sources of off-farm income. In terms of a broader, economy-wide study of the

allocative efficiency changes we have got from shifting resources from one sector to the other, we have not undertaken that as an empirical exercise.

**Dr Kennedy**—We have done a shift-share analysis, which is a question of labour moving from a low productivity sector to a high productivity sector. We have looked at the extent to which the shift in employment to mining, which is a relatively high productivity sector because of the amount of capital that is applied to it, offsets the fact that, within mining, productivity has been falling. The net effect is still a subtraction from productivity from mining, because the within-mining productivity component is larger than the composition effect.

**Senator SHERRY**—I would agree with you that, anecdotally, there is a shift from the rural sector, if you like—and there are other reasons; you mentioned the drought—which is probably a push, and at the same time we have the pull impact of resources. Are there any other areas of the economy where, anecdotally, there is a shift away from mining into what would seem to me to be some of the skills there—construction and even electricity? In those sorts of areas there would be a compositional shift to mining in the current circumstances.

**Mr Parker**—Steven, do you have any information on that?

**Dr Kennedy**—In general, I believe the composition effects have been positive over the last couple of years. There has been a general shift to higher productivity sectors, but the within-industry productivity has tended to more than offset that. Beyond the answer I gave a moment ago about the specific mining effect, we have not done much more than that. Construction productivity, I believe—and some of my colleagues might like to comment on this—has actually been growing reasonably strongly in the more recent period, but there are always measurement issues around, as Mr Parker outlined—whether the employment should be recorded in construction, for example, rather than mining.

**Senator SHERRY**—At least anecdotally. I accept the earlier point that was made that you can have construction activity that is directly related to mining, for obvious reasons, but you can also have shifts out of construction—because of the nature of the work in construction and the skills, which are clearly not mining related—into mining. I would have thought the example I gave earlier of the person from Devonport was actually that occurring: construction formerly, lower construction activity in Tasmania until recent times and making a decision to shift to the mining sector three or four years ago.

**Dr Kennedy**—The growth in the construction sector is extremely strong. Around the labour market at least, it is as strong as it is in the mining sector. Because of some of the measurement issues we have been tending to be considering mining and construction together. For example, over the last couple of years mining and construction together have lifted their share of employment from around 8 per cent to 10 per cent, and that is mostly construction. They are both quite strong.

**Senator SHERRY**—That increase in construction activity—albeit that it has been in part driven by mining—is not purely due to a mining explanation, is it?

**Dr Kennedy**—No, there are other—

**Senator SHERRY**—There is significant construction in other areas that are non-mining. I have not looked at the figures, but—

**Dr Kennedy**—That is correct, Senator.

**Senator SHERRY**—Are you going to attempt, in a more formal, quantitative way, to analyse those compositional shifts and impacts?

**Dr Kennedy**—We have done an analysis, in looking at movements of labour between industries, of each industry's contribution to overall productivity. We have done that analysis and in fact that composition style of analysis may have been published by the Reserve Bank as well.

**Senator SHERRY**—I was going to ask about the timing of that and any publication of any of the material as a consequence of that compositional shift.

**Mr Davis**—There was something published a couple of years ago, looking at the extent to which the compositional shifts and various other trends were explaining some of the trends in productivity we had seen. At this stage I was not intending to be doing a great deal more work in that particular area. On the compositional shifts, of course, within the economy we have underlying long-run trends that are going on in terms of where resources are moving, which we see in most developed economies. We have seen resources moving out of what are high measured productivity sectors with lots of capital associated with them—mining being a really good example of that—into things which are either hard to measure, like some of the unmeasured sectors or the non-market sectors, or into some of the service sectors which may or may not have significant amounts of capital associated with them.

**Senator SHERRY**—What about the manufacturing sector? There is generally higher capital, I would have thought. I have not looked at recent figures on employment growth in the sector; I do not know whether it is in actual decline. But, as a component of employment growth in the economy, it is probably in decline compared to other sectors, I would have thought, given the shifts in manufacturing off-shore. Do you have any observations to make about that?

**Mr Parker**—There is a secular decline in the share of manufacturing in the total economy—that is right. It is down to 12 per cent or a little less than that. If you go back a decade or so, it was 18 per cent or something like that.

**Senator SHERRY**—Has there been an observed flow in the composition of employment from manufacturing into other sectors?

**Mr Davis**—You can only get that from looking at the aggregate numbers in each of the sectors. If we have seen a relative increase in other sectors, then that may be a flow. It is hard to track individuals through that.

**Senator SHERRY**—I accept it is hard to track the individuals, but I would have thought you could make some relatively robust observations and conclusions about where those flows are occurring—to and from.

**Mr Davis**—What we can say is that consistent in the data across most countries is a flow out of the mining and manufacturing sectors into some of those service sectors, and yet in aggregate over the medium to longer term that has a small, depressing effect on measured

productivity. A statistical artefact of society is valuing the outputs of those things so resources are going there. But as a statistical artefact you get a small negative from that compositional shift over time.

**Senator SHERRY**—You referred to the general shift in comparative economies. The one difference with Australia, I would have thought, is the relative size and strength of our resources sector as compared to other advanced economies, except perhaps Canada, that I can think of.

**Mr Davis**—Norway would be another with large resources.

**Senator SHERRY**—Yes, that is oil based.

**Mr Davis**—That is right.

**Senator SHERRY**—Following on with a few more questions on the resources issue, the issue of the recent trends in prices Australia receives for its commodity exports and the recent trends in Australia's terms of trade—and we have touched on the resources boom of the last five or six years and the previous resources boom—would it be correct to describe the current resources boom as a once-in-a-generation boom? We do not see these sorts of booms occurring relatively frequently or for a relatively long period of time.

**Mr Parker**—They are not frequent. The question of how long it lasts is a difficult and moot point.

**Senator SHERRY**—Difficult and moot because I suspect you are examining that step-down issue we looked at earlier and presumably whether the two-step-down has to be moved out, given the strength of the current resources boom.

**Mr Parker**—That is one possible conclusion. It looks like this resources boom, in price terms, will be longer lived than some of the previous ones. That is in large measure driven by the emergence of China, and also India, into the global marketplace and the degree of development that is taking place, particularly in China, with massive levels of investment in that country which are very resource intensive.

All of that said, we still think it is reasonable to assume that commodity prices will track back from the peaks we have seen in recent years. It is not a story that one can tell, in a sense, over the whole commodity mix. We are already seeing declines in some commodity prices for coal and the like. But iron ore prices were still increased in the last contract negotiation. So the story across different commodity classes is a little bit mixed.

That said, one would expect that, when the present unprecedented investment levels we are presently seeing come on stream, you will get a large supply response into the market, and that could bring back prices more towards their longer-run averages. Just precisely how far that goes or whether it might overshoot is difficult to predict. There are a couple of reasons which one can argue to the effect that commodity prices may stay higher than they were through the nineties for a more extended period but not as high as where they are presently. A number of factors go to that. One is the fact that there has been a very substantial consolidation in the global mining industry. You now have a number of the giants—BHP Billiton, CRA, RioTinto and CVRD in Brazil—who account for a large share of the market in these commodities.

The classic so-called 'cobweb cycle' in economics is the kind of thing you would use to model these kinds of cycles. Another name for it is the 'hog cycle', because the story was originally told about fluctuations in the price of pigs. What happens is that, if you have an industry where supply responds slowly to price and you get a positive demand shock, price will rise. Eventually supply will rise to meet and in some cases exceed the initial demand shock and then prices will fall. It is called a cobweb because, if you draw the demand and supply curves and map the movement through time, the price goes round in a cobweb and looks like a spider's web.

That is a reasonable stylised description of the underlying economics of it. One of the features of the supply responsiveness in that model depends on whether or not agents who are supplying take account of other people's investment. If it is an atomistic competition, you are likely to get a large supply response because everybody will supply a larger amount and will not take as much account of the likely fall in price if supply goes up. If you have got consolidated industry, the supply response may be more careful than previously. That is one argument.

**Senator SHERRY**—It sounds as though you are almost describing the emergence of a mining oligopoly around the world, with a much greater ability of suppliers to control output much more directly in anticipation.

**Mr Parker**—I would not be attracted to particular labels or go to issues of collusion or anything like that. I think we are talking about—

**Senator SHERRY**—I am sure that does not happen in the real world!

**Mr Parker**—We are not talking about an OPEC scenario where everybody gets together and works it out and coordinates it.

**Senator SHERRY**—No, I was not suggesting that.

**Mr Parker**—It is just likely that, just behaving naturally, they will be a little bit more careful about overinvestment because they each account for a substantial share of the investment in the global industry rather than being a small share.

**CHAIR**—I presume it would be potentially dangerous to crystal ball gaze, because the demand side is the great unknown, isn't it?

**Mr Parker**—The demand side is the great unknown. It is possible to make an argument that, when you have the demand side growing in the way it has in the last several years—where growth from year to year is a relatively large proportion of the total output—you can only meet that increase in demand by basically bringing on extra mines. It is not a story of slightly augmenting the capacity of existing mines. You need large amounts of investment and, in order for that investment to come forth, people who are devoting the capital to it will need to be assured, in a sense, that they are going to get a return from that capital. It is not just small amounts of capital; it is a large amount of capital. You can construct models in those circumstances which show that, when you have very large growth relative to the volume, the price adjusts up in a step fashion—again, probably not to the extent of the initial price shock, due to the demand shock, but it may be higher.

**CHAIR**—Thank you.

**Senator SHERRY**—We talked earlier about the investment in mining in Australia. Presumably, where mineral resources in other countries are discovered or in the process of being discovered, a similar level of investment is occurring.

**Mr Parker**—It is.

**Senator SHERRY**—And with the more rapid and greater growth of international mining companies—the greater concentration—they would be able to at least factor in the investment in bringing online mines or make judgments about that internationally to a more accurate degree than if there were a lot more dispersed and relatively minor players in the world.

**Mr Parker**—Yes, that is the idea.

**Senator SHERRY**—With the demand for minerals, obviously there has been a lot of focus on China and India. For example, I notice India now have one of the largest steel-making industries in the world. In fact, it is in the process of taking over most European steel manufacturing capacity. But is it both as a consequence of the shift of manufacturing from a range of economies such as Australia to India and China or is it also the increase in minerals demand and, for manufacturing, an increase in their per capita demand for manufacture of goods in those countries and other developing countries?

**Mr Parker**—I think both factors would be at play. A third factor is that these countries and particularly China, for example, have a very high level of investment to GDP. I think it is about 50 per cent—

**Mr Gardiner**—Yes, 50 per cent.

**Mr Parker**—So half of China's GDP is accounted for by the level of investment. Investment—we are talking here about building roads, bridges, pipelines, power stations and the like—is very intensive in commodity demands. There is a lot of steel in it and a lot of energy in it, so in a sense it is a story about the inputs into the development process which are driving it.

**Dr Kennedy**—That is something that distinguishes this from the previous boom. It was more about energy in the late seventies mining boom, whereas this is both an energy and construction demand story—very strong demand for materials that feed into construction.

**Senator SHERRY**—We have touched to some extent on the effect of the resources boom effect on national income. Is there an impact of national incomes in areas other than mining?

**Mr Parker**—It flows through all of the transmission channels of the economy. One obviously is the exchange rate. With higher commodity prices, other things being equal, the exchange rate appreciates, and that is part of the overall adjustment mechanism. It is one of the reasons why we have adjusted to this terms of trade boom better than we did last time. Last time we had a fixed exchange rate arrangement, so deciding movements in the exchange rate was part of the policy mix. The last time we had a terms of trade boom the various participants arguing—it becomes a political process—that the exchange rate should depreciate. We have seen that automatic adjustment. That has the effect of dampening some other parts of the economy.

**Senator SHERRY**—The higher exchange rate would obviously have a consequence for rural production.

**Mr Parker**—It would have a potential consequence for the prices at which they—

**Senator SHERRY**—Yes.

**Mr Parker**—In broad measure, we tend to be price takers in the rural area, so we produce whatever we can in any particular year and the price drops out. It also has a dampening effect on those parts of the manufacturing sector which are servicing the non-mining parts of the economy. To pick up a point in earlier discussion: as we said, the overall conditions in the manufacturing sector have been quite subdued. That is in part due to the exchange rate and also in part due to competition from competitors like China. But those bits of the manufacturing sector which are exposed to the mining sector and the construction sector are growing quite strongly.

**Senator SHERRY**—Again on the commodity boom, I refer to the impact on revenues. Can you outline how the forecasts of the impact of that commodity boom on revenues are fed into the revenue group?

**Mr Parker**—Before we get into that and I tell you exactly what we do, let me give you some context. Conceptually, you could think about this in a bottom-up way and a top-down way. A bottom-up way would be to look at how much profit the mining sector is making and how much profit the financial and other service sectors which are serving mining are making and then try and work out what the effect is on the manufacturing sector. That is a very difficult and patchy exercise. You cannot just take the increase in profits of the mining sector and say that is the effect, because there are some other parts of the economy which are dampened. That is very quickly a bottom-up exercise which gets out of control in terms of the complexity in the data you need.

The other way you can do the exercise, in a top-down way, is to look at the effect of the terms of trade shock on aggregate nominal activity and income in the economy and then do it at the aggregate level. That basically says that, if national income is growing by a certain level plus X for the mining boom, then you can look at the plus X amount and see how that flows through into tax receipts. Regarding our input into the revenue forecasting stuff, Dr Kennedy's area is responsible for running the JEFG process—the joint economic forecasting group process—which feeds into what we call the parameters exercise. That produces a vast range of numbers of various economic variables including GDP, employment, income, profits and so forth. That gets fed into the revenue forecasting.

**CHAIR**—I think Senator Sherry has moved on from productivity into other areas, so I will throw to Senator Joyce.

**Senator JOYCE**—We have a terms of trade shock—that is interesting. Currently in our terms of trade, what are the major export items? Give me the top five.

**Dr Kennedy**—I can do the broad shares and then go within the shares. Non-rural commodities are about 40 per cent of our exports—the mining stuff.

**Senator JOYCE**—What is the biggest of the non-rural commodities?

**Dr Kennedy**—Coal and iron ore are the largest single shares, I think.

**Senator JOYCE**—How much is coal at the market?

**Dr Kennedy**—I do not know, off the top of my head. We will take the question on notice, if you like.

**Senator JOYCE**—We have talked about how our economy is geared towards the current resources boom—and everyone is agreed that there is one of those. What are the major threats, currently, to that boom? What would you have discussed as being threats to those major exports, of which you have noted that coal is a major one?

**Mr Parker**—Because it is a global phenomenon, there are substantial threats. Just as a point of language, we tend to talk about risks rather than threats.

**Senator JOYCE**—Risks.

**Mr Parker**—Given that this has been driven by China, were something to happen to growth in China for some reason then that can be identified as a substantial risk to the commodities price boom. That then gets you into a debate about the structure of the Chinese economy, the stability of their financial sector and the like.

**Senator JOYCE**—So a major external risk is a possible change in the dynamics of the China experience or the India experience?

**Mr Parker**—And more broadly the global economy.

**Senator JOYCE**—Is there anything on the horizon likely to happen there? Has anybody touched base on that?

**Mr Parker**—It is impossible to rule it out, but, in terms of likelihood, we think it is a relatively small possibility. It is possible to tell scary stories about what might happen if there is an avian influenza global pandemic and all that kind of stuff. There are a range of global imbalances, particularly around the US-China arrangement.

**Senator JOYCE**—If there were an imbalance or something were to happen, what sort of effect would the loss of coal exports have on our economy?

**Mr Parker**—It would be a nasty shock to our trade accounts.

**Senator JOYCE**—Nasty or disastrous?

**Mr Parker**—What you might expect if that were to happen—and we are talking in purely hypothetical terms—is that the exchange rate would depreciate, and possibly quite significantly.

**Senator JOYCE**—Quite significantly.

**Mr Parker**—That would then put into reverse all of the adjustment mechanisms that we have seen take place over the last little while. Suddenly the manufacturing sector would become much more competitive internationally. We might see resources flow back into that.

**Senator JOYCE**—If manufacturing were to become more competitive, what market share would we be taking if we lost one of our major exports in coal? What would be the market share in manufacturing that we would be likely to pick up? Who would we be taking it off? China or someone?

**Mr Parker**—Yes, that is right.

**Senator JOYCE**—Would we be competitive against China in that area?

**Mr Parker**—We would be more competitive against China.

**Senator JOYCE**—Are there any internal threats against coal? Have you ever had any discussions about current or likely policy change that could have an internal threat against coal exports?

**Mr Parker**—There are, of course, all of the greenhouse issues around that, but we have not done work with the macroeconomic group about what might be the macroeconomic implications. We had this discussion earlier.

**Senator JOYCE**—But that is a real threat. Why wouldn't you do some studies on the macroeconomic threat of an internal change of policy to our production of coal, seeing that it is, as you have stated, our major export and would bring about a terms of trade shock if it were to disappear?

**Mr Parker**—That would be because it is not in prospect that any response to the greenhouse gas issue would involve turning off the coal industry on one day.

**Senator JOYCE**—You might need to take this on notice—

**Senator SHERRY**—In other words the Greens are never going to get into government!

**Senator JOYCE**—What is the window for coal exports into the future at our current rate of production? How long into the future can we continue to export coal?

**Mr Parker**—A couple of hundred years.

**Senator JOYCE**—A couple of hundred years sustaining the proportion of the economy that it sustains at the moment?

**Mr Parker**—This goes to the issue of what the reserves are and the level of economically extractable reserves. It is not just a question of how much coal or whatever there is absolutely in the ground; it is a question of whether it is economic to extract it. As the price goes up it becomes economic to extract more.

**Senator JOYCE**—Do we have a competitive advantage in our extraction of coal? Is ours like a far more affordable product to extract than, say, our major competitors in the coalmining industry? Do we have an avenue of basically less overburden and coal close to the surface that gives us a huge competitive advantage in our extraction of coal?

**Mr Parker**—I am not sure of the details.

**Senator JOYCE**—Can you take that on notice?

**Mr Parker**—Yes.

**Dr Kennedy**—I am aware that we have some advantages in that we have high-quality coal reserves, particularly metallurgical coal, compared to some other countries such as China. In answer to your earlier question, coal by volume is about 23 per cent of non-rural commodity exports.

**Senator Minchin**—\$25 billion a year, I think it is.

**Senator JOYCE**—We have coal and iron ore exports, but what portion of our exports at the moment is manufacturing?

**Dr Kennedy**—Elaborately transformed manufactures, or manufactures more broadly, are a little under 20 per cent by share of manufactures.

**Senator JOYCE**—Manufacturing is 20 per cent of our total export income—is that right?

**Dr Kennedy**—I will take it on notice and check, but that is the broad rule of thumb. Basically, about 40 per cent is non-rural commodity exports and the rest is split between agriculture, services and manufacturing, in broadly equal shares.

**Senator JOYCE**—In layman's terms, 40 per cent is mining and then the rest is—

**Dr Kennedy**—services, manufacturing and agriculture.

**Senator JOYCE**—What portion of the trade account deficit is due to the importation of fuel?

**Dr Kennedy**—That is a question I can take on notice. We are a net importer of liquid fuel. We import more than we export.

**Senator JOYCE**—What is the largest item on our trade account deficit? What is the largest item of import into Australia?

**Dr Kennedy**—In terms of types of goods, it probably is manufactures—capital equipment—and also consumer items. I do not have the shares to hand, but it would be a split between those two.

**Mr Parker**—We can give you a split—that is not a problem.

**Senator JOYCE**—I would like you to take on notice what the portion of fuel is in our trade account. We might have it here, I will just check.

**Dr Kennedy**—In terms of the share of imports, if we split it this way, we have goods and services. Goods imports are about five times the size of services imports.

**Senator JOYCE**—What are the main goods imports?

**Dr Kennedy**—We could split the goods imports three ways into consumption goods, capital goods and intermediate and other goods. Intermediate and other goods would be things like fuel or other things that are going to be used as—

**Senator JOYCE**—What are consumption goods?

**Dr Kennedy**—Of total goods debits of a little over \$15 billion, in December consumption goods were about \$4½ billion; capital goods were about \$3½ billion and intermediate and other goods were about \$7 billion.

**Senator JOYCE**—I am curious because there is a continual argument put up about how much of our trade account deficit is due to the importation of fuel. I want you to take that on notice to stop conjecture on it.

**Dr Kennedy**—Sure.

**Mr Parker**—We export and import liquid fuels.

**Senator JOYCE**—What is the threat from the importation of fuel and how does it relate to our capacity and competitiveness in the exportation of mining products, which are highly

reliant on fuel? What contingency plans, in your threat analysis, do you have to deal with that issue?

**Mr Parker**—We will take that on notice.

**Senator JOYCE**—Do you have any contingency plans with regard to threats to major import sections of our mining resources?

**Mr Parker**—There is a whole policy framework around the so-called liquid fuel emergency arrangements. I am not an expert on that at all. It basically involves a schedule of responses to a cessation of supply into the industry and the like. There is a well-established framework there, but I am not the person to give you answers on the details of that. That is something which is properly directed to the industry department.

**Senator JOYCE**—Seeing that coal is one of our major exports, do you have any modelling on the effects of any transition out or any problems with the cessation of coal exports and what that trickle-down effect would be in the economy?

**Mr Parker**—I think the short answer to that is no.

**Senator JOYCE**—Do you think that, in light of discussions that have been publicly held—and you see them in the paper all the time now—it would be something you might have an interest in?

**Mr Parker**—I think that event is pretty unlikely to occur. It is the case that, almost irrespective of policy responses—

**Senator JOYCE**—Why would you say that it is unlikely?

**Mr Parker**—Let us hypothetically say that, as part of the greenhouse response around the world—

**CHAIR**—I am a bit concerned about hypotheticals but informed debate—

**Mr Parker**—I think it is very unlikely that the coal industry is going to get shut down.

**Senator JOYCE**—Why? There are people—

**Mr Parker**—Because if you shut down the coal industry that also means shutting down the electricity industry. It is the case that the major part of installed baseload power in Australia and China is driven by coal.

**Senator JOYCE**—So you are saying our major interaction with China is driven by coal so it would be highly unlikely because you would be threatening all of that?

**Mr Parker**—You would be putting the whole of the global economy under threat if you were to shut that down. The Australian economy would have to be shut down if you were to shut down the coal industry because there would not be—

**Senator JOYCE**—So you are saying the Australian economy would have to be shut down if they shut down the coal industry?

**Mr Parker**—Yes, because there would not be enough electricity to run the place.

**Senator JOYCE**—That would be a bit of a trade shock, wouldn't it?

**Mr Parker**—Yes, so I think it is rather unlikely.

**Senator JOYCE**—So you are not aware of any policies that have been touted at all by any sectors that might affect any of that?

**Mr Parker**—Of course I am aware of the debate which is going on in the political arena.

**Senator JOYCE**—It is your job. That is a potential contingency, isn't it? There must be certain effects, certain requirements, certain caveats, that people would start putting on that would start to affect this thing that you say, quite rightly, would shut down the whole of the Australian economy. Surely you would have to be pouring through some of these ideas that are floating around and working out what this means to everybody who expects to have some sort of terms of trade and to have some sort of capacity as a nation to purchase something.

**Mr Parker**—I go back to my previous answer. It is inconceivable to me that we would have a policy response which would shut down the coal industry on one day.

**Senator JOYCE**—It is inconceivable to you, but it is not inconceivable to others.

**CHAIR**—Mr Parker, I think Senator Joyce is asking you, irrespective of whether it is likely, what the impact would be of a reduction. He may want to put some scenarios to you in a question on notice about reductions and what the impact could potentially be. With the greatest respect, I do not think you can answer his question by telling him that you do not think it is going to happen.

**Senator JOYCE**—Yes. We have fleshed out that the greatest threat to the coal industry is an internal threat and not an external threat, unless we are talking about H5N1. Internal policy is the greatest threat. If I can read about it on the front page of the paper then it is obviously evident and obviously something that needs to be thought about. I do appreciate that you say that it would just mean shutting down the Australian economy. I am going through the implications of that because I think it is very important that it is in the public forum and that people completely understand exactly what we are dealing with. You are dealing with only a small portion of the workforce. You said about only two per cent of the workforce is involved with mining; is that correct?

**Mr Parker**—That is right.

**Senator JOYCE**—So people's actual connection to the issue is pretty slight; however, the ramifications are immense. You have said you have a window of 200 years of this potential income stream into the future, so you are giving people plenty of time to slowly whittle away your position. If we did not have the coal industry, what do you think would be the alternative? Where would we concentrate next?

**Mr Parker**—If you think about it in terms of the adjustment that would happen if you shut down the coal industry, the first thing that would happen is electricity prices would rise to extraordinary heights.

**Senator JOYCE**—That would make us uncompetitive in other areas.

**Mr Parker**—Yes, that is right.

**Senator SHERRY**—Pretty obviously, though, we would have no electricity in load sectors of the economy, except for perhaps Tasmania.

**Mr Parker**—You would have some hydro, some gas and a bit from wind.

**Senator JOYCE**—How would you generate that electricity if there was a policy that inhibited the use of coal burning? How would you actually go about generating the electricity?

**Mr Parker**—You would have to replace the entire capital stock.

**Senator JOYCE**—Are there any alternatives to coal-fired plants if you get rid of electricity?

**Mr Parker**—There are a range of alternatives to that.

**Senator JOYCE**—Can you suggest any?

**Mr Parker**—It depends very much on the ranking of the costs. Obviously, there are the technologies of gas, nuclear, wind, solar and geothermal.

**Senator JOYCE**—How much slack would wind be able to take up in the generation of electricity? Would wind be able to keep us internationally competitive?

**Mr Parker**—That is a difficult question.

**Senator JOYCE**—I can make it easier for you.

**Mr Parker**—There are some countries which have a much larger share of wind generation than we do—for example, Denmark.

**Senator JOYCE**—Let's talk about Denmark. How much does wind contribute to Denmark's economy? Does that keep them competitive? Do they have a big manufacturing industry reliant on wind generation?

**Mr Parker**—I have no idea, Senator.

**Senator Minchin**—The industry department will have their resources and energy section here this evening, Senator Joyce. You may want to pursue some of those issues with them.

**CHAIR**—They are scheduled for tomorrow night.

**Senator JOYCE**—Talking about economic theories, you brought up Robert Solow. How much of this accepted wisdom drives your planning and your modelling? What is the process involved in your modelling in regard to how Australia works? How adaptable is that modelling to changes in world trade?

**Mr Parker**—That is an interesting question because it basically goes to the core of how we, in a sense, run our business. It is probably fair to say that practical research into economics and forecasting and the like is a difficult business. Compared to the physical sciences, it is rather hard for us to run experiments. You cannot change one factor and see what happens; you have lots of factors changing. You have got a data set and you cannot actually run a counterfactual. We run a macroeconomic model in the Treasury which tries to capture the salient features of the macroeconomy. We use that for research and we have talked about doing simulations in that model to pick up the terms of trade, to pick up the terms of trade shock. Suppose you knocked out the energy sector, it would be possible in some of that modelling—though we do not model the production side of the economy—to translate that into some demand shock and run it. The level of confidence that you would have

in the results that come out would have to be relatively low in terms of how much confidence you attach to the precise numbers.

One of the features of economic modelling and research is that you can explain what has happened. The model captures the story in a sense of what has happened and is then quite good at answering questions of what might happen if something similar happened. You can model things which are within the sort of normal run of events. If you try and model something which was extraordinary like shutting down the coal industry on one day—

**Senator JOYCE**—Not shutting down on a day; shutting down over a period of time. It would diminish your ability to effectively deal with coal, because of a supply-side inhibitor, and how it would play through your model. With our terms of trade, what are the current main lights on the horizon into the future? Do you have any warning issues?

**Mr Parker**—We are projecting that the terms of trade will come down over the projection years. That is a technical assumption which we have put into the budget that involves returning key commodities, specifically iron ore and coal, as part of this commodity cycle and restore it back to long-run historical averages. They are not forecasts. We are not saying that we predict that this will happen. We basically use a prudent fiscal assumption so that we can see what the budget would look like in the event that commodity prices come back down, not in aggregate to the long-run level but by some amount. Since we expect that some fall is likely, we do not know when and we do not know by how much, but it is prudent in a sense not to bank on commodity prices staying at present levels forever.

**Senator JOYCE**—The point is we need strong contingencies. You believe that there will be a trend back down to a long-term average in commodity prices. It is a fair enough proposition to pose that there will be a long-term trend down to a long-term average for coal and iron ore. That poses the question that it is a gap area that the nation has to make up if it wants to sustain its current standard of living.

**Mr Parker**—What drops out from the technical presumptions that we have made is that gross national income grows more slowly for a period of time.

**Senator JOYCE**—Are there any other growth inhibitors in the nation? Do we have the potential as a nation to quickly be able to move resources and people to new areas to make up that deficit, which will obviously come about? Where are those areas and what industries are involved?

**Mr Parker**—The economy is a dynamic, evolving thing. In the event that you saw an unwinding of the terms of trade boom, a lot of the adjustments that we have seen would unwind in the same way that they have adjusted to absorb this terms of trade shock. It is likely you would see the exchange rate come off. That would provide a boost to the rural sector, manufacturing, tourism and services and so forth.

**Senator JOYCE**—There would be a boost to the rural sector. As you said, the price of the Australian dollar comparatively would fall and make our rural exports more competitive. Likewise, we would have to increase rural production substantially not only to meet the fact that our exchange rate had fallen but also to fill in the gap from what we had formerly earned from coal and iron ore. Are there any areas in Australia where you could suggest there would be further development or where there is a chance of expansion for those rural exports to

increase? Would it be fair to say we have a competitive advantage in the production of rural exports?

**Mr Parker**—Yes, that would be fair.

**Senator JOYCE**—Whereabouts are we heading to increase our rural capacity?

**Mr Parker**—The intellectual framework that I bring to this is that that will just happen naturally. If you go back 200 or so years when Adam Smith published *The Wealth of Nations* in 1776, he cracked the critical ordering force in the economy: as people follow their own self-interest, the market mechanism operates to ensure that somehow or other the whole thing is brought together so that the right stuff gets produced in the right amounts at the right prices and so forth.

**Senator JOYCE**—The question I am really asking is: geographically, not economically, is there a section of Australia that has the potential for growth in the rural sector?

**Mr Parker**—That is undoubtedly the case.

**Senator JOYCE**—Whereabouts?

**Mr Parker**—Do you mean which parts of Australia?

**Senator JOYCE**—Yes, which part?

**Mr Parker**—It could be all over Australia.

**Senator SHERRY**—Tasmania for one.

**Mr Parker**—Yes.

**Dr Kennedy**—The vast majority of the Australian economy's activity takes place in the services sector, not in the agricultural, manufacturing or mining sectors. They would make up around 18 or 19 per cent of the economy.

**Senator JOYCE**—In our export growth.

**Dr Kennedy**—Not of exports. I mean of all the activity going on inside the economy. Is this a question about where we are going to find extra exports?

**Senator JOYCE**—That is right; that is what the question is about. Australia relies on terms of trade and, if we do not put something on a boat and send it off in a certain direction, it is going to be exceedingly hard to grab something coming back to you, unless you want to borrow the money to pay for it. If you borrow the money to pay for it, you are setting yourself up for a huge fall. The question I am posing is: if there were a downturn, or even if coal and iron ore come back to average, then we have a gap to make up. We are currently running a trade account deficit, so we have to be mindful of it already. We are not going to be filling that with the export of services, because we are just as likely to be importing them as exporting them.

**Dr Kennedy**—Twenty-three per cent of our exports are services.

**Senator JOYCE**—In what areas?

**Dr Kennedy**—Mainly in education and tourism.

**Senator JOYCE**—If you are talking about tourism, what about our exports of tourism? I imagine Australians are going overseas as well.

**Dr Kennedy**—I am not certain, off the top of my head, if we have a services trade deficit or surplus. I think we have a small services trade surplus. In other words, we export more trade services than we import. That is broadly where the numbers come in.

**CHAIR**—Senator Joyce, your comments were well made before. You are perhaps moving into other areas. Do you have much left on this?

**Senator JOYCE**—No. I would like to put this on notice. Obviously there is a move towards further development of new areas in rural production. If we just wait for the Adam Smith model, we will get to it eventually. I pose the suggestion that things might happen a little bit quicker than that. If we are not on the front foot, your trade account shock might come a bit sooner than you think.

**Senator SHERRY**—Going back to our discussion on productivity and the resources boom, in respect of the earlier comments on productivity, do you believe it is reasonable to say that the extent of the productivity slowdown in the economy is explained wholly by the mining sector?

**Mr Parker**—No. It is not explained wholly by the mining sector. Another substantial part of it is the non-market sector, which has slowed down.

**Senator SHERRY**—Do you have any observations about that slowdown in the non-market sector? I am sorry. We discussed in a fair amount of detail the resources sector.

**Mr Parker**—Yes.

**Senator SHERRY**—But not the non-market sector.

**Mr Parker**—The non-market sector is harder to measure.

**Dr Kennedy**—It is best in a productivity discussion to focus on the market sector. That is why the ABS does not publish non-market sector productivity estimates—presumably because they can put this question and they do not find them as reliable as the market sector. Mr Parker gave the example of education and how we capture productivity in the education sector. It just means that that sector is fraught with difficulties. If we focus on the market sector, mining is a big part of some of the slowdown in productivity in the market sector. Then we have this other part of the economy, which is not an insignificant part of the economy, which we tend not to focus on in terms of trying to distil underlying productivity trends.

**Senator SHERRY**—I understand the difficulties in measurement, but I gave a couple of examples earlier of finance and insurance. Do you have any observations to make about the trend annual growth which is very low in productivity in that sector for example? What would be the explanation?

**Dr Kennedy**—I do not, but there is one point I would make which goes to that discussion. At any time, for average productivity, you are going to find industries at either side of the average and it is one thing to be careful of—

**Senator SHERRY**—Yes, I accept that. I know the way averages can be abused, but when I refer—

**CHAIR**—Senator Sherry can you let Dr Kennedy finish his point.

**Dr Kennedy**—You might question us in drawing out the mining story and saying: ‘Well don’t we just expect some industries to be low at some time and other industries to be high? Why would that be a reasonable explanation of some slowing in average productivity?’ An argument you could put is that circumstances are particularly unusual in that industry at the moment that put them outside normal historical ranges. I have not got in front of me the detail about all the various industries’ productivity changes, but I expect there are some slow and that some are doing quite well relative to their average; that would be normal.

**Senator SHERRY**—I accept that you have not got the statistics in front of you. I have some statistics in front of me. We have well explored the resources issue, I accept that, but I am looking for an explanation. I accept the caveat on averages; I know the use and abuse to which averages can be used. But looking at the trend annual growth and the two areas I touched on—one of which was finance and insurance, the other was health and community services, which is significantly below the average—I accept there are always sectors above and below the average but these are significantly below. They are not negative, as the electricity, gas and mining sectors had been—that may change. And I accept the caveat on data reliability. I have a healthy respect for Treasury’s judgment and the officials within Treasury so that is why I am seeking an explanation in those sectors for example about this lower trend annual productivity growth.

**Mr Parker**—Graeme, do you have any views on the sectoral thing? I preface it by saying we are focused on the mining sector in a sense because we understand that and we can tell a story about it. For the other sectors, I am not aware of stories that would explain the most recent development in finance and insurance, for example, but Graeme is the man.

**CHAIR**—Mr Parker, if you do not know, you are better off saying that you do not know it. It is not going to be terribly helpful to the committee if you are pulling part of the story out and not telling the whole story.

**Mr Davis**—I think that David is right. It is quite complex to try to unpick any particular sector and understand the short-term trends in it. I have had a look at finance and insurance and the short-term trends. Their output is very difficult to measure; I am not sure precisely why the numbers have done what they have done.

**Senator SHERRY**—Why is output difficult to measure in finance and insurance?

**Mr Davis**—What is the output of a bank? That would be a nice interesting question. How would you measure the output of a bank?

**Senator SHERRY**—Fees they charge?

**Mr Davis**—If they make more loans, have their outputs gone up? If they take more deposits, have their outputs gone up? It is a set of services that is quite challenging to get precise measurement on. Within there you have also got the insurance sector, so it is not homogeneous thing with a bunch of widgets coming out the door and you just count the number of widgets; it is quite a complex mix of things. But the simple answer is short-run

movements in aggregate productivity are hard to understand, but when you get down to industry level you can come up with a set of hypothesis about what might be going on but that is what it is—it is a set of hypothesis.

**Senator SHERRY**—Again, we have touched on this to some extent, but what about the estimated productivity in the aggregate market sector excluding mining?

**Mr Davis**—I do not have the precise numbers with me.

**Dr Kennedy**—If you look at the detail of labour productivity in the market sector, excluding mining in 2005-06, it is about 2.7 per cent

**Senator SHERRY**—What about long term, long run?

**Dr Kennedy**—The long-run averages for the market sector are about 2.2 per cent.

**Senator SHERRY**—What about the trend average since the late 1990s, the last seven years—I am forgetting it is 2007.

**Dr Kennedy**—Now you have stumped me. I do not have that number to hand, but we could certainly calculate it for you.

**Senator SHERRY**—Thank you. Just coming back to those compositional changes, can you outline with greater precision the decline in productivity in the mining sector being offset by the shift away from lower productivity sectors in the economy, and we touched on agriculture earlier. Are you able to do that with any greater precision?

**Mr Parker**—We could do the analysis for you and take that on notice.

**Senator SHERRY**—Earlier, Dr Kennedy, when we discussed this compositional change, you referred to it not fully offsetting. I am just wondering to what extent it has offset.

**Dr Kennedy**—The compositional effect is a substantial effect. I believe the Reserve Bank, in their November monetary policy statement, published the composition effects around productivity when they were looking at this issue of slow output and employment. I do not have the numbers to hand, but my understanding of our own preliminary analysis was that, as I said before, the fall in productivity within the mining sector more than offset the positive effect that labour going to mining makes to productivity. I do not have a number to hand; I can take the question on notice.

**Senator SHERRY**—Thank you. We were touching earlier on the revenue impact of the commodity boom. I just wanted to complete some questions in this area. Mr Parker, you had mentioned the link contact between the forecast group and the revenue group. Had you concluded your response on that? I was not sure frankly, before we got on to other doomsday scenario issues, whether you had finished.

**Mr Parker**—If there are particular dimensions of that which you would like to tease out, then I would be happy to answer further questions.

**Senator SHERRY**—There are, but I was not sure whether you had finished your earlier comment. Does the commodity boom and its effect on profitability have an impact on profitability across other sectors of the economy?

**Mr Parker**—Yes, it does.

**Senator SHERRY**—For example, how would it impact on profitability in agriculture, forestry and fishing, or manufacturing?

**Mr Parker**—Other things being equal, it will reduce profitability in those sectors.

**Senator SHERRY**—Would it reduce profitability in all sectors? I referred to those two, but what about construction for example?

**Mr Parker**—You would expect that during the transition to the new equilibrium, there is going to be a construction boom, and that is what we are seeing. So you would expect the construction sector to do very well, and that is exactly what is happening. Other bits of the economy, you would expect the manufacturing sector, which is servicing the mining and construction sector, to do pretty well, and that is happening as well.

**Senator SHERRY**—Noting the earlier conversation about working and living, in those areas where the mining boom is happening, you would expect an increase in profitability in retail trade, accommodation and the like—

**Mr Parker**—Transport.

**Senator SHERRY**—in those relevant sectors that are directly connected.

**Mr Parker**—Yes, that is right.

**Senator SHERRY**—Would there be a decline in profitability in those sectors that I have just referred to that are not directly reflected?

**Mr Parker**—Yes, there could well be because of the exchange rate effect. Of course, there are other effects as well. The commodities price boom has lifted the general level of demand in the economy, so untangling all of that on a sector by sector basis is an exercise that rapidly gets out of control; it is something that you just cannot keep the dimensions of it in control. So the way that we have tended to think about the revenue implications from the resources boom has been that tops down exercise: what has been the aggregate effect on the economy and what revenue implications flow from that.

**Senator SHERRY**—Obviously, you have been making some observations, but do you do any detailed work on the impact of that profitability across other sectors?

**Mr Parker**—Not that I am aware of.

**Dr Kennedy**—We do in a qualitative sense. As Mr Parker said, we look at how the level of demand is running and likely profitability in other sectors, but we do not translate it all through in terms of ‘if mining does this then X does this’. We have looked at what mining profitability is likely to be, in particular given the increase in the prices of the goods it produces, but we tend to look at economy-wide profitability at more of an aggregate level rather than sector by sector.

**Senator SHERRY**—The level of profitability and the flows into company tax revenue—I am sure you are in regular contact with your revenue group and the tax office on this issue. Do you have any observations to make about the impact of the mining sector’s profitability and its underpinning of the increased company tax flows?

**Mr Parker**—I could, but you would get a better answer to the question from revenue group.

**Senator SHERRY**—But a drop-off or decline in the mining sector, the end of the boom, whenever that may occur, would clearly have an impact on company tax revenue, for example?

**Mr Parker**—That is right.

**Senator SHERRY**—The OECD carried out some research, published in its latest Economic Survey of Australia in August 2006, which modelled the effect of temporarily high commodity prices. Is Treasury aware of that modelling—or the survey, I should say?

**Mr Parker**—Yes.

**Senator SHERRY**—The OECD uses the terms ‘real output gap’ and ‘real income gap’ in the context of that survey and the modelling that was reported. Could you outline for me Treasury’s understanding of the use of those terms in that report?

**Mr Parker**—Yes. When the OECD and some other international organisations are comparing the stance of macroeconomic policies across different countries, they need to reference that according to where a country is in the economic cycle, and so they are able to calculate these things called structurally adjusted surpluses. The thing that drives those calculations is an estimate of where the economy is in output terms compared to its trend level of growth. What you tend to have during a period of slow economic growth is slack in the economy; that, all other things being equal, reduces tax revenue and increases outlays and hence leads to a reduction in the fiscal balance, but it is a cyclical thing which is driving that. When you take the structural balance and abstract from the cyclical story, you tend to get a smoother evolution of the fiscal situation. The output gaps that the OECD calculates are for that purpose, and, within the context of that purpose, that is an entirely reasonable exercise. We have previously had discussions about whether the calculation of output gaps is a sensible exercise for the purposes of setting policy at any particular time in the economy, and you would recall that we are rather sceptical about the usefulness of that—again, due to a range of data issues and calculation issues.

The income gap measure, just to complete the answer to your question, reflects some new work that the OECD has done which is meant to pick up the point that, if you are looking at the fiscal position of an economy, not only is it driven by the real economy but also it is driven by what happens to incomes in the economy—the nominal economy, so to speak.

What we have seen through the resources boom is that commodity prices go up. In terms of the immediate measured effect on the real economy, it is rather muted. We have not actually been shifting more tonnes of coal and iron ore, but we have been getting a lot more money for them and that money is subject to the tax base. What the OECD has done in looking at the income gap thing is to take that additional element into account. There are a number of countries which have volatile terms of trade—we are one, Canada is another, Norway is another. So the intention is to take out the abstract from those price effects, driven by changes in terms of trade, to get at the underlying structural balance.

**Senator SHERRY**—The OECD estimates that the higher terms of trade created a 5½ per cent of GDP real income gap in 2005—that is, an income level 5½ per cent of GDP larger than if commodity prices were at their normal levels. Do you agree with that evaluation?

**Mr Parker**—I think it is broadly correct, yes. If you look at the present circumstances then it has gone a little higher than that. We have had roughly a 35 per cent increase in the terms of trade.

**Senator SHERRY**—Because the OECD, in the same report, estimated the higher terms of trade at 1¾ per cent to Australia's budget surplus in 2005.

**Mr Parker**—Yes, and that is a general government surplus too. It is not just Commonwealth; it is state as well.

**Senator SHERRY**—You agree with those estimates?

**Mr Parker**—Put it this way: we have not published estimates of that sort. We understand the way that they have got them.

**Senator SHERRY**—It is in the ballpark?

**Mr Parker**—Yes, it is in the ballpark.

**Senator SHERRY**—What is the approximate size of Australia's latest budget surplus in 2005-06 as a percentage of GDP?

**Mr Parker**—At the Commonwealth level, it is 1.5 per cent. Does anyone have the state number in their head?

**Senator SHERRY**—Perhaps if we have the Commonwealth percentage—

**Dr Kennedy**—I have 2006-07 here. Did you want 2005-06?

**Senator SHERRY**—Yes, if you have it.

**Mr Parker**—We will dig it out for you. It will not take us a moment. This is small print!

**Senator MURRAY**—I am always fascinated by people who take off their glasses to read close print.

**Mr Parker**—It was 1.6 per cent. In 2004-05 it was 1.5, and in 2003-04, prior to the quantities being released getting underway, it was one.

**CHAIR**—Senator Murray, the brilliance is that Mr Parker cannot see us without those on.

**Senator MURRAY**—I was pondering if we are in fact smaller than the print and he needs his glasses for us, but I do not think we should go there.

**Senator SHERRY**—As much as I attempt to probe for the views of Treasury officials from time to time, that is not one area I have even thought about going to—the physical vision as distinct from the policy vision. Coming back to the OECD's estimates, which you agree with, the higher terms of trade added approximately 1¾ per cent of GDP to Australia's latest budget surplus in 2005-06. You said 1.6; it is pretty close to 1¾ per cent of GDP.

**Mr Parker**—Yes, but the 1¾ per cent that the OECD has calculated is both federal and state.

**Senator SHERRY**—Yes.

**Mr Parker**—So the impact on the federal level would be less than 1¾.

**Senator SHERRY**—Hence the 1.6.

**Mr Parker**—I think it would be somewhat less than the 1¾.

**Senator SHERRY**—Yes, okay. I wanted to go to some inflation issues.

**Senator MURRAY**—Just before you do—where does the exchange rate fit in with this picture? I have noticed more significant movements recently and I wondered if that was anything you would want to comment on.

**Mr Parker**—I try not to look at the exchange rate on a day-to-day basis. Obviously, I do in my job. But, in terms of the macroeconomic consequences, the day-to-day movements in the exchange rate—putting aside large level shifts—are largely irrelevant. In terms of where the exchange rate has been over recent years, I think you would have to say it is a situation of remarkable stability compared to some of the recent history. Obviously, we had a run-up in the exchange rate as the resources boom got underway, but over the last couple of years it has been really stable.

**Senator MURRAY**—That is why I made the remark. I would not call it volatile, but I have sensed greater daily movement than has been the norm and I wondered if that foreshadowed anything or was merely a market phenomenon that will pass.

**Mr Parker**—It is hard to predict where markets go, and the exchange rate is no exception. Paul, do you have any observations on recent exchange rate developments?

**Dr O'Mara**—I think it is important to recognise that the exchange rate is actually driven by a whole range of factors. There is a tendency in Australia to think that there is a direct link with commodity prices, particularly in the exchange rate. Certainly, it is true historically that that has been an important factor, but we should never fall into the trap of thinking there is a one-to-one link there or that is the only factor at work. There are a whole range of things like drought, the strength of consumer spending and the strength of investment spending more generally that would all be influencing the exchange rate. I think one observation that we could make is that, if the exchange rate was only responding over the last year or two to the run-up in commodity prices, it probably would have been a good deal stronger than it actually has been. But what we have seen in addition to the commodity price effect is that there has been some moderation in consumer spending and there has been a drought, and probably the exchange rate has reflected the net effect of all of those things to try and balance them up.

**Senator SHERRY**—What about the level of our interest rates compared to the rest of the world and their impact on the exchange rate?

**Dr O'Mara**—Interest rate premiums or discounts relative to the rest of the world are yet another factor that can influence exchange rates in the shorter term, yes.

**Senator SHERRY**—I wanted to turn to some issues relating to inflation. What is Treasury's assessment of recent developments in our domestic inflation? Do you have any observations to make about recent developments and trends?

**Dr Kennedy**—The outcomes around inflation are broadly in line with what we forecast in the latest MYEFO, which was released in December last year. We expected there to be somewhat of an easing of inflationary pressures. We were also aware that, because of bananas and oil and those types of things, the headline inflation rate was likely to fall reasonably substantially this year, and the recent CPI release largely confirmed that outlook.

**Senator SHERRY**—Would it be correct to say that Treasury has been more relaxed about domestic inflation compared to the Reserve Bank?

**Dr O'Mara**—The Reserve Bank obviously do their own forecasts and have their own views on the inflation outlook. For our part, we publish our own forecasts, and in those forecasts and assessments we have emphasised the very significant effect that higher fuel prices and of course banana prices has had on recent inflation outcomes. We did indicate that we thought both of those factors would unwind.

We have also made the point that, even if one looks at the underlying inflation measures, there is still some fuel price effect in those. The underlying measures strip out the impact of higher fuel prices that motorists pay at the bowser, as consumers, but the impact of higher, particularly diesel, prices working their way through the production system and the transport system is still basically in the underlying inflation rates.

Our assessment has been that some part of the run-up in underlying inflation over the last 12 or 18 months was, in fact, those broader first-round effects of fuel working their way through the system, and that they would, in fact, moderate and indeed reverse if fuel prices peaked and then came off. We believe we are now seeing that effect beginning to come through. Those broader first-round effects of fuel have probably just about run their course in terms of driving underlying inflation up. We will see more moderate outcomes from that source over the next 12 months or so.

**Senator SHERRY**—I am obviously aware that the Reserve Bank is doing a significant amount of its own work in this area. But when I look at both the observations here today, the observations made publicly by Treasury when it makes them and at previous estimates compared with, say, the Reserve Bank pronouncements, publicly and otherwise, it seems to me that Treasury has been—and I do not want to use the word 'relaxed' in a critical sense—less concerned about domestic inflation compared to the statements and observations of the Reserve Bank. There has been a different tone.

**Dr Kennedy**—Our forecasts have been broadly in line with the type of picture the Reserve Bank has been painting. There has been no dramatic difference in the outlooks presented, from what I can see.

**Mr Parker**—It is probably worth recording that the process by which we prepare our forecasts for the government is done through the joint economic forecasting group—the so-called JEEG. The Reserve Bank is a member of that. There is a very close working relationship between the Treasury and the bank on these issues.

**Senator SHERRY**—That jumps to my next question. My assumption is that there is a regular dialogue between Treasury and the Reserve Bank, apart from board meetings. At the end of the day, you have your own skill sets and officials, and the Reserve Bank has its own, doesn't it? It would not be unusual that there would be different observations. They are not necessarily going to be identical, are they?

**Dr Kennedy**—That is true within Treasury and within the Reserve Bank. We would all have different judgements; it has to be the case that we will all take a slightly different view on different issues.

**Senator SHERRY**—Sure, but institutionally you will bring those observations together as Treasury, once you have sorted out whatever the differing attitudes are—and the Reserve Bank will do the same. Where they are presented publicly, on occasions they will be presented a little differently, and maybe even more differently, on the same fundamental issue. That does not seem to me to be an unusual circumstance. Turning to the methodology for examining and forecasting core inflation, is there any difference between the ABS's and the RBA's measures?

**Dr Kennedy**—The RBA has two statistical measures of core inflation which it publishes on its website. The ABS has the headline measure of CPI and then publishes a group of analytical CPI series which excludes volatile items and various other disaggregations. They are different measures. I am not aware of any issues between the two. The RBA's analytical measures take the ABS data and they use statistical methods to derive those estimates.

**Senator SHERRY**—I assume from the comments made earlier that Treasury was expecting core inflation to slow to the extent it did in the December quarter.

**Mr Parker**—We were certainly expecting it to slow slightly—

**Senator SHERRY**—To that extent?

**Mr Parker**—but whether to that extent—it probably came as a slight surprise.

**Dr Kennedy**—It would have been a mild surprise to see it slow to that extent.

**Senator SHERRY**—What risks does Treasury see to inflation and inflationary expectations?

**Dr Kennedy**—These were some of the things we outlined in MYEFO, and partly they relate to many of the things we talked about before: the mining boom and commodity prices. The labour market is already pretty tight and the employment-population ratio is at a record level, so there are a lot of people in the labour market out there. Obviously if demand were to strengthen significantly across other sectors and if the economy were to grow more rapidly then that would likely put pressure on wages and inflation. That would be the upside risk. Similarly, if the economy were to ease, there would be downside risks.

**Senator SHERRY**—Will Treasury's expectation of core inflation be at the upper end of the target band until the end of next year?

**Dr Kennedy**—Are you talking about 2007?

**Senator SHERRY**—Yes.

**Dr Kennedy**—We basically have inflation settling towards the middle of the band in 2007-08.

**Senator SHERRY**—Not the upper end?

**Dr Kennedy**—By which you mean more than  $2\frac{3}{4}$ ?

**Senator SHERRY**—Yes.

**Dr Kennedy**—No.

**Senator SHERRY**—Has Treasury sought to estimate the impact of the drought on inflation?

**Dr Kennedy**—We certainly have had a look at how the drought is likely to affect inflation. Again, it has some pluses and some minuses. The increases in slaughtering rates as a result of the drought probably would have put downward pressure on meat prices.

**Senator SHERRY**—Short term?

**Dr Kennedy**—Short term—

**Senator SHERRY**—Longer term they would go up.

**Dr Kennedy**—and then there would be some longer term. But it is actually quite hard to pick out a general inflation effect down the track. You will pick them out in food items, of course.

**Senator SHERRY**—What about the impact of drought on, for example, short-term fruit and vegetable prices, bread and dairy commodities—milk and cheese? Every time I have been into the supermarket in the last year, prices in the food sector seem to be increasing in comparison to other areas

**Dr Kennedy**—Certainly food prices have been growing more rapidly than other prices, but that has not all been drought related. There has been frost related activity and other climate events that have driven some of those food price increases.

**Senator SHERRY**—But the principal climatic impact would be drought, would it not?

**Dr Kennedy**—The most recent movements around fruit and vegetables—and I will confirm this for you later—I think were more due to frost related activity, and obviously there were the cyclones around the well-known banana effect. But certainly there will be drought effects.

**Senator SHERRY**—So you have that issue under close examination? There are significant parts of Australia that are drought stricken and I would have thought it reasonable—

**Dr Kennedy**—It is the major reason for us revising our growth down from 3¼ per cent to 2½ per cent in 2006-07.

**CHAIR**—I take it your inflation forecast is based on a number of factors, including the drought, I take it?

**Dr Kennedy**—Yes.

**Senator SHERRY**—Does Treasury believe there are second-round effects on inflation from the oil price spike last year?

**Dr O'Mara**—I commented on that earlier. I do not think of them so much as second-round effects but rather as broader first-round effects. When we go from a headline inflation rate to a so-called underlying inflation rate, all that that exercise does is remove the effect of higher petrol prices at the bowser which motorists are paying. It does not in any sense remove the impact of higher fuel prices on transport costs more generally through the economy or higher fuel prices on production costs more generally. So the impact there is still basically in the underlying inflation numbers.

What I think of when we start to talk about second-round effects is what happens if inflation expectations start to go up and, more particularly, if wage demands and settlements

start to go up in response. Then I think you could talk about genuine second-round effects of fuel, and to date I think it would be fair to say that there is very limited evidence of that happening. Wage settlements, as we know, have been relatively moderate. The wage price index and most of the measures of wages have been quite stable at around the four per cent per annum mark; they have not shown any particular signs of accelerating in response to either fuel prices or the strength of the labour market more generally.

**Senator SHERRY**—What about the potential impact of housing rents flowing through to inflation; has that been given any recent examination? Today there is a superannuation link story, but there has been more regular commentary about the increase in housing rents, the increase in returns. Does Treasury have any observations to make about what are apparently increasing housing rents?

**Dr Kennedy**—Housing rents, in the CPI, have been growing, I think, at around 3.7 per cent through the year—once again, it is a number I will get checked in a moment. But it is also the case that the whole stock of rents take a fair bit of time to change, to turn over, and there has clearly been evidence of acceleration in housing rents. So it is an issue that we have been thinking about and the extent to which it might feed into prices.

**Senator SHERRY**—Has the growth figure been higher than that 3.7 per cent in the immediate past?

**Dr Kennedy**—I will take that on notice. I think there has been somewhat of an acceleration of rents in that CPI number. There is certainly evidence coming to bear that the new rents that are being settled, if you like, have been increasing. But, as I said, that takes some way to work its way through. A measure of rent is based on the whole stock of rents. The increase in rents would have been an acceleration, certainly since its longer run growth was reasonably modest for some time.

**Senator SHERRY**—So it is a recent trend for it to edge up, if you like, or move up?

**Dr Kennedy**—I believe so. I will confirm that for you.

**Senator SHERRY**—Why would that be the case? Why would housing rents increase? What has happened that has led to that?

**Dr Kennedy**—Basically, more demand, presumably, for those rental properties than there has been supply would see rents start to increase, and that is likely to be what we are seeing. Activity around the housing market has been quite modest for a couple of years, and the population has continued to grow reasonably strongly. It would be mixed, but I am certainly aware that rental vacancy rates are low in most cities—in fact, all cities, I think, around two per cent or lower.

**Senator SHERRY**—What proportion of the CPI are housing rents? Is it reasonably significant? I am not looking for the exact figure.

**Dr Kennedy**—What do you mean by ‘is it significant’?

**Senator SHERRY**—The weighting by level compared to other components would be a better way of putting it, I think.

**Dr Kennedy**—I think it is low single digits, but I can get someone to find that out for you while you're asking questions, if you like.

**Senator SHERRY**—Yes, sure. I don't think we'll finish before the lunchbreak at 12.30—I am sure we won't—but perhaps if you can get some information on that for when we resume after lunch.

**Dr Kennedy**—We think it is about four per cent of the basket, but we will check that for you.

**Senator SHERRY**—Thanks.

**CHAIR**—We may be able to go through to quarter to one, unless that causes any great problems.

**Senator SHERRY**—It doesn't worry me, but I probably have another half an hour to 45 minutes of questions in this area, so I think we would struggle to get through by quarter to one.

**CHAIR**—Let's go through till a quarter to one and see how you go.

**Senator SHERRY**—Okay. Has the impact on inflation of the exchange rate appreciation that we have seen run its course?

**Dr Kennedy**—It probably largely has. The appreciation occurred approximately two years ago and, as Mr Parker said, the exchange rate has largely stayed around the level that it appreciated to.

Let me just add to that. The lags from the pass-through from the exchange rate can be quite variable and difficult to estimate. Dr O'Mara might want to make a comment on that.

**Dr O'Mara**—Just to the effect that what we have seen over the last decade or so is that the apparent pass-through of exchange rate movements into the CPI in either direction tends to be much more muted than we have become accustomed to in times past. In other words, we do not see nearly as much of the apparent price effects of an exchange rate movement ever showing up in the CPI in the way that we used to. I think there is a whole range of factors there, such as the extent of currency hedging that exporters and importers are undertaking and, of course, the strength of competition in the various wholesale and retail chains and so on. Absorbing some of these things in profit margins and smoothing them out over time is probably more prevalent now than it used to be.

**Senator SHERRY**—That observation about currency hedging is an interesting one. Is that measured in any way? Are there any statistics on currency hedging within the Australian economy?

**Dr O'Mara**—I would be surprised if the ABS do not have some measures of those sorts of transactions, but I could not give them to you off the top of my head.

**Senator SHERRY**—No, it is okay. If they have got it, we will ask for it. It is just an interesting issue that I had not thought about before, until you mentioned it. Coming back to some further issues on drought, the forecast is for the drought to reduce farm GDP by around 20 per cent in 2006-07. They will shave just over 0.5 per cent from GDP—that is market forecasts. They are consistent with your assessment of the impact?

**Dr Kennedy**—Yes, the direct effect. We see it at around half a per cent and then there are indirect effects on top of that, so the total subtraction is in the order of three-quarters of a point.

**Senator SHERRY**—The drought and contraction in farm outputs of this sort of magnitude: what would be the flow-on effects to the rest of the economy?

**Dr Kennedy**—What other industries are likely to be affected, do you mean?

**Senator SHERRY**—Yes.

**Dr Kennedy**—Industries such as transport and storage. Obviously, in the regions in which income is being reduced, retail and other types of industries would be affected. Even manufacturing industries, perhaps, that contributed to packaging around agricultural products—obviously there will be a lower demand for their cardboard or whatever. So there is quite a broad range of sectors affected by the drought.

**Senator SHERRY**—Has Treasury done any detailed work on the current drought in this regard—the flow-on consequences?

**Dr Kennedy**—I suppose it depends what you mean by ‘detailed’. Certainly we have considered what we think would be the aggregate indirect effects from the drought and thought about how they would turn up in the rest of the economy. I mentioned transport and storage as a specific example. Our approach to forecasting is to focus very much on the aggregates in the national economy, so we have not, if you like, used the large computable general equilibrium model to model all the various effects of the drought on different sectors of the economy. That is something we have not done, but organisations like ABARE may well have done that type of modelling.

**Senator SHERRY**—Presumably ABARE would be one of the government organisations most closely involved in examining the issue. Presumably, you have frequent liaison with them on this matter, particularly in the current circumstances.

**Dr Kennedy**—Yes, we certainly talk to them about this matter, as well as other commodity prices and a range of prices, and we noted that their modelling was giving similar aggregate effects of the drought to ours.

**Dr O’Mara**—The estimate of a further quarter of a point in those broader effects is quite consistent with historical experience. If we look back at some of the other very severe droughts that have been analysed thoroughly since, it would appear as though, for each dollar of a decline in gross farm product at the farm gate, you could probably say there would be at least another 50c worth of cutback in broader GDP, most of which would be measured in the non-farm sector.

**Senator SHERRY**—To what extent have you factored the drought into the current forecasts for farm GDP growth in 2007-08?

**Dr Kennedy**—In 2007-08 we are seeing a return to average seasonal conditions, so we naturally get a bounce-back in farm production. We take into account low water storage issues and factors that we know would be there even if there were a return to average seasonal conditions. It is our practice to assume average seasonal conditions. That is what we were doing at budget, for example, for 2006-07. As we go through the year, we take into account

what has actually occurred and, using information from the Bureau of Meteorology, do our best to estimate what will happen over the course of this year. But for that out year, it is our common practice to assume average seasonal conditions.

**Senator SHERRY**—But given that we are much closer to that out year—

**Dr Kennedy**—Do you mean 2007-08?

**Senator SHERRY**—Yes. We are now much closer to it, and you are presumably doing preliminary work on the budget. You would have to be re-evaluating that forecast, wouldn't you, given that the drought has not broken?

**Dr Kennedy**—We certainly continue to work on it, but at budget the assumption for 2007-08 will be average seasonal conditions. That is the normal approach.

**Dr O'Mara**—The critical period will be between now and June. That is the window of opportunity for planting winter crops and it is also the critical time in terms of getting pasture growth going into winter. If we have not had a very widespread and significant breaking of the drought between now and certainly the end of June, I think we can say there is a very real question mark hanging over farm production in the following financial year as well.

**Senator SHERRY**—Certainly a large part of it.

**Dr O'Mara**—Yes. It is too early yet. We are only in February. These El Nino type effects typically break in the autumn.

**CHAIR**—That is probably a matter for the May estimates. I rather hope Senator Sherry does not have to ask that question again. If he does, it will mean it has not rained. That is going to cause enormous problems for all of us.

**Senator SHERRY**—The other issue directly related to drought would seem to be historically low levels of water storage, particularly in irrigation areas, impacting directly on irrigation. I am not an expert in this field, but we do not appear to have seen this low level of water availability at any time, even compared to previous droughts. Have you been factoring in this issue in your analysis?

**Dr Kennedy**—Yes, we have in our forecasts.

**Dr O'Mara**—I think we can go back to the previous drought of 2002-03 when, of course, water storages fell away very significantly. There was an expectation that we would see those bounce back. Often what happens in Australia is that you have a severe drought and then the following year you have an above-average season, or even a couple of above-average seasons. This time we have seen the very severe drought in 2002-03 followed by, at best, average seasons subsequently and then another severe drought in the current year. Those water storages have not had an opportunity to be replenished at all in the way that would have typically happened on previous occasions such as the 1982-83 drought, which was followed by remarkably good seasons in 1983-84 and 1984-85.

**Senator SHERRY**—So effectively we are going to start from a lower base in terms of water storage.

**Dr O'Mara**—Yes.

**Senator SHERRY**—Which compounds the problem to an extent we have not seen before.

**Dr Kennedy**—That is certainly a factor we are taking into account in terms of a bounce back, even if we observed average seasonal conditions.

**Senator SHERRY**—I understand—again I do not know the precise details of this—that we are having, at least in the last 10 or 20 years—higher average temperatures. I understand that that actually compounds the impact of drought. Given the rainfall levels and the rainfall recoveries that occur, the slightly higher temperatures lead to comparative higher evaporation rates, which again compound the impact of a drought.

**Dr Kennedy**—I believe that is the case, but you are quickly moving beyond my area of expertise.

**Senator SHERRY**—I would not expect you to give me any sort of detail. I am just interested to know whether you have actually—it probably goes to this broader issue of climate change et cetera—taken into account some of these issues now, as we get more knowledge of them.

**Dr Kennedy**—To really get at the core of our numbers, we are not building any major climate change type scenarios. We will take average seasonal conditions in terms of the pattern of rain, but we are certainly building it in to the extent that it has been reflected in very low water storage and the extent to which subsoil moisture is very low, and those types of issues, at present. With respect to the period over which we are going to forecast, which is the next 18 months, those things are taken into account. But we have not moved to change our expectations dramatically because we think there is some fundamental shift in agricultural production.

**Senator SHERRY**—I come back to you, Dr O'Mara, because you seem—certainly from my recollection of estimates and your information today—to have been observing this area for a fairly lengthy period in a fair amount of detail. Have we seen long-term historical reductions in production in some areas as a consequence of water and drought issues?

**Dr O'Mara**—Certainly, rice production has been markedly affected by the current low levels of water storage at the moment, so that is certainly true. Our sheep flock at present is at around 50-year lows. Of course, that is not all weather related. There has been a longer term issue about the wool market in that area. But I do not know that I would point to any other longer term issues of that sort. What I was going to throw into the mix in terms of longer rain issues is that, while we typically see seasons bounce back very rapidly—and I pointed to the 1982-83 drought as an example of that—if we go back further in history, the sort of experience that we are currently facing is not atypical. We can point to, say, the early 1940s when there was a long run of very below average seasons.

**CHAIR**—You said 'atypical', didn't you?

**Dr O'Mara**—The current period is not atypical compared with that very longer term run. I was mentioning the 1940s. About 1940 to 1944 there was a very long run of below average years, culminating in a severe drought in 1944. The history books tell us that 1896 to 1902, the so-called Federation drought, was a very long run of below average years culminating in a massive drought around the turn of the century. Of course, back then we did not have the sort of water storage capacity that we have got now. So we do not know, in a sense, whether our current problems with water storage are different from what would have occurred in the past,

because we did not have the sort of dams and water storage back in those days to make a judgement on. So what we are currently experiencing is atypical in terms of the last 20 years or so, but I think we need to be careful about thinking that it is atypical over a century as a whole.

**Senator SHERRY**—There have been considerable discussions recently about water management issues, particularly in the Murray-Darling Basin. Has Treasury yet given any consideration to the macroeconomic effects of changed, and hopefully better, water management in rural Australia?

**Mr Parker**—We have not done modelling that would look at increased production potential if you shifted water from relatively low value uses to relatively high value uses, and that is what you would expect to occur, if you had a substantial functional market in water. I am not sure if ABARE has done some work on it. There has been work which has been done on the value which could be released, but I do not think it is Treasury that has done it.

**Dr Kennedy**—No.

**Mr Parker**—There are very substantial differences in the level of value-added per litre of water between the different potential uses.

**Senator SHERRY**—But that assumes that that can easily be shifted from one sector to another. There would be a considerable range of variables in that sort of equation. Rural production is not a free market anyway, is it—

**Mr Parker**—No.

**Senator SHERRY**—given the international subsidies and protections that occur?

**Mr Parker**—Yes, that is right. The people who can really answer your questions on how water trading might work and the like are, again, in Fiscal Group.

**Senator SHERRY**—No. I was not going to go to it in any more detail but just to ask, given the recent debate on the water management issues in Australia, whether Treasury had given it any closer macro examination in recent times.

**Mr Parker**—I think it would be fair to say that the evolution of the water market has been relatively slow—certainly slower than was initially envisaged. So I think the macroeconomic implications of that would be too small to discern.

**Senator WATSON**—I have a related question. In a market-driven water market, isn't there a need to have almost a two-tiered approach, because there is a greater capacity for the city interests, as it were, to outbid the rural interests?

**Mr Parker**—Again, I think that issue is probably better directed to Fiscal Group, who are involved in the policy issues.

**Proceedings suspended from 12.42 pm to 13.46 pm**

**Senator SHERRY**—Before I deal with the issue of modelling that I touched on earlier this morning, I have some issues relating to housing affordability. What is the current level of housing affordability in Australia?

**Dr Kennedy**—According to measures such as the HIA's First Home Buyer Affordability Index, housing affordability is at quite low levels at the moment.

**Senator SHERRY**—Do you have a figure?

**Dr Kennedy**—The First Home Buyer Affordability Index was at an all-time low in the December 2006 quarter, indicating that first home buyers would need to spend 30.7 per cent of average household income on mortgage repayments.

**Senator SHERRY**—When you say an all-time low, how far does 'all time' go back?

**Dr Kennedy**—The history of that series?

**Senator SHERRY**—Yes.

**Dr Kennedy**—I do not know off the top of my head. It would go back at least 15 years.

**Senator SHERRY**—Perhaps you could just confirm that detail on notice.

**Dr Kennedy**—Yes.

**Senator SHERRY**—What is the level of debt servicing burden at the present time in Australia?

**Dr Kennedy**—It is around 11.2 per cent of gross household disposable income, but I will confirm those numbers for you.

**Senator SHERRY**—How does that compare historically?

**Dr Kennedy**—That is a historic high.

**Senator SHERRY**—Again, when you say 'historic'—

**Dr Kennedy**—That is going back through the 1990s and the 1980s.

**Senator SHERRY**—What is the Treasury's observations/analysis of the reason for the trends in housing affordability and debt servicing?

**Dr Kennedy**—In large part due to the very strong demand for housing and the increase in housing prices.

**Senator SHERRY**—With the high levels of household debt and low levels of housing affordability, would you agree with the proposition that, for each 25 basis point rise in interest rates, they would have a larger impact on disposable income than in the past?

**Dr Kennedy**—Yes. The household debt to income ratio or the extent to which households are geared says that is the case. That is the direct effect. They would directly reduce the amount of income. The extent to which people can borrow and smooth their consumption and other behaviour over time has also changed.

**Senator SHERRY**—In what way has that changed?

**Dr Kennedy**—An example is financial deregulation, which has allowed more people to access debt than in the past, and the way that people might have used this debt to purchase assets means that a whole range of behaviours might have changed around that gearing ratio.

**Senator SHERRY**—Would an example be the rise in equity drawdown?

**Dr Kennedy**—Yes.

**Senator SHERRY**—Do you have any observations to make about the behaviour or the trends in equity drawdown in the last year or two compared to historically?

**Dr Kennedy**—No, I do not. I will ask one of my colleagues.

**Mr Ewing**—I do not have the exact figures to hand. I do recall that, after a period of relatively high mortgage equity withdrawal, that has fallen off somewhat in line with a fall in general consumption across the economy and other aspects of consolidation of household balance sheets.

**Senator SHERRY**—Would it be reasonable to say that 20 years ago equity drawdown on your house was a relatively rare situation and virtually unattainable for most people but access to that provision expanded rapidly in the 1990s?

**Mr Ewing**—Yes. It would be fair to say that is one of the consequences of financial deregulation that Dr Kennedy mentioned. The level now would undoubtedly be far higher than 20 years ago.

**Senator SHERRY**—Would you agree that the factors that we were just touching on are primarily demand side?

**Dr Kennedy**—The housing affordability issue?

**Senator SHERRY**—Yes.

**Dr Kennedy**—A large part of the story is demand side.

**Senator SHERRY**—Are there any other elements of the demand side of the story that you have not touched on?

**Dr Kennedy**—Partly, very good economic conditions for a long time have enabled people to purchase more dwellings.

**Senator SHERRY**—Would it include confidence, low unemployment, and issues like that?

**Dr Kennedy**—Yes.

**Senator SHERRY**—What about on the supply side?

**Dr Kennedy**—Additional housing has been relatively modest over the last couple of years after a period of quite strong growth before that. In general, housing supply has broadly kept pace with housing demand, at least in terms of the number of dwelling units being built from year to year and the additional number of units required, but there would be a range of supply factors in place, too. I do not have a detailed knowledge of the ins and outs of the housing market in terms of planning issues and those types of supply issues. I know that is a set of issues that the Productivity Commission looked at in the context of first home buyers a couple of years ago. They might be better placed to talk about some of the supply issues.

**Senator SHERRY**—Are there any other supply issues that come to mind?

**Dr Kennedy**—No.

**Senator SHERRY**—Have Treasury carried out any weighting of the various factors on the supply and demand side? Have they attempted to evaluate what are primary issues as distinct from secondary issues on both sides of the demand-supply equation?

**Dr Kennedy**—Not in a quantifying sense, saying that it is X if it is supply and Y if it is demand. Our broad judgement would be that it has been primarily a demand driven issue, but there certainly are supply side issues going on in particular jurisdictions. Part of the story has to be demand driven with little supply response in that. If there is increased demand for people to live in inner city areas, there is limited ability to supply additional units in those areas. That is the extent that supply is influencing outcomes there.

**Senator SHERRY**—A demand shift in terms of location and residence desirability?

**Dr Kennedy**—Absolutely, yes.

**Senator SHERRY**—Has Treasury examined the impact of Commonwealth taxation laws affecting housing prices over the past decade?

**Mr Parker**—Yes. We have had a look at that and you would be best directed to talk to the revenue group people about that.

**Senator SHERRY**—With the increase in household debt over the past decade, we referred earlier to a 25 per cent basis point rate rise. Has that generally made households more vulnerable to economic shocks?

**Dr Kennedy**—That is an interesting question. It makes them more sensitive, in the direct sense that we talked about a moment ago, to interest rate changes and it is something that we are watching carefully, because it is a significant shift, so we do not have the advantage of seeing how households respond to a broader economic downturn and being this heavily geared. To the extent that there is some uncertainty about how that will unfold in the future, that is certainly there. On a counter to the fact that people are more heavily geared, they certainly have used most of this debt to purchase assets, so we also have to think about that matter. Also, it is the extent to which—and we were talking about the drawdown of equity before—they can use the enhanced financial flexibility to smooth through any adverse circumstances. It is an interesting question, because we have had many years of good growth and this run-up—this increase in the gearing ratio—has occurred over that period and we have not seen people have to respond to a significant deterioration in economic circumstances. My general guess would be there would be enhanced sensitivity in the household sector to poor economic circumstances, in part because of the extent to which they are more heavily geared these days.

**Senator SHERRY**—At the same time as we have had a significant increase in household debt, is it the case that household assets have increased faster than that debt?

**Dr Kennedy**—I think the household asset-to-debt ratio has been broadly stable at around 16 per cent to 17 per cent. They have increased broadly in line with each other.

**Senator SHERRY**—What are the major areas of growth in household assets by sector?

**Dr Kennedy**—The major asset they hold is housing. The growth rates might be something that I need take on notice. I do not have that to hand.

**Senator SHERRY**—Would it be reasonable to suggest that the other most significant growing household asset has been the superannuation accumulation?

**Dr Kennedy**—Certainly; that would be highly likely.

**Senator SHERRY**—In responding to economic adjustments or shocks, whatever description we use, is it fair to say that it is not possible to access superannuation because of the legal parameters around it for access?

**Dr Kennedy**—That is something I cannot answer. I do not know all the ins and outs of superannuation access.

**Senator SHERRY**—In terms of early access, drawdowns, borrowing against et cetera.

**Mr Parker**—There are a number of provisions that provide for early access in cases of financial hardship. Our revenue group colleagues could tell you the detail about that.

**Senator SHERRY**—I know the details of those. The guts of my question is that it is not easy to access a superannuation asset in the event of an economic shock?

**Mr Parker**—No. It is not particularly difficult to access it informally through the financial system.

**Senator SHERRY**—What do you mean by that?

**Mr Parker**—You cannot, in a sense, mortgage your superannuation fund but, as I understand it, a number of financial institutions, in a sense, will take account of your superannuation holdings in determining your creditworthiness.

**Senator SHERRY**—In terms of access for the consumer, it is not an easily accessible liquid form of saving, is it?

**Mr Parker**—That is right.

**Senator SHERRY**—Yes.

**Mr Parker**—That is as it is intended to be, of course.

**Senator SHERRY**—Yes, I do not have any argument about that. We have the two most significant asset growth areas for households with limited access. You can sell the house but, again, it is not an immediately accessible liquid asset, is it?

**Dr Kennedy**—Or you could draw down the equity.

**Senator SHERRY**—Just going back to the earlier conversation we had about the drawdown in household equity, what would that indicate?

**Dr Kennedy**—As Mr Ewing suggested, consumption has been reasonably slow over the last couple of years—I think around two per cent through the year. Our analysis would suggest that households have been consolidating their financial position somewhat, moderating their saving, particularly compared with income growth, which has been quite strong over that period driven by both employment and wages. In summary, we would say there has been some consolidation around the household sector. You have seen that in the national accounts household savings ratio, which we always caution people not to take too seriously.

**Senator SHERRY**—Nevertheless you are going to refer to it.

**Dr Kennedy**—Yes. Let me refer to the broad trends in it.

**Mr Parker**—Cautiously.

**Senator SHERRY**—Not for the last two years?

**Dr Kennedy**—Over the last three or four years it has tended to drift up.

**Senator SHERRY**—Is household net worth a reliable real world indicator of capacity to service debt, given the sorts of caveats and study and interest you referred to earlier in that you are keeping a watchful eye on this?

**Dr Kennedy**—It is certainly relevant insofar as we are interested in understanding how much assets households hold compared with their liabilities. It is certainly very relevant for household solvency or their underlying financial position. We do have to take into account some of the factors you have been discussing about households' abilities to meet ongoing liabilities—payments around liabilities—and those types of issues. It affects households' behaviour and has done in the past. If their wealth has been increasing, they realise they can change their consumption pattern in response to that.

**Senator SHERRY**—What would be the impact if interest rates hit 17 per cent in this environment?

**Mr Parker**—I think we would be talking about another doomsday scenario there.

**Senator Minchin**—A bit like 1990, I suppose.

**Senator SHERRY**—Do you have any response, Mr Parker?

**CHAIR**—I do not know that he has any obligation to answer that.

**Senator Minchin**—I am not sure that a Treasury officer should engage in hypotheticals of that kind.

**Senator SHERRY**—Minister, you were not here when we had the hypotheticals—the doomsday scenarios—from Senator Joyce this morning. There was response allowed to that doomsday scenario.

**CHAIR**—No, but I did clarify that.

**Senator SHERRY**—A bit late, I thought.

**CHAIR**—As you well know, my exact words were that if it was an informed debate I would allow some discussion, but I do not, with the greatest of respect, view that as such.

**Senator SHERRY**—In the context of that, we have had a real-life scenario—and I am not just going to stop at a 17 per cent interest rate rise because I have a long memory as well, as Senator Minchin knows—of 17 per cent interest rates, have we not, Mr Parker?

**Mr Parker**—In history, that is correct.

**Senator SHERRY**—Yes. I also seem to recall a real-life 22 per cent in interest rates further back in history when the current Prime Minister was Treasurer of Australia.

**CHAIR**—I am surprised you are raising this, Senator Sherry.

**Senator SHERRY**—Do you recall that, Mr Parker?

**Mr Parker**—Yes, I do. I was rather young at the time.

**Senator SHERRY**—So was I, but I can still recall it.

**CHAIR**—Senator Sherry, I think you should move on to your question.

**Senator SHERRY**—I am moving on to my question.

**CHAIR**—I will make some judgements about its relevance or otherwise.

**Senator SHERRY**—There was apparent glee when I raised the issue of 17 per cent interest rates from some, not such apparent glee when I got to the 22 per cent interest rates under our current Prime Minister when he was Treasurer.

**CHAIR**—Let us move on.

**Senator SHERRY**—Just going back to the demand and supply side of the equation on housing affordability, you had indicated largely demand side factors as against supply side factors. Has Treasury done any work on the impact of planning issues and land availability in the context of supply side issues?

**Dr Kennedy**—In the macro-economic group we have not done any detailed work around that. I cannot answer for my colleagues in the fiscal group, so it might be worth raising the issue with them.

**Senator JOYCE**—Mr Kennedy, who is responsible for releasing land? What level of government is responsible for the allocation of land and releasing of land?

**Dr Kennedy**—Most of that takes place at the state level.

**Senator JOYCE**—Do you think that there is a restriction on land being released at the moment that could have an effect on the market?

**Dr Kennedy**—It is a possibility.

**Senator JOYCE**—Thank you.

**Senator SHERRY**—We had a brief discussion on general modelling activities this morning. I touched on climate change and water. I just wanted to be clear. Treasury, or at least the macro group, has not examined the long-run macro-economic implications of climate change?

**Mr Parker**—Not that I am aware of, no. In order to do that, one would need to know what the policy response to climate change was going to be. Obviously, there has been a range of policy responses in the past, but the form and degree of the policy response in the future is an issue that is still in play and, until we have a good understanding of how that was going to work out, it would be a hypothetical exercise.

**Senator SHERRY**—But I would have thought at least improving understanding would have involved an active interest by Treasury in this matter.

**Mr Parker**—We are actively interested in climate change issues.

**Senator SHERRY**—And the degree of that activity?

**Mr Parker**—We have a unit, again in the fiscal group, which is involved in environment issues. One of the reasons that Martin Parkinson is not here today and you have me as a poor imitation is that Martin has gone off to head the Prime Minister's task group on emissions trading. So it is something that Treasury is intimately involved in.

**Senator SHERRY**—Yes, I was aware of that. One of the reasons I am pressing this issue is that I noticed that the recent review of the economics of climate change by Sir Nicholas Stern was run from the secretariat in the UK treasury. Are you aware of that?

**Mr Parker**—Yes.

**Senator SHERRY**—Does the Australian Treasury intend to produce a report on the economics of climate change with an Australian focus?

**Mr Parker**—I am not aware that that is presently planned, but again you should direct that to the fiscal group.

**Senator SHERRY**—I note page x of the summary of the Stern report states:

In summary, analyses that take into account the full range of both impacts and possible outcomes—that is, that employ the basic economics of risk—suggest that BAU—

business as usual—

climate change will reduce welfare by an amount equivalent to a reduction in consumption per head of between 5 and 20%.

Have you read the Stern report?

**Mr Parker**—I have not read all of it, no.

**Senator SHERRY**—Are you aware of this concern that I have just referred to?

**Mr Parker**—Yes.

**Senator SHERRY**—Does Treasury share that view?

**Mr Parker**—That is a very difficult question as to whether we share that view. There is presently an active debate going on within the climate change and economics profession about that issue. I personally do not profess to be an expert in that debate, so I would actually be speculating.

**Senator JOYCE**—You do not have any meteorological experts in Treasury?

**Mr Parker**—No, we do not have meteorological experts in Treasury. We do have a relationship with the Bureau of Meteorology, and from time to time we do talk to them about climate issues, and we have a fairly active internal debate on the issue as well.

**Senator JOYCE**—Around a coffee, like everybody else does at this point in time?

**Mr Parker**—We have seminars and the like; often a little bit more formal than around the tea break.

**Senator SHERRY**—I would not begrudge Treasury officials a cup of coffee when they are discussing these issues.

**Senator JOYCE**—Neither would I.

**Senator SHERRY**—A cup of tea or even a biscuit.

**Senator JOYCE**—I am just saying that their expertise is probably as acute as our expertise in deciding the finer points of climate change.

**Senator SHERRY**—Just coming back to Stern's conclusion of five to 20 per cent, are you indicating Treasury does not have a view?

**Mr Parker**—I said that you should ask the fiscal group about whether they have a particular view.

**Senator SHERRY**—You are going to flick it over to them.

**Mr Parker**—I am going to flick it to them, that is right.

**Senator SHERRY**—There is an obvious significant interest in the UK and an obvious major debate, whatever we think about that debate and the issues that are coming from it. I just get the sense that Treasury does not particularly seem to be taking this issue as seriously as it should.

**Mr Parker**—There is obviously a question about how seriously we should take it. There is a question about how much you would want us to do. But let me assure you that the issue of—

**Senator SHERRY**—At the moment I am trying to discover what you have been doing.

**Mr Parker**—climate change has been on the policy agenda for some time and it has been subject to an active work program.

**Senator SHERRY**—The Stern report also stated at page xii:

The Review estimates the annual costs of stabilisation at 500-550ppm of CO<sub>2</sub>e—  
carbon dioxide emissions—

to be around 1% of GDP by 2050—a level that is significant but manageable.

Again, does Treasury have any view on this cost of around one per cent of GDP by 2050?

**Mr Parker**—Macro-economic group does not have a view on that issue.

**Senator SHERRY**—Do you know if these issues will be incorporated in the *Intergenerational report*?

**Mr Parker**—The *Intergenerational report* is presently being prepared. It looks at long-term fiscal pressures and it is undoubtedly the case that the form of the policy response to climate change could have an impact on long-term fiscal pressures, and that is essentially the driver of the debate around moving at some point to an emissions trading scheme. The view is that an emissions trading arrangement will bring about any given level of CO<sub>2</sub> abatement at a lower cost than other, in a sense, non-economic instruments.

**Senator JOYCE**—Just on that emissions trading issue, do they envisage emissions trading to go right back down to the farm level, where the person on the property has the ability to regard the trees that are standing on their property as a tradeable item? Is that possibly how it could work or is this something that is only going to work between big business and governments overseas?

**Mr Parker**—It is conceptually possible to go down to that level and, indeed, some people have proposed that it should go down to the individual level.

**Senator JOYCE**—That would not make them participate. If the government in Queensland has gone out and basically signed away people's rights to their vegetation—it has

not acquired it because it has not paid anything for it—it has stolen a tradeable right of the people of Queensland that could be worth billions and billions of dollars. It is worth billions and billions of dollars to the people who formerly owned it before they traded it away. The government has stolen it. It is an item that could be traded on the world market and would otherwise have been returned to the farmers and the people who own property on which those trees are grown.

**Mr Parker**—I am not in position to comment on how past policy has evolved, but certainly were it the case that carbon markets went down to, in a sense, local levels you can have some very interesting things happening.

**Senator JOYCE**—Likewise, the government of New South Wales has stolen it. In fact, any of the state governments which have put on this vegetation management act have stolen an asset that was formerly owned by an individual.

**Mr Parker**—One of the attractions of the emissions trading thing is that it allows people to natively look for interesting and innovative things to do. There is an interesting story around carbon trading in the Northern Territory at the moment. Most of the Northern Territory forests burn naturally every year, started by lightning and the like. If those forests burn late in the year, it tends to be a hot fire and it reduces the undergrowth to basic ash. If it is a fire which burns earlier in the year, in the wet season, you get a lot of carbon left over—charcoal which gets incorporated into the soil. A nice little example of how markets have evolved is that the Indigenous people of the Northern Territory have actually been able to capture the benefit of that by setting up a scheme where they deliberately burn the forests early in the year. That gives rise to a carbon credit which they have transacted with gas.

**Senator JOYCE**—How much is that worth to them?

**Mr Parker**—It is a multimillion dollar exercise.

**Senator JOYCE**—So it makes complete sense that this is the sort of income that has been compromised by the landholders of Queensland and New South Wales by reason of a state government that has just signed away—stolen off them—their vegetation rights.

**Mr Parker**—I could not comment on the history. I am not just that familiar with the story.

**Senator JOYCE**—But it is fair to say that if you have carbon on a property in the form of trees you would have a tradeable right that is worth money.

**Mr Parker**—It could be worth money. The capture of carbon could well be worth money, yes.

**Senator JOYCE**—And if someone took those trees off you then they have that right.

**Mr Parker**—Trees are one of the relatively small number of mechanisms we know about to economically remove carbon from the atmosphere.

**Senator JOYCE**—Thank you.

**Senator SHERRY**—I was going to come to carbon trading. I note that the Stern report, again on page xii of the summary, identified four ways to lower carbon emissions: reducing demand for emissions-intensive goods and services; increased efficiency, which can save both money and emissions; action on non-energy emissions, such as avoiding deforestation; and

switching to lower-carbon technologies for power, heat and transport. Given the conversation we have just started to enter, does Treasury agree emissions trading is an efficient way to reduce demand for emission-intensive goods and services and increased efficiency?

**Mr Parker**—The thing about emissions trading is that it can affect all four of those factors. It can set up incentives to come up with lower carbon-intensive technology; it can set up incentives for carbon capture in the non-energy sector. The nice part about it is that it will, if it is done properly, bring about a given level of carbon reduction at the lowest cost because some of these may be very low cost and some of them may be high cost.

**Senator SHERRY**—What capacity at the moment does Treasury have to advise on emissions trading issues?

**Mr Parker**—You had better ask the people who are doing that—the fiscal group.

**Senator SHERRY**—So, on more detailed questions on carbon markets, examination of emissions trading issues et cetera, you would refer me to the fiscal group?

**Mr Parker**—Indeed.

**Senator SHERRY**—Was Treasury involved in writing the discussion paper on national emissions trading published by the Australian Greenhouse Office in 1999 and 2000?

**Mr Parker**—I am not personally aware of the facts surrounding that.

**Senator SHERRY**—Who would be aware of that?

**Mr Parker**—If you ask the fiscal group about that issue, I am sure that between now and then they will be able to find the answer for you.

**Senator SHERRY**—I just thought I would check that before we moved to fiscal at some later hour of the day or night. One final area I want to go to is what appears to be increased takeover activity and the financing of it from the Treasury perspective. I note that the Reserve Bank governor, Mr Stevens, said at a CEDA event in December:

... corporate leverage, and the associated exposures around the financial system, could be rather more prominent as an issue over the next five years or so than it has been for a couple of decades.

I have noted various other statements of concern, I think would be a best description, from a number of other leaders in the finance sector, particularly banking executives, about this issue. Can you explain the increase in corporate borrowing and corporate leverage that appears to be taking place?

**Mr Parker**—That is a very difficult question. There is obviously a mix of some broader economic issues which go to that. One that is relevant over the last decade or so is that we have seen a very substantial reduction in volatility of the market. You can measure the volatility of the share markets and financial markets of GDP growth and inflation. It is not just an Australian phenomenon but a worldwide phenomenon. Volatility has fallen. In that context, risk and perceptions of risk tend to decline, and so the valuation of financial assets goes up but also the willingness to acquire assets through gearing may well go up. That is a very long-run story. If you were to ask, ‘That sounds reasonable but how come we have seen this very rapid acceleration over the last year or so in private equity transactions?’ then I find it difficult to explain from a macro-economic perspective why you would have seen an acceleration over

the last year. There are issues of fashion and herd behaviour and all that kind of stuff. There are difficult behavioural issues to get in there which might play a role, but this is a global phenomenon. One can ask questions about whether policy changes in Australia have had some effect on this. If you wanted to ask those kinds of questions, the relevant people would be the markets group, who look after the financial system, corporate governance and so forth. It is a bit difficult to tell a story about Australia being driven by domestic policy things when this is essentially a global phenomenon.

**Senator SHERRY**—I note you added to risk ‘and perceptions of risk’. What do you mean by ‘perceptions of risk’?

**Mr Parker**—You can measure risk in a backwards-looking fashion; basically that is driven by measures of volatility. You can also measure perceptions of risk by looking at pricing in options markets, because essentially the price of an option on a share is influenced by its perceived volatility. It is the expected volatility that should bear on that. You can measure that out of financial markets. Whether markets get that right, of course, is a completely different issue.

**Senator SHERRY**—You do not sound confident that they may get it right in the current circumstances.

**Mr Parker**—That is essentially what the governor was getting at. The concerns that he voiced around this obviously relate to the overall macro-economic implications and the stability of the financial system. Markets do not always price these things correctly.

**Senator SHERRY**—You have made some general observations and remarks. Given the discussion we have had, has Treasury examined this activity and set of issues, say, over the last year or 18 months in any specific project form or more detailed form?

**Mr Parker**—There is an ongoing discussion and examination of these issues in the Treasury. It has largely been done in the markets group as far as I am aware. Steven, have we been involved in that?

**Dr Kennedy**—On the periphery, but that is a discussion that mainly takes place in the markets group.

**Senator SHERRY**—Obviously the markets group will be here later on, but is it fair to say that in your particular area you have been giving this area greater examination?

**Mr Parker**—It is an area that we have been looking at, when we were not looking at it a year or so ago.

**Senator SHERRY**—Specifically, has Treasury looked at the revenue consequences of the proposed Qantas takeover?

**Mr Parker**—It may have, but that would not be us. That would be the revenue group.

**Senator SHERRY**—Are you able to outline the consequences generally of the revenue impact of a Qantas takeover or a similar type takeover?

**Mr Parker**—Probably the sensible answer to that is to say no, personally I am not. I have vague ideas, of course.

**Senator SHERRY**—When I say ‘you’ it is a reference to you and officers generally, not you specifically.

**Mr Parker**—Again, the revenue group would be the better people to ask about that. In any particular deal it obviously depends on how the arrangements are structured, where the increased debt that is associated with the transaction ends up, whether it ends up on the balance sheet of the company that has been taken over or held by the people who are taking the equity interest in it. It depends on whether they are residents or non-residents and so forth.

**Senator SHERRY**—Related to this Qantas issue and the general discussion we have been having, has Treasury examined the macro-economic consequences of a major collapse of a highly leveraged Australian company?

**CHAIR**—I would have thought that we are getting into never-never land because I think this has—

**Senator SHERRY**—It may be. I would be interested to know.

**CHAIR**—It is more the language associated with the question than the question itself.

**Mr Parker**—I am not aware that we have.

**Senator SHERRY**—Probably the activity of Bond and Skase most readily come to mind. It was highly leveraged activity—obviously not overseas in their case—that did have economic consequences. I am sure you can remember that, Mr Parker.

**Mr Parker**—It would be pretty difficult to pick it up at the macro-economic level. The largest failure in recent years, of course, was the HIH failure.

**Senator SHERRY**—Yes.

**Mr Parker**—As you probably know, Treasury was intimately involved in the government policy response to that to provide replacement cover to the people who lost their insurance rights under that. Obviously, that had some effects on the way that insurance markets operated for a number of years. We all know that story of those difficulties in attaining particular types of insurance. But it would be pretty difficult to then go and say, ‘What was the macro-economic impact from that?’

**Senator SHERRY**—In the case of HIH there was certainly a significant interest because of the reasons you have indicated—the response that had to occur given the consequences—but, from Treasury, I am certainly aware at the time when we discussed this issue it was not just in markets; there was close examination of all of the consequences of this virtually across all of Treasury.

**Senator Minchin**—Can I interrupt. My recollection is that HIH did not collapse because of high debt level.

**Senator SHERRY**—No, I am not suggesting that.

**Senator Minchin**—You are talking about companies collapsing because of high debt levels. Companies collapse for a whole lot of reasons all the time.

**Senator SHERRY**—My question went to the collapse of a highly leveraged major Australian company. Then Mr Parker drew our attention to HIH. I suspect HIH was highly leveraged, given the false actuarial valuation.

**Senator Minchin**—It was poor pricing of product really, wasn't it?

**Senator SHERRY**—Based on questionable actuarial statements of assets, amongst other things. That is probably a leverage angle—leveraging off an inflated asset value. I am not suggesting that in the case of Qantas. The impact of a major Australian company is of interest to Treasury.

**Mr Parker**—I am certainly interested in whether it might have broader ramifications for the stability of the financial system and so forth. As to your prior question about what work Treasury did on the macro-economic implications of the HIH collapse, I am not personally aware of it. I was over at the OECD for a number of years, so it is a gap.

**Senator SHERRY**—I do not have any further questions in this area.

**Senator WATSON**—Along the same lines, particularly about this part of the world being awash with cash and the new financial products, does Treasury agree with the Reserve Bank of Australia warnings about debt leveraged buyouts in Australia?

**Mr Parker**—Yes. We do not disagree that they contain a risk. There is a risk there.

**Senator WATSON**—What are your reasons for supporting that approach?

**Mr Parker**—If you look at the leverage in the corporate sector, one of the key features of this long period of economic expansion that we have had is that the balance sheets of the corporate sector have become extremely healthy. The levels of gearing in the corporate sector have dropped very markedly compared with where we were heading into the 1991 recession when corporate gearing was quite high. In fact, at that time the epicentre of the recession was largely around corporate asset holdings. Since then, gearing has declined very substantially. What we are now seeing, however, is a tick up in that level of gearing, partly because of the private equity of transactions. That must mean, other things being equal, that the level of risk has risen; but, given that balance sheets have got into such a strong state over the last 15 years, it is not the kind of risk where you would be worried in the immediate term. It is clearly the case that were there to be an economic downturn at some period in time then the corporate sector is now, in aggregate, a little more exposed than it was previously.

**Senator WATSON**—Given the acquirer's high debt levels that it is going to impose on Qantas, an airline operating in a very volatile market, should there not be some warnings from Treasury about the consequences of SARS or terrorism? The coincidence of those sorts of things happening at a time early in the 70 per cent—

**CHAIR**—Would you mind speaking up a little bit, please. I cannot hear you.

**Senator WATSON**—I think Mr Parker did.

**Mr Parker**—Yes, I broadly heard that. As I said, this is an issue which we have under notice. We are looking at it. If we felt that there were immediate issues associated, then one might imagine that we or the Treasurer might say something.

**Senator WATSON**—Has Treasury any national interest concerns about the sale?

**Mr Parker**—I did not hear that question.

**Senator WATSON**—I will speak louder for your benefit. Has Treasury any national interest concerns about the sale of Qantas?

**Senator Minchin**—Given that is the subject of a FIRB review, I do not think you need to respond to that. It has now been considered formally and officially by FIRB, Senator Watson, so I do not think it is an appropriate question to Treasury officials.

**Senator BERNARDI**—May I pick up a question here. Qantas is an emotive issue. Treasury has no place in making comment on the internal gearing mechanisms of a company. If the Qantas management determined that they were going to leverage their balance sheet as much as they can, it would not be an issue for Treasury, would it?

**Mr Parker**—That is quite right. That is why I was careful in my remarks to talk about it only in macro-economic terms. I think we are far from this situation, but if you saw gearing in the corporate sector get to a point where you were substantively worried about the implications for the stability of the financial system then you might expect there to be further pronouncements along the lines of those by the governor. We are not at that stage.

**Senator JOYCE**—One of the issues that you brought up is that you said that the corporate sector now has strong control of debt. Would it be a fair proposition to say that that is by reason of an accelerating share price more than a retirement of debt?

**Mr Parker**—I would have to take that on notice and go back and look at it.

**Senator JOYCE**—The proposition is that, if you are in an environment where interest rates are rising—and they rise by reason of what is happening overseas, macro-economic effects throughout the world—the only thing you should really talk about when you refer to a government is the differential between its interest rates and the United States interests rates, or another benchmark, rather than saying its interest rates are lower, its interest rates are high. If you talked about interest rates in a period when there is a trend up throughout the world, and we had a position where stock prices stagnated, then a company that had a high leverage would be in a completely different position now from, say, 10 years ago when obviously there would have been a trend of interest rates going down or a propensity for greater exposure.

**Mr Parker**—I think you are just restating the point that a higher level of gearing brings with it a higher degree of risk to an external shock to the company.

**CHAIR**—I am mindful of the program. If there are no other questions, we might move on. I thank Mr Parker and the officials for a most interesting 4½ hours.

**Senator JOYCE**—I have one final question on debt. How many companies could go off the Australian stock market if there was an equity buyout before it started affecting them? Take that on notice.

**CHAIR**—That is an interesting question for Mr Parker, but I do not think that we expect a response.

**CHAIR**—We will now call the revenue group and tax. I notice we have with us today the distinguished former senator, Mr Tchen. We welcome Mr D'Ascenzo, Mr Callaghan and their officials.

[2.40 pm]

**Senator WATSON**—My first question is directed to the Commissioner of Taxation and concerns the thin capitalisation rules. Do the thin capitalisation rules extend to contrived leverage takeover arrangements such as Qantas, in the final outcome?

**Mr D'Ascenzo**—The scope of the thin capitalisation rules is about companies operating with a gearing usually higher than three to one in terms of debt to equity, and that applies across the board, provided it comes within the provisions.

**Senator WATSON**—So it would apply to them?

**Mr D'Ascenzo**—I do not know the circumstances of particular cases.

**Senator WATSON**—In the 70 per cent leverage position.

**Mr D'Ascenzo**—Any company or business operating in Australia—certainly Australian resident companies—has to meet the thin capitalisation rules, which generally for operating companies is in the order of three to one.

**Senator MURRAY**—Can you give us your usual carefully constructed rundown on Wickenby—in other words, not going into the operational matters, but at least giving us a progress report? I see there is a lot of speculative commentary, which is of interest.

**Mr D'Ascenzo**—As I mentioned over previous briefings, we have been working very carefully with other Commonwealth law enforcement agencies in relation to Project Wickenby. We are at the early stage of trying to build our capability and explore the evidence-gathering exercise as part of the project. The Australian Crime Commission and the Australian Federal Police have in the order of 10 criminal investigations afoot. We and ASIC together have in excess of 100 additional civil and criminal inquiries under way. Last year we had charges laid against three people in Queensland. This year there has been one person who has come before the Federal Court and is likely to be pleading guilty without going through a committal stage. I think that is a ramp-up, the outcome, of those inquiries coming to fruition. Over the previous two to three years, the ACC has had over 20 challenges to its authority. The ACC has been successful in all those 20 cases. Both we and the ACC have also been before the courts on questions of legal professional privilege claims, but so far they have been put behind the investigative force, and again we are looking to further progress matters this year.

On the legislative front, the government has given support to moving a measure to provide more exchange of information in relation to the parties involved in projects such as Project Wickenby. That is a positive government response to us. In terms of revenue, we have raised assessments just under \$30 million, with expenditure on Wickenby a little under a similar amount.

**Senator MURRAY**—Did you say 120 criminal investigations are under way or did I mishear?

**Mr D'Ascenzo**—There are 10 criminal investigations by the Australian Federal Police and the ACC and then there are another 100 ATO audits or ASIC investigations. Some of them may be criminal and some may be civil.

**Senator MURRAY**—I was a little surprised at the criticism of the authorities, including yours, involved in the Wickenby matter, that it was going too slowly. My own expectation was that, due to the court actions attempting to hold you up and due to the obvious difficulties of winking out the information, the entities and the individuals involved in this matter, it would be a lengthy process. In my own mind I had a five-year time frame, not a one-year time frame. Can I give you the opportunity of this hearing to answer the critics that it has been too slow and has produced too little benefit so far?

**Mr D'Ascenzo**—The key to a project like Project Wickenby has been to try to send a signal to the community and to elements of the community that want to flout the law that the Commonwealth is prepared to work together across a number of agencies to get an outcome in accordance with the law that safeguards Australia's interests. I think very early in the piece one of the criticisms had been that the authorities will not be able to work together, that there will be divisions and that there will be the usual demarcation processes. I can say from personal experience that very much from the senior echelons of all those organisations that are part of Project Wickenby there has been nothing other than full support and a very full commitment to work together. We have joint teams in developing our plans. We have very regular fortnightly, monthly and quarterly meetings at very high levels, and that goes all the way down to in the organisation and all the organisations involved. Trying to bring matters to fruition in terms of criminal charges requires a degree of evidence gathering. I think the very fact that the ACC has been able to respond with 20 court actions in the last three years and to be successful in all 20 goes to show how tenacious those that do not want the see due process achieved are trying to block that progress.

**Senator MURRAY**—And how well resourced they are.

**Mr D'Ascenzo**—And how well resourced they are. What we have found is that we have been able to succeed—the ACC has been able to succeed—in 20 of those matters that have been put before them. We are now seeing people, like the recent example, where the person is saying, 'I do not even want to go to committal. I want to come and plead guilty, cooperate and get on with things.' I think that should speed up our process immensely. If the tack was to be taken that people wanted to fight their way through to committal proceedings, that could be an extra 12 months at least in terms of when that happens. The fact that we have been able to get to this stage is modest, but I think it does foreshadow a positive response over the next 12 to 24 months.

**Senator MURRAY**—Whilst it may take some time to process these matters in the framework in which you have outlined, a legislative response can be quicker. I do not mean with respect to changing the law retrospectively. If, for instance, you identify loopholes in our integrity systems, legislation can be altered relatively quickly to attend to those issues. My question is: as a result of how far you have got so far, has the Taxation Office been able to make recommendations to the government for any changes to the law as at this moment in time?

**Mr D'Ascenzo**—We have been piecing together what is involved with many of these schemes and, ultimately, the criminal arrangements that we are looking at primarily are trying to hide the existence of amounts that would otherwise be taxable in Australia. It becomes one where it is people trying to put themselves not within the law but outside the law, hoping that

alleged contravention would not be found out. That is why we are targeting areas where you have a lack of secrecy or where you have a range of secrecy and confidentiality. Indeed, one of the challenges to the ACC was in relation to their request for assistance from the Swiss authorities in relation to gathering information. That was successful. The ACC was able to get that information, and it is piecing it together. What we have found is that, at an operational level, to be able to share information that each of us has to get is an important step forward in the efficient progress of these matters, and we have put to the government a request that people in designated project teams like Project Wickenby should be able to provide information that is relevant to that project amongst the players. In terms of legislation, we have gone to that procedural improvement. We have not yet identified a particular loophole in the law that necessarily requires urgent attention.

**Senator MURRAY**—I had the impression that one of the legislative areas which might be examined was an indirect consequence of these matters and that is the improper use of legal professional privilege to actually shield criminal or corrupt activity. I had understood that there were discussions between the authorities and the Attorney-General's Department and, I presume, Treasury on that matter. Is that an accurate understanding?

**Mr D'Ascenzo**—I do not know if there has been those discussions. There may well have been. I am not privy to all those discussions. I did mention that both the ACC and the ATO are in the course of challenging claims for legal professional privilege. The point is that people might be using legal professional privilege improperly, if we are successful, and the courts will be able to use the current law to say that is not on. When you look at legal professional privilege, there are two types of legal professional privilege. One is in relation to contemplated litigation, which is not the sort of area that we would be concerned about. We are concerned with advice given about how you could structure your affairs in a way that was avoiding the tax laws. For legal professional privilege, that advice cannot and should not go to a commission of an offence because, if you are providing advice to break the law, legal professional privilege does not take you that far. In a broad sense, one would have thought that properly prosecuted through the courts the distinction of where legal professional starts and ends could well be clarified through that process. There may be other inquiries and other views about how wide or narrow that should be.

**Senator MURRAY**—So, essentially, your response is that a jurisprudential resolution of these matters is more likely than a legislative one, at least with respect to professional privilege?

**Mr D'Ascenzo**—I think it would be good at the very least to quite understand where the area of concern is with a degree of specification, and I am not sure whether we have got to that point yet.

**Senator MURRAY**—Turning to your budget for Wickenby, I recall it was in the order of \$300 million. Do you think that figure is likely to be needed? In other words, will you spend less or do you think you are likely to spend more? Is it too early to tell?

**Mr D'Ascenzo**—It is over a five-year period. I can say that the ATO have spent in the 2007 year—that is, from July to now—a bit over \$10 million on Project Wickenby out of a planned budget of \$14.5 million. So we are underspending at the moment on the project to the

tune of \$4.5 million for that period of the year. The reason for that is just the time it takes to recruit. Also, a lot of the costs will be in pursuing some of these matters through the legal processes. The investigative part of the journey has been a hard one for us, given the challenges that we have had along the way.

**Senator MURRAY**—This is the last question from me on Wickenby. Has the exercise so far given you as the Taxation Office a better feeling for the amount of money that is held offshore or is moved through tax havens? I do not mean that which is moved legitimately, because you would there have a handle on it; I am talking about illegitimate monies. If the answer is yes, I would obviously want to know whether it is greater or lesser than the tax office had thought.

**Mr D'Ascenzo**—I do not think we have a figure to say this is how much it is in quantitative terms, so I might have to answer that in terms of what I feel is the outcome there. As I mentioned early in the piece, there has been some very strong positives from Project Wickenby. The fact that the agencies involved have been working very well together, the fact that we are improving our capability across the whole of government in addressing these and the fact that we have been engaging with overseas tax authorities, overseas police and overseas authorities in other areas has started to send a signal that is important. We monitor as much as we can the flows to tax havens and we risk-assess how big that issue is as part of our tax office processes and I am sure that the police and others would do that in the context of money-laundering and other criminal purposes. From a tax perspective, given the approach that we have had since AUSTRAC has been part of our structural features, the level of use of tax havens for tax purposes is significantly less than other countries. In this context I am talking about other developed countries.

**Senator MURRAY**—Have you based that opinion from talking to other authorities?

**Mr D'Ascenzo**—That is right; very much so. A lot of their projects have a traditional use of tax havens for people to put their money away from the gaze of the Revenue. What we are finding here is that a number of promoters have been marketing these arrangements. There has been some take-up. It has not been endemic to the extent that it is in some other countries. The estimate for Wickenby was a return of over \$300 million over the five-year period of the project and that will be easily met.

**Senator MURRAY**—I assume that you are aware of the South African example where they had an amnesty for individuals who had their money stashed overseas and, provided they declared it and indicated the source and where it resided, they would not be charged more than the standard tax rate—in other words, there were no penalties to apply. I do not know how successful that was. I do not know if that is an area that Australia should be interested in, but I want to know whether you are aware of it and whether you think that it has any relevance to Australia.

**Mr D'Ascenzo**—I am not sure that I was aware of the South African example, but I do know the examples of amnesties in other countries. In Indonesia, they certainly touted one, even if they did not pursue it. There is a danger. Amnesties often come to the fore when the country believes that the amount of abuse is endemic and there is no other solution. The drain is so much that they need to find some way to get these funds back. I do not think that the

Australian context is at that level of desperation. Our problem is within manageable limits under normal process. The question of amnesty—and I am speaking from the view of the Commissioner of Taxation—is more a matter for the government than the commissioner to propose. It goes to the policy that you want in allowing people to have an arrangement that is more favourable than other taxpayers who pay their tax on time. It does send the wrong signals to the rest of the community, and there are also questions of what sort of amnesty it is. It is one thing to say that there are no penalties but what if you know that the proceeds have come from some collateral criminal activity? Do you close your eyes to that collateral criminal activity? There are some very real questions about where amnesty starts and finishes. We had a legislative amnesty in relation to the transfer trust measures some 10 years ago in Australia. We did not get much of a response because the terms of the transfer trust concessions were that people had to tell us where the money came from, and they were concerned to say that because that might open them up to other sanctions, whether tax or criminal sanctions.

**Senator SHERRY**—I have some questions on the same matter, as well as on high wealth individuals. We have discussed this before. The crackdown on high wealth individuals, if I could describe it that way, is different from operation Wickenby. Can you provide an update on the ATO's crackdown on high wealth individuals since the November supplementary estimates hearing?

**Mr Konza**—The high-wealth individuals project is an increase in capacity of the ATO to deal with the expanding high-wealth individuals population. It is not a crackdown as such. It is a response to the expansion of that population. Since we received the funding on 1 July 2006, we have increased members of the task force from approximately 100 to approximately 150. This equates to five new audit or assessment teams. In addition, we have a number of staff—about 15—who are working on some longer term improvements on the way we do our risk assessment and particularly the way we do our intelligence gathering with regard to high-wealth individuals' taxation.

**Senator SHERRY**—Are those 15 part of the 150?

**Mr Konza**—No. That is in addition to the 150. We anticipate putting on another 10 staff, the equivalent of another audit team, before the end of this financial year. Over the course of this year, we have done a lot of work on profiling the high-wealth individuals, responding to the intelligence in our data and in the external world, and the extra resources have allowed us to complete some backlog work and also complete some further work there. I hasten to remind the committee—I think we have discussed this in the past—that in the high-wealth individuals project there is a profiling stage where we need to establish the assets of the individual. That is the assets that they control rather than the assets that they own, and that is quite a significant amount of work in establishing whether you have a high-wealth individual or not, and if you do, the extent of the assets that they control. Secondly, there is a risk assessment process to see whether or not—as we discussed previously—their tax performance equates to their economic performance overall. Thirdly, if they fail that risk assessment, there is an audit to see whether there are any problems with their taxation affairs. We have completed about 160 additional profiling cases with the resources that we have. Last time I told this committee that we anticipated covering about 1,000 high-wealth individuals. I

informed the committee that there were about 860 high-wealth individuals and then there was a margin for those who might be very close to being high-wealth individuals or required the attention of the task force for other reasons. However, the profiling work that we have done has now resulted in us so far identifying 1,100 high-wealth individuals.

**Senator MURRAY**—That is the growing economy.

**Mr Konza**—Yes. We were not overly surprised and we probably expect to keep finding high-wealth individuals as we go on. Also over the course of the year we have, as I said before, put on five new audit teams. That is not an easy process, because you cannot just go out and buy 50 very highly skilled tax auditors to do high-wealth individual audits. What it has necessitated is our taking some of our experienced staff and seeding new teams, if you like, with those staff. The upshot is that we expect to undertake five new audits in the remainder of this year. The total number of audits for the year will be probably five more than we had started.

**Senator SHERRY**—What has been the expenditure to date—or as up to date as you can give me—on the task force?

**Mr Konza**—I might need to take that on notice, because I have been mainly looking at the resources, the human resources, that we have got on the task force.

**Senator SHERRY**—What about the revenue raised to date as a result of the operation so far this financial year?

**Mr Konza**—So far this financial year the High Wealth Individuals Taskforce is exceeding its revenue plan for the year-to-date figures.

**Senator SHERRY**—Which is?

**Mr Konza**—I would need to find those details.

**Mr D'Ascenzo**—I might add that the recruitment this year, which is in the order of 60 to 70, is part of the commitment that we were funded for in the last budget to increase our numbers to the order of 270. We are making some steady progress there. Not only are we just bringing new people onboard but also, as Mark said, we are trying to better refine our risk management processes. We have a special project team looking at how we can better data mine and better find indicators of wealth that might not otherwise be obvious.

On another aspect of the approach that we take with high-wealth individuals, as Mark said, it is not easy to get fully trained people to deal with what are very complex technical issues and also complex issues to manage at a personal and project level. We do use a lot of external consultants to assist our people and to help ensure that our people have the right level of business acumen to understand the practical business context of arrangements that we have to look at.

**Mr Konza**—So far we have collected \$47.7 million—these are end of September figures—versus \$155 million.

**Senator SHERRY**—Sorry—versus \$155 million? What is that figure, Mr Konza?

**Mr Konza**—Those are the tax collections planned. For the year, we planned to raise \$770 million in liabilities. Our pro rata target to the end of September was \$189 million, and we

had raised \$686 million, which points to an important point with the High Wealth Individuals Taskforce. If you look at the annual report table, you will see that it has achieved very good revenue collection outcomes, but they are very lumpy, because major cases come through and they do not come through on a production line.

**Senator SHERRY**—It is not a constant stream.

**Mr Konza**—It is not a constant stream.

**Senator SHERRY**—I understand that.

**Mr Konza**—We have concluded this year a couple of very large cases and we have issued the assessments for those. That is why we have issued amendments for \$686 million. The collections for those amendments have been agreed. I think the greater part of them will be collected before the end of the financial year, but they have not been collected yet.

**Senator SHERRY**—So as of September, \$47.7?

**Mr Konza**—Yes.

**Senator SHERRY**—Is there any crossover of the individuals being investigated as part of the High Wealth Individuals Taskforce in terms of operation Wickenby?

**Mr Konza**—As a matter of fact, there might be one or two individuals, but we do not see it as a systemic overlap.

**Senator SHERRY**—I was just interested, because it would seem to me reasonable that there would have been some identified through both operations.

**Mr Konza**—There have been instances of transactions that have been identified in Project Wickenby and then referred to the High Wealth Individuals Taskforce, because they are a high-wealth individual taxpayer.

**Senator SHERRY**—Just going back to those numbers in the profile, I think you said you have readjusted your target of profiling to 1,100 and you have completed 160 profiles. When you say ‘completed 160 profiles’, does that mean that there are effectively 940 outstanding?

**Mr Konza**—No. That would cause me heartburn.

**Senator SHERRY**—Tell me why you have got the heartburn concern.

**Mr Konza**—These figures are a little out of date from what I have just told you, but they will give you an idea of the dynamics. As at the end of September 2006 we had identified 1,283 high-wealth individuals in Australia. We exclude 284 of them because they were non-active cases. They may in fact have gone bankrupt after we identified them or passed away or left the country. When you take that figure off, we were left with 999 high-wealth individuals. What I was saying was that last year I told you that we had 860-odd confirmed high-wealth individuals. What I am saying is that we have identified a further 160 high-wealth individuals, and they will be added to the group of taxpayers who are monitored by the task force.

**Senator SHERRY**—In terms of the ‘clearance rate’, individuals who have been identified, profiled and for which work is completed, how many have gone through the complete process to date?

**Mr Konza**—Sorry, the complete process including an audit; is that what you are saying?

**Senator SHERRY**—Effectively there is nothing more you can do. They are audited and that is it or, if the audit is completed and an assessment has been raised and the revenue has not been received, it is obviously not completed.

**Mr Konza**—I would have to take that on notice, because it includes a calculation of audit coverage rates over multiple years. People may have been audited two or three years ago and they are on a watching brief now. We would count them as having been covered, so to speak.

**Senator MURRAY**—Some of those who are dead, broke or have gone overseas would fall into that category too, would they not?

**Mr Konza**—Yes, although not the dead—but the bankrupts often you have to keep a watching brief on in any case because they come back.

**Senator SHERRY**—What do you mean ‘they come back’?

**Senator MURRAY**—There is one who strolls up and down Cottesloe Beach that I would like you to keep a very close eye on!

**Senator SHERRY**—They come back because they—

**Mr Konza**—They are still entrepreneurs, obviously.

**Senator SHERRY**—And there is a tax liability that you will collect at some point in time?

**Mr Konza**—There will be parts of the ATO that will keep an eye on tax liabilities for bankrupts but, no, it is more a matter that we have identified over the years people who, though being bankrupt, have access to resources and enter into business transactions. If they were a risky taxpayer before that, we keep an eye on them again.

**Senator SHERRY**—Is it also the case that they may have had some undiscovered assets?

**Mr Konza**—Yes, that is right. That is a risk.

**Senator SHERRY**—Did you mention the revenue figure raised as a consequence of operation Wickenby?

**Mr D’Ascenzo**—I mentioned that the Taxation Office had issued assessments in the order of \$30 million.

**Senator SHERRY**—What about the actual collection of revenue?

**Mr D’Ascenzo**—I may have that, but I thought in the order of \$24 million had been recovered out of that exercise.

**Senator SHERRY**—In terms of the distinction between ‘project’ and ‘operation’, I notice the description has been changed. Is there any reason for that? Is that reflected in anything?

**Mr D’Ascenzo**—I think the Australian Crime Commission is probably better situated to explain the differences. Under the Australian Crime Commission, the ACC is given a mandate. That mandate covers, I think, nine of the 10 matters that I said to Senator Murray that were being considered for criminal charges by the Australian Federal Police or the ACC. That is the mandate that they have. The wider scope of the project includes many more than just that level of activity. One relates to a particular scope of the project for ACC purposes and the other one covers the wider work of all of those agencies in relation to a much wider brief.

There is some distinction. The distinction is mainly, under that referral for the ACC, a smaller subset of the wider analysis that we are doing as part of a whole-of-government approach.

**Senator SHERRY**—Are you able to identify the number of individuals who have faced the courts to date as a consequence?

**Mr D'Ascenzo**—I think I have mentioned there have been many challenges in the judicial sense by the taxpayers or the promoters. But, if you are looking for charges, there have been three charges laid in Queensland. Recently, one taxpayer has been before the courts and the indications are that that taxpayer will consent not to go to committal and go straight to the Federal Court.

**Senator SHERRY**—Still with this financial year, or the remainder of it, do you anticipate that many more prosecutions would be launched?

**Mr D'Ascenzo**—Again, I think there would be some benefit from the whole-of-government approach if the hard work that all the agency has put into the evidence gathering would ultimately translate to appropriate charges. I think it would better confirm the signal or message to the community that the Commonwealth is serious about this, and also allay the concerns and criticisms that take away from that important message. But, having said that, you do not want to ignore the realities of ensuring that you do a good job, a professional job, that the evidence is there and that due process has been followed. These are matters that, on the criminal side, are more in the domain of the ACC and the Commonwealth Director of Public Prosecutions.

**Senator SHERRY**—I understand the limitations on your being able to provide accurate numbers. As I say, I am not expecting five for the remainder of the financial year or something like that. But are there any indications that more prosecutions will be laid over the remainder of the financial year or the calendar year?

**Mr D'Ascenzo**—I am reasonably confident that more charges will be laid. As to the timing of those, I think it will be dependent on the evidence-gathering exercise.

**Senator SHERRY**—When you say 'charges laid', they are other individuals other than the three individuals against whom charges have been laid?

**Mr D'Ascenzo**—That is right.

**Senator SHERRY**—Thank you for that. That finishes my questions on high-health individuals and Wickenby. I have got plenty of other areas to go on to.

**CHAIR**—Does anyone else have any questions about that?

**Senator MURRAY**—I have. But I am happy to follow Senator Sherry. He often picks up the same areas, in which case I will intercede.

**Senator SHERRY**—While we are on compliance, I want to come to the additional compliance activities in respect of the GST. Can I have an update on the program, Mr Jackson?

**Mr Jackson**—At this stage additional staff have been directed into those activities, as I highlighted last time. I do not yet have information on the revenue outcomes as a consequence of those actions. The changes do require us to modify our intelligence-gathering and analysis

processes. Those sorts of changes can take a little while, but I would anticipate being able to provide a report certainly before the end of the fiscal year on the current state.

**Mr D'Ascenzo**—What we are finding now in the GST area is an increase in our workload in relation to litigation. More people are objecting to more complex arrangements than in the past. That has required a degree of reallocation of resources within the GST group. That has required us to manage the compliance issues very carefully.

**Senator SHERRY**—That is the explanation for not being able to outline the revenue—

**Mr D'Ascenzo**—No. Mr Jackson has said that he does not have the figures to provide you with at this time, but I was just trying to give you the wider context and—

**Senator SHERRY**—I was going to ask why.

**Mr D'Ascenzo**—the sorts of issues we are facing in the GST area. One of the areas where we are finding a greater than anticipated jump in workloads is in the litigation area.

**Senator SHERRY**—One final area of compliance that I wanted to go to was the legal brothel program. I am not sure whether that would be the best description. It has had a considerable amount of media attention over the last few months. When did that program commence?

**Mr Jackson**—Are you referring to our adult services industry work?

**Senator SHERRY**—Yes, I am.

**Mr Jackson**—We have been working in the adult services industry for a considerable period. It is not a recent advent at all. We continue to work in that area. One of the observations I would make is that the media is attracted to that sort of story, as you would imagine, and some of the numbers that I see quoted in the media are reflective of analysis and assumptions made by various parties that I am not particularly confident in at a work level.

**Senator SHERRY**—Specifically?

**CHAIR**—Mr Jackson, while you are collecting your thoughts, can I ask you a question. Is it limited only to the activities referred to by Senator Sherry or is it a wider industry inquiry?

**Mr Jackson**—The reason it is an issue and where I was getting to is that it becomes a matter of definition more than anything else. There is an article in today's *Sydney Morning Herald* where some claims are made about numbers of brothels, I think, in New South Wales. The establishments are variously described as everything from acupuncture studios to massage parlours to escort agencies and many other things. Some clubs and organisations have a basic function which might be to sell food and beverages, but they might provide entertainment. Sometimes entertainment might verge into exotic dancing or something of that nature. Is that described as an adult services industry organisation? That is the issue we get into here. It is no different for brothels. People who are writing these articles are making some observations and drawing conclusions that can be very general and broad and do not necessarily reflect the majority of the operation of the organisation they are looking at. We view those sorts of numbers with some scepticism—'scepticism' might be an overstatement—reservation and conservatism. Whether an organisation derives its income from selling food and beverages or from having a strip show on the side or something of that nature, that

income is still required to be returned for tax and GST purposes. Our job is in looking at organisations to assess whether they have returned their income, not to enter into a debate with them about categorisation or characterisation of their business operation.

The other issue that comes into play here, of course, is that the adult services industry is a fairly transitory industry, I think it would be fair to say. People enter into that industry, they may be engaged for a week or a month or a lifetime perhaps, but it is in general fairly transitory and may not necessarily represent a person's full income. They might during the week work in a factory or some other activity and on the weekend they might undertake escort services. Again, are they a factory worker or someone working in the adult services industry? Irrespective of the name and the way things are described, we look at the income a person has earned, whether they have returned it and whether it matches their lifestyle and expenditure.

**Senator JOYCE**—How many people actually nominate that they are in adult services?

**Mr Jackson**—I cannot tell you, but not many.

**Senator JOYCE**—Is there any relationship between your view of how people are working in the adult services industry and how many people actually submit tax returns saying they are in the adult services industry under their description of income category?

**Mr Jackson**—Our view is that not a lot of people describe their business or occupation as adult service industry. They are more likely to describe it as a club, a restaurant or bar, acupuncture or escort agencies. They are more likely use those sorts of titles. Of course, there are many, many businesses that operate in those areas that do not have any adult services association.

**Senator JOYCE**—There would be a huge cash economy, wouldn't there? Not that I frequent brothels, but I imagine people are not putting it on their MasterCard?

**Mr Jackson**—I do not have details about the level of payment that is cash and the level that is by way of a charge card or other mechanisms. But I think you would be surprised that many people do. It depends on the service being provided, of course. If people go to a club where there is dancing, it may well be that they are quite happy to pay for that with credit cards or cheques. If they are going to a brothel, issues of privacy might persuade them that the use of cash is better. I do not think that you can draw a conclusion that everyone pays in cash in those sorts of circumstances.

**Senator JOYCE**—Have you done any investigation to see whether they in general pay in cash or by MasterCard?

**Mr Jackson**—As I say, off the top of my head, I am not aware of any numbers that differentiate between that. We have certainly done investigations of organisations running adult services of various kinds, including brothels, and there is income received in different ways.

**Senator JOYCE**—It sounds like I am being flippant, but I am not. You can obviously drive down a main street in Sydney, Kings Cross, or the Valley; it is quite obvious that there is a huge industry there—churning away. They are not doing it for free. So there is money

floating around. If you cannot track it down, how do we actually get to the bottom of it? Do we just station someone at the door and do an exit poll or something?

**Mr Jackson**—I do not think I said that we cannot track it down. All I said was that there is an issue of categorisation here. A lot of the articles that you see in newspapers take a fairly flexible interpretation of what constitutes an adult industry organisation, and therefore you can get some large numbers. The other thing that you see in some of these articles—people making the observations—is that one person might earn \$100 an hour because they provide some sort of adult service. If you multiply that by 40 hours a week and 48 weeks of the year and assume there are 10,000 people doing it, you get this big number. The reality is that this is a highly transitory industry. Whilst a number of people may transition through the industry over any given period, you cannot simply make those extrapolations. They make a nice headline, of course, and people are interested in looking at that. But I suspect that underneath that the hard numbers of people who are permanently working full time in the industry are much smaller. People do work for many establishments. Establishments come and go. It is quite difficult to put numbers around this thing. That is a problem.

Having said that, if we look at a club, our methods of income reconstruction and analysis do not really get driven by the sort of service that was provided to the client. So whether it is a sexual service or other sort of service, we still look to reconstruct tax affairs based on how much income was earned, how it was spent and how the assets of the client have varied and so on. The actual nature of the service probably does not drive our ability to construct their tax affairs.

**CHAIR**—Senator Sherry did have the call and I am quite happy to come back to these. I think we have filled *House on the Hill* and *Struth* about three times over now! I think we will go back to Senator Sherry and then we will come back to these.

**Senator SHERRY**—If we can use the term ‘adult business industry’ perhaps, is it correct that you have recently provided in terms of the legal adult business industry a two-tiered model for the GST for application in the industry?

**Mr Jackson**—It is probably fair to say that we are currently consulting with the representatives of the various adult industry businesses, the service providers, health professionals and the sorts of people who provide advice specifically in those areas to review the information that we have made available to that industry over time. We want to make sure that the information we provide is obviously correct but also current and useful. We are working with them at the moment and may well revise some of the information that is available in due course.

**Senator SHERRY**—This is a media report, and I am always a bit cautious about accuracy. Is it correct that the Adult Business Association provided the ATO with a list of 600 illegal establishments?

**Mr Jackson**—I am not aware of the provision of any such list. I have seen that sort of number floated around as well. In fact, as I understand it, at the moment we are looking to see if such a list exists.

**Senator SHERRY**—Does your activity in this area focus on illegal establishments as well as legal establishments?

**Mr Jackson**—We do not differentiate. From our perspective, the key issue is whether or not they have returned the income that they have earned in an appropriate fashion. It may be for others to determine whether or not that is a legal establishment. As I said earlier, often adult services of various kinds are provided as an adjunct to an existing business.

**Senator SHERRY**—In terms of the adult services industry that we have been discussing, have you been able to both track and monitor compliance and revenue over time in this sector?

**Mr Jackson**—As to whether I can provide a time sequence, I do not think I could.

**Senator SHERRY**—Has your activity been increasing in terms of compliance and has there been any improvement in revenue gathered from the sector?

**Mr Jackson**—That is the point I make. How would we define the sector? In looking through tax return information, for example, to identify how revenue has moved, which taxpayers would we be looking at? Would we be looking at taxpayers who declared themselves to be a cafe or a restaurant? It is relatively straightforward if someone is declaring themselves to be a brothel. We could probably do that. But there would be very small numbers who would make that sort of declaration. We do not have that kind of sequence for this fairly broadly described adult industry group.

**Senator SHERRY**—That completes my questioning in this area.

**Senator JOYCE**—I am not sure who can answer this, but my question relates to the capital gains tax exemption that is currently in place for overseas investors and Australian non real property assets. There were some costings given in that regard stating how much it would cost Australian tax revenue, and now taking into consideration the advent of foreign equity companies. Does the taxation department stand by those figures? I think it was \$45 million, \$60 million—about \$180 million over three years. Or does it believe, as I suspect, that those figures are grossly undervalued? With respect to the cost to Australian tax revenue of exempting foreigners, as opposed to Australians, with respect to non real property assets such as shares in companies like Qantas, what is your belief regarding the costing of that?

**Mr D'Ascenzo**—I am not aware that there have been any additional costings on those measures. Treasury might be able to enlighten people.

**Mr Callaghan**—As far as I am aware, there has been no change in the costings that were presented when this measure passed through the parliament.

**Senator JOYCE**—Were you involved in those costings? Who was involved with those costings?

**Mr Callaghan**—It is done within the revenue group. I am the executive director of the revenue group. People within my group do the costings for revenue measures.

**Senator JOYCE**—Do people feel confident about those costings?

**Mr Callaghan**—In a very general sense, you focus on the size of the costings. There are a number of factors that you have to take into account in looking at that particular measure. One of them is that it did narrow the CGT down to land-rich assets, and it introduced what could be called an integrity measure in that it would tackle interposed companies. Previously, the

one way of getting around this measure would be to have a company overseas that held the assets in Australia and then you sold the company and you did not get any revenue at all.

**Senator JOYCE**—I am aware of the interposed entity issues.

**Mr Callaghan**—Also, in a number of our treaty negotiations, there would be a reduction in this measure as part of those negotiations. In terms of looking at all these factors, they were influencing the size of the revenue that we are getting now and that is all the influences that have to be taken into account in determining what is going to be the cost of this measure in terms of income forgone.

**Senator JOYCE**—Are you saying that there is the potential for large Australian investments overseas to attribute capital gains tax back to Australia?

**Mr Callaghan**—No, that is not what I was saying. What I was saying is that you are looking at the costs now and, obviously, from the way that you are presenting it, you believe—

**Senator JOYCE**—I believe the costs are way underneath. I can look at the 30 per cent figure, for example, with Qantas—\$10 billion. If that was a foreign organisation and they got a 20 per cent increase, which is about \$2 billion, these figures are way in excess of the \$40 million and \$50 million figures that I saw in the paper, when talking about what it was going to cost the Australian economy.

**Mr Callaghan**—Like all of these costings, it is done on assumptions of the level of activity that was going to be taken going forward, and that can change. The point I was trying to make was that, if you were looking at the magnitude of it, you would have to think in terms of what would be counterfactual if this measure had not gone through.

**Senator JOYCE**—Can you explain what the counterfactual would be?

**Mr Callaghan**—I do not know what it is but I am telling you that many of these activities can take place, when there is a change between foreigners, through an interposed company.

**Senator JOYCE**—I understand the interposed entity situation. Will the closing-off of the interposed entity section mean there will be a substantiation of the costings? Will that mitigate in some way the obvious loss of income that we are going to get from the purchase and sale of Qantas? It is going to be purchased and sold. If there is a \$2 billion profit, there is \$600 million in income just in that transaction alone that will be compromised.

**Mr Callaghan**—This is foreigners selling it between themselves?

**Senator JOYCE**—Yes.

**Mr Callaghan**—What I was saying previously is that, if they had a company structure and they were selling the company that held the assets here, we would not get the money now. A fact of life is that this was happening quite a bit in terms of the way people could get around the CGT liability.

**Senator JOYCE**—Couldn't we have changed the interposed entity structure without having to give an exemption to foreigners?

**Mr Callaghan**—As this was debated, we moved ourselves into line with the OECD model. We moved ourselves into line, which was the outcome of many of our treaty negotiations in

terms of the rationale—improving the attractiveness of Australia as an investment location—and we tightened up on the interposed entity on the land-rich aspect.

**Senator JOYCE**—The OECD: England is one that is called to mind. Does America have a similar arrangement?

**Mr Callaghan**—I would have to check.

**Senator JOYCE**—Do you know of any country apart from England that has it?

**Mr Callaghan**—I think the US has it. The majority of OECD countries have it. I do not have a list of those who do or do not. I would have to take that on notice.

**Senator WONG**—The commissioner may have to take some of this on notice. Commissioner, I apologise; I would like to return to the corporate issue for the tax office in relation to recruitment. I do not know if you have relevant officers here. My questions relate primarily to the use of the independent selection advisory committee.

**Mr D'Ascenzo**—I do not have the officers here, but if you ask the question I might be able to answer it.

**Senator WONG**—As I understand it, the ATO has signed an MOU with the merit protection commission in relation to the use of independent selection advisory committees. Is that correct?

**Mr D'Ascenzo**—That is correct.

**Senator WONG**—I also understand that, pursuant to the Public Service Regulations, there is a mandatory requirement that an ISAC established in respect of an employment opportunity must, amongst other things, assess the relative merits of the candidate. I had a look at the memorandum of understanding and it appears that, whilst the ISAC oversees the recruitment and co-designs selection methodology and plays that scoping role, the assessment of candidates is intended to be done by private sector recruitment agencies. My first question is: given the relative responsibilities that are set out for the ISAC in the MOU, can you explain to me how that complies with the Public Service Regulations to which I referred?

**Mr D'Ascenzo**—I do not know the detail of that. The full arrangements are done in partnership with the merit protection commission.

**Senator WONG**—That is not the question.

**Mr D'Ascenzo**—No, but they do have some authority and some responsibility for that legislation.

**Senator WONG**—Perhaps you could take that on notice. My question relates to compliance with the process that is envisaged in the MOU and the role of the ISAC with what appears to be a mandatory requirement for assessment in the regulations. Could you also tell me if there is either a cost distribution or payment from the ATO to the MPC for ISAC services.

**Mr D'Ascenzo**—I am not sure about that. I will have to take that on notice.

**Senator WONG**—Are you able to tell me what the contracts are with external recruitment agencies in the financial year to date pursuant to this arrangement?

**Mr D'Ascenzo**—We can make that information available to you.

**Senator FIELDING**—I would like to go back to the costings for what I will label as a capital gains rort for foreign investors. I had some calculations done on the Qantas proposal. The total cost of Qantas shares is \$11 billion. Foreign interests amount to about 40 per cent, which is \$4.4 billion. I have looked at holding the investment for five years and, at the conservative end, at a 50 per cent gain, which is what the investors are at least looking for over that five-year period, and taking out CPI—assuming that at three per cent over those five years—a rough calculation would mean, with an initial cost of \$4.4 billion for the investment, the value at the end of that period is roughly \$6.6 billion. If you take out the indexation for CPI, you get to about \$5.1 billion, which leaves a net capital gain of \$1.5 billion, which means a loss of capital gains revenue to Australia of \$450 million. Do those calculations sound right? They are rough calculations.

**CHAIR**—I think with all due respect to the witness, there have been a lot of figures thrown in there, so you might want to answer in the context of 'roughly' rather than having some definitive answer.

**Senator SHERRY**—The witness may well have a definitive answer.

**Mr Callaghan**—There are two aspects, I would say, in terms of what you are doing, and I do not know what the answer is. In coming to that calculation—and coming back to what we were talking to Senator Joyce about before—what allowance do you make for those shareholders who were resident in countries to which, in our tax treaties, we have given away this measure already, so we would be receiving no CGT from those, as part of the treaty negotiations? The other factor is the extent to which those residents—if we go back to what the arrangement was before the measure was introduced—may have a company structure, so in selling any of their shares, they would be selling the company and as such would have been avoiding the CGT measure. Those are factors. I do not know what the answers are, but in trying to come to the conclusion, what you have is a very simple measure. There is far more going on that you would have to factor in. I do not know what the answer is.

**Senator FIELDING**—We will leave it here because basically it is far more than the millions that were being talked about at the time of being forgone. From just one calculation it is in the hundreds of millions, so I make that point and leave it there. I want to focus on the Change Program. I think in February and May last year we were asking some questions about the Change Program in regard to tax. This time I want to focus on another IT related project—the superannuation guarantee systems redevelopment project. Can you tell me about that project?

**Mr D'Ascenzo**—Yes. We had money in the budget to replace our super system some years back, and we started to develop specifications for the rebuild of our super system outside our Change Program agenda. Since then, we have had the budget announcement of super simplification, and we have explored in the marketplace opportunities for solutions to suit the super simplification measures, because the specifications of our super rebuild were not going to cater for the new functionality that was required. We got some external advice there; I think the Gartner Group were involved. They said there was no external system that could meet our purposes—in other words, we would have to do some build. Since then, we has been

exploring with our Change Program partner whether or not super simplification could be built within the integrated core processing system. The reason for that is that super simplification, or parts of it, links into our income tax system. There has to be an interface between our income tax system and super simplification. The next process is to go out to formal tender for that arrangement, and I think that has occurred.

In the meantime, we have had to consider what this means for our full Change Program. One of the issues with expanded scope of systems requirements has been the difficulty or the anticipation of how we are going to skill up ourselves and any integration partner we have in terms of having sufficient resources to do Change Program and super simplification. Super simplification is a government parliamentary measure. It has to take some precedence and, therefore, what we are currently doing within the office is rescheduling our Change Program to ensure that we give as much focus as possible on the super simplification aspects of that rebuild. This is likely to mean that we will have to push out our Change Program deliverables for 12 months while we build super. If super is going to be integrated into our income tax system, I have to have the income tax systems of the integrated Change Program in there first. It is a very high risk, in a technical sense, and complex IT build.

**Senator FIELDING**—Thank you for outlining that. As with the Change Program, are there what they call Cap Gemini reports on that particular change system?

**Mr D'Ascenzo**—I have reports from Cap Gemini about the choice that has to be made in relation to the sequencing of super simplification and our previous existing Change Program. What I have asked to be done is to integrate the super simplification proposal into our broader change issue, and that sequencing decision—what parts you put first to ensure the best success of super simplification—has, according to Cap Gemini, been very difficult and one of the hardest decisions that has had to be made as part of the management of our Change Program. Once it becomes integrated into our Change Program agenda, Cap Gemini will remain the IT assurer for our Change Program initiative, including the Change Program. In the meantime, we have had the Commonwealth gatekeeper arrangements in place, and we have had review 1, which is the need for super simplification, and review 2, the procurement exercises. We have had a report from them earlier this month. I think it is worth mentioning the report from them because it sums up the sorts of issues that we face in terms of a very ambitious and very important change agenda. It is titled *Gateway 2 procurement strategy review: ATO superannuation simplification project*, received 2 February 2007. The review conclusions read:

The gateway review team finds the overall status of the project is amber. In summary, the gateway review team finds stakeholders universally demonstrated a commitment to the success of the super simplification project and the Change Program and a strong ethos of teamwork. Stakeholders also demonstrated a strong technical capability and consistency of message. The approach ATO has adopted to the engagement of accentuating particularly the adoption of business outcomes as performance targets appears to have engendered a positive and constructive super supplier relationship and integrated team culture. The direct source method of procurement has been evaluated, justified and approved by the ATO in accordance with the Commonwealth procurement guidelines. Notwithstanding, super simplification project is high risk, as is the Change Program within which it is integrated.

That summarises, hopefully, what I said to you beforehand.

**CHAIR**—We will have a short break.

**Proceedings suspended from 3.56 pm to 4.15 pm**

**Senator FIELDING**—You were outlining that the changes that have been announced need some changes in the systems. I think you are outlining the original Change Program is going to—not be merged—impact on another. That is what I think you were saying; is that right?

**Mr D'Ascenzo**—It will be merged in the sense that the management of the Change Program and super simplification will be part and parcel of one project management approach, which includes the regular reporting through the Change Program's steering committee, which I chair, and it will be built into that exercise. We think that probably the best solution is to tie it into the income tax component of the integrated core processing system, which means I then have to sequence delivery of the income tax component of the integrated core processing first, then I have to release super simplification, and then I have to ensure it works off the new system. In the rest of the Change Program it will have to be back-ended throughout 2008 rather than a December 2007 delivery.

**Senator FIELDING**—You mentioned a report before. Am I able to get a copy of the reporting at all?

**Mr D'Ascenzo**—Yes. I am trying to get it photocopied and I will submit it formally.

**Senator FIELDING**—I will come back to that because that one I am less fully aware of, if you know what I mean. I was originally on the Change Program system. Could you again go through where we are at with the overall Change Program, the one that was a four-year contract with Accenture?

**Mr D'Ascenzo**—It is actually a fixed-cost contract. When the scheduling changed initially in late 2004, early 2005, we wanted to do it in the quickest time frame. But at that occasion Cap Gemini indicated to us that there was no way in the world that we would have been able to get resources to staff up for this delivery and then drop down and staff up. We then had the Change Program scheduled for a four-year period, with the delivery at least of the integrated core processing for December 2007. The two previous deliveries was release 1—the centrepiece of release 1 was the client relationship management system—and last year we were scheduled to roll out release 2. That was scheduled to be finalised by July this year. We are still on track. Release 2 is changing 180 case management systems into one. It is our work-flow system and a few other components as well. It is a very major release as far as we are concerned. I think it is the biggest release of Siebel case-management capability in the world. That has been deployed. The amount of training and commitment will involve in the order of about 14,000 people being trained in the organisation. There are some IT glitches that we are tidying up and patching up after roll-out. Cap Gemini have said, considering the size and complexity of the roll-out, these are to be expected. We are still very confident of being able to achieve the target delivery date of July 2007.

**Senator FIELDING**—Was it December?

**Mr D'Ascenzo**—I think it is July 2007.

**Senator FIELDING**—A year ago, in February 2006, the ATO advised that the total budget for that program was, I think, \$447 million and the total actually spent to 31 January 2006 was \$228 million. What is the overall picture now?

**Mr D'Ascenzo**—On my understanding, the original business was \$453 million, so I am not sure where the discrepancy is.

**Senator FIELDING**—I am happy; that is fine.

**Mr D'Ascenzo**—Since then there have been some approved changes. We have had some underwriting of hardware costs. The approved changes were in the order of \$5 million. This is on top of the scope that we originally had. This is 'in addition' scope.

**Senator FIELDING**—How much extra was that?

**Mr D'Ascenzo**—\$5 million. We have had a fee to Accenture to underwrite hardware costs of \$8.6 million. That is our insurance, which was not in the scope of the original contract. At the moment, for delivery of the program we are pretty much on target. Now the beauty about the contract is that it is a fixed-cost program. It may be that the Accenture budget is over budget, but in terms of the Commonwealth we are still tracking to the original budget outlays. One of the problems that arises in terms of the push back of delivery, given other the requirements, particularly skill shortages and the need to meet the government super simplification measure, it means that there is a push back of the benefits from the Change Program in a recovery sense. It is not an extra cost; it is just an opportunity cost that we have to incur, given the need to manage resource shortages and significant extra scope.

**Senator FIELDING**—I fully understand the fixed cost. The additional \$5 million makes sense, with the extra work that was required. What is the insurance part again?

**Mr D'Ascenzo**—I think it is just underwriting hardware costs. I am not totally au fait on what that is. The way I saw it was that it was just protecting any shortfall in terms of the payment to suppliers, but I can provide a fuller explanation of that.

**Senator FIELDING**—That was not covered in the original contract or—

**Mr D'Ascenzo**—No, it was not.

**Senator FIELDING**—I think the last time we said you were about 40 per cent through. What insurance is required after 40 per cent that was not there at the start?

**Mr D'Ascenzo**—I suppose it may well have to deal with the changes to the scheduling of the program, but that is only an educated guess on my part.

**Senator FIELDING**—Could you come back to us on that, on notice?

**Mr D'Ascenzo**—Yes.

**Senator FIELDING**—You mention skill shortage. What skill shortage is there?

**Mr D'Ascenzo**—I think there is a general shortage of IT resources. For us there are certainly skill shortages in people that understand the Siebel systems. There is a scarcity of project managers. The point is that there are quite a number of other private sector and public sector organisations in Australia, and particularly Canberra, that are expanding their IT

platforms. There are a number of Commonwealth agencies, for instance, that are similarly seeking to start into change programs, and that is making the market very tight.

**Senator FIELDING**—To come back to the original point, what is the overall budget at the moment to date, to last month, or whatever you have got?

**Mr D'Ascenzo**—The total budget is \$466.6 million. This does not include super simplification, because we have not yet been able to manage the process of working out what that cost will be. What we are scheduling at the moment is that we think that we will come within one per cent of that budget when we deliver that Change Program functionality.

**Senator FIELDING**—I was just trying to work out where we are at at the moment. How much of the revised number of \$460 million, I think it was, has actually been spent so far?

**Mr D'Ascenzo**—We have already spent \$336 million, which is something like 70 per cent of the total Change Program cost.

**Senator FIELDING**—How far are you through that project, without taking into account potential for changes through the super simplification?

**Mr D'Ascenzo**—It is a tricky way of having to measure that. For instance, we have pretty much built the integrated core processing system. The problem is: when can we deploy it, because to deploy a system that takes over 75 of our back-end systems, I need a window of opportunity where there is not too much business activity. It has to virtually be on a December-type basis. A lot of the build work has been done in terms of the Change Program, but we still need to do a lot more testing.

**Senator FIELDING**—Thank you for that.

**Mr D'Ascenzo**—Having said that, I do not want to underestimate the risk here. The risk is sometimes not even necessarily in the build, and it certainly has to be verified in terms of the testing. To deploy an IT system, the amount of training and business re-engineering work that is required is ultimately the key to a successful rollout.

**Senator FIELDING**—I noticed you mentioned there were 14,000 staff to be trained in just release 2, so I understand it is not just a couple of people. I appreciate and I understand it is a major change program. That was the whole idea of it, to simplify and make it easier for people. That was the whole idea. That was where I started my original questions, going back a year ago. My concern was about 1980s-type systems. There was talk about how much it was to fit and there was the Cobol program, but we will not go there yet.

**Mr D'Ascenzo**—No. That is fine.

**Senator FIELDING**—You said you were short in what was it, the Siebel system? Was it Siebel or was it Cobol?

**Mr D'Ascenzo**—Siebel was the supplier of both the client relationship management system and a lot of our release 2 products, the main ones being case management and workflow management.

**Senator FIELDING**—So is that still programming in that area? Was it programmers you were short of there?

**Mr D'Ascenzo**—People with skills in the Siebel system are able to understand the system and, therefore, are able, in terms of testing it, to react to any glitches or issues that have to be patched up along the way.

**Senator FIELDING**—You were kind enough to give me a copy of the Cap Gemini reports. Am I able to get updated copies of those?

**Mr D'Ascenzo**—Yes.

**Senator FIELDING**—Rather than have to come back, could I just get the updated ones along the way?

**Mr D'Ascenzo**—I am happy to do that.

**Senator FIELDING**—Back in January 2006 on that Cap Gemini report there were four indicators—either red or amber. What is the current status of those? I am just trying to see whether it has improved.

**Mr D'Ascenzo**—Is that the release 2 Cap Gemini report?

**Senator FIELDING**—It was for release 2.

**Mr D'Ascenzo**—I cannot specifically talk about each one, but my overall summation is that we are putting a number of patches in and we are hoping to have all of those glitches ironed out by the scheduled delivery date of the end of June 2007. Until those glitches are out of the system, they remain on the status that you see there.

**Senator FIELDING**—So the release 2 has gone into production. Is that what you are saying?

**Mr D'Ascenzo**—That is right. We have had a lot of issues. I think that is what the Gap Gemini report shows, but it also says, considering the size and complexity of it, these were expected issues. We are working with a range of people, including the suppliers, to iron them out. This is where the extra resources could be very useful, to help us iron out those glitches. At this stage, we are still confident that we will overcome those technical problems by the scheduled final delivery date of the end of June 2007.

**Senator FIELDING**—It is a fixed cost, so I suppose time on one hand may not drive the cost, although I think originally you told me there was a return on investment of 6.1 years.

**Mr D'Ascenzo**—What this will do is push that return on investment back. In other words, any time delay pushes back the expected benefits of a change program. So delays are a cost, but they are an opportunity cost in that sense.

**Senator FIELDING**—If, say, 70 per cent of the costs are through and we may not have received 70 per cent of the benefits—

**Mr D'Ascenzo**—There are two aspects of it. I think the benefits were always at the back end. In fact, I think even under the previous schedule the maximum benefit was not likely to be here in under a decade.

**Senator FIELDING**—I am not trying to bore people here. It is a genuine response. The reason I showed so much interest originally was that there was talk about tax changes to the system, and the whole idea of this was to make it, first, simpler but also, second, to make it

easier to adapt to changes. Knowing of the super system tax changes, quite rightly you are saying it needs to be linked into the tax system. That is why I am interested in knowing how quickly that will occur.

**Mr D'Ascenzo**—As we have indicated in previous meetings here, we did choose a less risky option in terms of scaling up to the sort of scale that we have. They are choices you make. It still had a high component of new software. I think it was something in the order of 30 per cent. The design is still such that, when we reviewed super simplification, we thought about having standalone systems, of trying to get a totally different, separate system. That would fundamentally alter our strategic direction in terms of having an integrated system. My understanding is that the best way of building super simplification under our current configurations is not to patch up our old super system but to integrate it into our new, integrated core processing. It does show that we are able to do that, if we deliver.

**Senator FIELDING**—How many more releases are planned, and just roughly when?

**Mr D'Ascenzo**—There are a lot of things within those releases, but basically there are three main releases in the old Change Program. The first one, as I said in the key criteria, was the client relationship management. That is in. The second one is the case management and work-flow management systems. They are deployed. We are ironing out some issues. There is still a lot of business re-engineering, familiarisation of our people and glitches that we need to iron out in terms of our operating approach and structure. We are still hoping to have those done and put to bed by the end of this fiscal year. What we are planning to do is to release 3, which is our integrated core processing, which was planned to be done at the end of December 2007. Now, what we are hoping to do—we still have not made a decision—is to release the income tax component of integrated core processing in December 2007 and then deliver the super simplification system as a priority in June of that year to meet the appropriate legislative requirements and then to progressively roll out the rest subsequently, probably at the back end of 2007 and the beginning of the 2008 year.

**Senator FIELDING**—When you say release 2 is out there, how many users are on it, roughly? Are a lot of users on it at all? I just want to get a feel for that.

**Mr D'Ascenzo**—Again, as far as I am concerned, it is pretty much rolled out to most of the organisation, or at least it is halfway through, so you would have at least 5,000 to 6,000 users on it.

**Senator FIELDING**—When I was questioning originally there was some feel there was a high fit of the original system just based on the American system that was being adapted here. What is the level of fit after going down the track with R2 now?

**Mr D'Ascenzo**—I think the fit was more into our integrated core processing, which was the integrated accounting and registration systems. What the integration department had an interest in was the integrated core processing, which is the registration and accounting block of our systems. That was trialled I think in Washington state or was it Washington DC? I think it was Washington DC. It was an older version of what is being rolled out in Singapore, for instance. The Singapore one works on midframe whereas ours still works on mainframe for most of its grunt. That has not changed. The design is pretty much the same as we had and that is why we had the specifications and we are pretty much close to finishing the build. The

client relationship management system is more a separate system that was developed by Siebel and is, as far as I understand it, now the leading client relationship system that is used that can be integrated into our integrated core processing but can stand alone if needed to; and the same thing for the Siebel case management and workflow management. I am not sure that the other authorities necessarily had those Siebel applications.

**Senator FIELDING**—Am I right in just assuming, because it is a fixed price contract, that even if the percentage of fit dropped it does not really make much difference because it is fixed price? In other words, the programming changes are in the price of what you required?

**Mr D'Ascenzo**—One of the beauties of having an outcomes based contract, not just necessarily a fixed but an outcomes based one, is if there are newer ways of doing things, for instance, Accenture redevelops its system to make it more efficient. If it is cheaper for them but more efficient for us, then we would certainly be very happy to take that system. So, again, because we are scaled up, all we really needed in terms of the overseas comparisons was a workable site to see how it worked. Because of the scaling up issues we took a safer option than we could have.

**Senator FIELDING**—Is the project on budget?

**Mr D'Ascenzo**—The change program itself is on budget for us. As I said, Accenture may well be over budget, but as far as the Commonwealth is concerned we are within budget. In terms of the timeframes, we are still meeting the high level end-of-release milestones that we set ourselves right at the beginning, so there has been no slippage in those milestones. But in getting to those milestones we have had the share of issues that you would expect to have in managing a very complex and highly technical rollout, and we are working through those. But at this point in time we are on budget and on time in terms of the deliverables that we had planned for this period of time under our Change Program. What we have to do now is to ensure that the Change Program does not impede our delivery of the super simplification system and therefore we are thinking of the different sequencing of our Change Program to give super simplification the best chance of success.

**Senator FIELDING**—I will be interested in getting those reports so I can keep an eye on it that way.

**CHAIR**—Thank you. Senator Sherry?

**Senator SHERRY**—I have some follow-on questions from the questioning from Senator Fielding regarding the super simplification. You seem to cast some doubt on the ability of the tax office to deliver the necessary IT changes required to support the changes in the law, Mr D'Ascenzo.

**Mr D'Ascenzo**—No, I did not. It may have been put in the media that way, but I think what I was trying to explain is what I have tried to explain to this committee: these are very high-risk, large and complex arrangements. We are managing them very well. We have independent assurors there. We have as much expertise as we can to help us get over the line. But I like to be honest to people. I like to explain to people why you cannot sometimes deliver overnight a better system, and I wanted to point out to them that these are high-risk projects. Because of, say, trying to ensure that the super simplification system requirements meet

community expectations in terms of being there at a time when they are required and being able to operate effectively, we try to give them as much space as possible.

Here I am faced with a very ambitious but I think very important Change Program. There is a scarcity of resources given other projects underway. I have to manage the complexity of the Change Program and the complexity of resource shortages. Because of the size of these issues there are always going to be interruptions along the way. Basically, the sequencing that we have in mind is all about trying to deliver super simplification, but that has meant a pushback of other Change Program deliverables in terms of time.

**Senator SHERRY**—I understand the pushback of other deliverables. I just want to concentrate on this super simplification program. Frankly, the track record on superannuation program implementation going back over the last 10 years has had some issues with it, has it not? For example, on the surcharge implementation, your predecessor had to apologise for the difficulties in implementation of assessments. That is correct, is it not?

**Mr D'Ascenzo**—Yes, it is. In fact, one of the reasons we wanted to integrate the super simplification into our Change Program and ensure that it has constant high-level monitoring under very sophisticated modern project management techniques was to try to ensure that we do not have those issues recurring. The reality is that no-one can stand there and say, 'I can give you a 100 per cent guarantee.'

**Senator SHERRY**—I was just going to ask you that actually: what guarantee is there that the ATO can deliver on time?

**Mr D'Ascenzo**—I think our processes are in place to give super simplification the best opportunity of effective delivery. Ultimately, if there are issues that arise that at this stage we do not anticipate, we are working on contingencies, including the use of our Legacy systems. If you are drawn back to a Legacy system, what you have is a more chunky system for the community, and I would like not to do that.

**Senator SHERRY**—I understand that. You have a fallback provision in the event of a problem occurring?

**Mr D'Ascenzo**—That is right.

**Senator SHERRY**—Did I hear you say earlier that you had not finalised the costs of the super simplification changes?

**Mr D'Ascenzo**—No. We still have to work that out and go to the department of finance for funding.

**Senator SHERRY**—But we already have an announced cost by the Treasurer in his press release of 7 December, 'Departmental administration costs including capital', and there are figures there for the forward estimate period.

**Mr D'Ascenzo**—That is right. That was the estimate. We now need to work out whether or not—

**Senator SHERRY**—That is only an estimate?

**Mr D'Ascenzo**—It is what we conceived at that time as being the cost of the implementation.

**Senator SHERRY**—So the cost may go up?

**Mr D'Ascenzo**—The cost will be dependent on what we can negotiate in terms of delivery, but I am not sure how much is covered by that and what the costings might be.

**Senator SHERRY**—I am more than a little concerned if you are not sure what costs are included. We have \$479 million.

**Mr D'Ascenzo**—I understand that. I meant I am not sure off the top of my head what the break-up of the figures is.

**Senator SHERRY**—So you stand by the validity of these estimates?

**Mr D'Ascenzo**—I am saying that they were the estimates that were made. Now I have to work through that in terms of what the requirements are of the new system.

**Senator SHERRY**—The costs have already blown out by a billion dollars in terms of the total package.

**Mr D'Ascenzo**—Again—

**Senator SHERRY**—From budget announcement to final announcement—

**Mr D'Ascenzo**—This is the wider simplification feature.

**Senator SHERRY**—Yes.

**CHAIR**—Ms Vivian, did you have something you wanted to add to this?

**Ms Vivian**—The only comment I was going to make is that at the time those costings were undertaken you will understand that it was very early in the piece at the time of the discussion papers, and naturally since then, as we have been working through with industry and working through with government, we have been firming up on some of the costs, so that is what the commissioner is talking about in terms of some of the changes.

**Senator SHERRY**—I understand the process between May and December last year But I had understood that we got some robust costs in December last year.

**Ms Vivian**—There would have been costings there but, again, what the commissioner is referring to is that we have been working through quite a few things in terms of what this means to our Change Program. There are other issues the commissioner has alluded to, just in terms of what you were talking about—the robustness of the overall super systems, the importance of getting them in place, the impact on the Change Program and the delivery dates. I think in terms of the overall costings they are the sorts of costings the commissioner is referring to.

**Senator SHERRY**—I am sure you appreciate, given my line of questioning, for example on the tax file number issue that is going to be posed by the ATO, that we do not want to be back here in a year or two—and I certainly do not want to be sitting there in a year or two if we are in government—having to defend massive tax—

**CHAIR**—Now we are really getting into the hypothetical.

**Senator SHERRY**—increases on contributions as a consequence of a problem or a glitch with respect to implementation of the tax file number process that you are going to go through. You do understand that, do you not?

**Ms Vivian**—I certainly understand that. With any program of this size and nature, there are some things that cost you a bit more than you thought they would because sometimes there are changes in scope, and other things as well that end up costing less. We will be constantly reviewing our costs and making sure that we can deliver what the government needs.

**Senator SHERRY**—My concern is not just cost; it is successful implementation. The bills have gone through the Reps and will go through the Senate presumably in the next fortnight. Were the general issues you have been referring to, Mr D'Ascenzo, communicated to government?

**Mr D'Ascenzo**—I think the issues that these are high-risk major system changes were communicated even to parliament in my annual report.

**Senator SHERRY**—In respect of the superannuation changes? I do not recall that in the annual report.

**Mr D'Ascenzo**—I think the whole process of the change agenda, which includes super simplification—

**Senator SHERRY**—Now it 'includes'. Originally the changes did not include—

**Mr D'Ascenzo**—I agree. But—

**Senator SHERRY**—I accept that that is an add-on to the challenges you are now presented with.

**Mr D'Ascenzo**—That is true.

**Senator SHERRY**—Certainly when this was discussed last year, in February—

**Mr D'Ascenzo**—But let me make it clear: I am being honest in saying that these are very big projects and there are risks with any big project. It does not matter whether it is super simplification, the Change Program—

**Senator SHERRY**—I accept that.

**Mr D'Ascenzo**—We are managing them well.

**Senator SHERRY**—But for a couple of years at estimates all was hunky-dory and fine with the co-contribution. All was hunky-dory and fine with the payment of SG back contributions, and then we discovered a couple of years later that there were very significant problems.

**Mr D'Ascenzo**—If there are any significant problems of the type that impact, my approach would be to make it open and transparent.

**Senator SHERRY**—Good. Because I do recall in respect of a couple of individual cases of failure to pay superannuation back contributions, for example—and I issued a press release on this—the next day the former commissioner finally fessed up to the problem. I do not think that was coincidence. My concern is that those difficulties were effectively covered up for a number of years.

**Mr D'Ascenzo**—I do not know what the circumstances were in relation to that. All I am saying is that I have not shied away from bringing to people's attention publicly the fact that this is a difficult job, this is how we are handling it, these are the checks and balances we are

trying to put in place, and there are going to be glitches in terms of the experience that people will feel sometimes as we build a better highway. That is the approach of being honest and transparent.

**CHAIR**—Senator Sherry, I take it you are not alleging that Mr D’Ascenzo is withholding information?

**Senator SHERRY**—No. But certainly on a previous occasion Mr Carmody had to apologise to this committee because some of his officers did in fact do that, and that is on the public record—all too unfortunately. As I have said, one of my major concerns is the tax application in the event of non-application of tax file numbers. As I say, I do not want to be fronting up here in whatever capacity in a couple of years time having to square off and discover we have a significant problem on our hands.

**Mr D’Ascenzo**—In terms of super simplification, at this stage all our dials are still green. We are progressing in accordance with our plan. It is a high-risk project and we are giving it every chance to succeed.

**Senator SHERRY**—I have a fair few other superannuation issues, but in the fullness of time I just had to follow on from Senator Fielding. I just assume that is why you gave that speech on the issues we have been discussing—and your frankness in alerting to potential problems and pleading for patience—and the public indications in that speech that was reported in the *Financial Review*.

**Mr D’Ascenzo**—I think this speech was a much bigger one and covered a lot of I think pretty important issues of where I see tax administration going, and was a full and frank story of our direction. It is a very positive story. It was put in the context of the Change Program and the resource issues that are making the management task a very difficult one. It was highlighting the fact that we are managing it very professionally and at this point in time are still pretty much on track with the Change Program at this stage, although we are going to re-sequence that, and we are planning for the successful implementation of super simplification.

**Senator SHERRY**—Is the reported figure of an extra 500 staff in the superannuation unit over the next two years an accurate report?

**Ms Vivian**—Probably it is an approximation in the sense that because we have different resources—they go up in some years and then down—the broad figure in terms of our overresources is that we will probably peak at about 859 additional staff over the next four years in terms of implementing super simplification plus some of the ongoing costs as well.

**Senator SHERRY**—What is it at the present time—going from to what?

**Ms Vivian**—I use an approximation of about 1,000 people in the office. That is a bit of an approximation in that we have people directly in one area focusing on superannuation, but there is a whole lot of work in terms of processing and just building IT systems—those sorts of things. Broadly, this year we are looking at about 270 additional staff. Next year it goes up to about 850 staff—

**Senator SHERRY**—Sorry, I am just not clear. The average level of staff at the present going to what figure?

**Ms Vivian**—Sorry, probably the average is about 1,000. This year we are probably recruiting up to about 1,280 in terms of superannuation work across the office. Next year we go up to about 1,860 staff doing that work.

**Senator SHERRY**—So from about 1,000 to about 1,800?

**Ms Vivian**—Yes, moving up there.

**Senator SHERRY**—I do not blame you for recruiting because I think you will need them to find all of these tax file numbers and identify all these people amongst all the other things you are going to have to do.

**Ms Vivian**—It is a large project.

**Senator SHERRY**—I am going to go on to some issues of compliance with unpaid superannuation guarantee a little later. Can you give me an assurance that the program of compliance on SG collection and enforcement will not be suffering as a consequence of this?

**Ms Vivian**—It is certainly not at the moment. We actually were given some additional funding from government this year to address some of our backlogs. I do think, though, a lot of the complaints possibly that you see and we see as well often relate to not only compliance but also assessing the charge; also, we cannot pay any money to the fund until we receive it from the employer.

**Senator SHERRY**—Yes. That is the heart of it, frankly, for a lot of people.

**Ms Vivian**—Yes, and I think that is—

**Senator SHERRY**—You have not been able to collect the money in order to pay it to their fund.

**Ms Vivian**—Those are ongoing challenges for us, but certainly in terms of super guarantee compliance we have put quite a few additional resources into it this year, and it is the same right across our debt collection processes for super guarantee as well.

**Senator SHERRY**—I will come to some specific issues on that later on. I just wanted to go to the managed investment scheme issue. On forestry management investment schemes, that category, and non-forestry management investment schemes, do you have an approximate figure on what the cost to revenue has been?

**Mr D'Ascenzo**—No, we do not.

**Senator SHERRY**—Sorry?

**Mr Konza**—No, we do not have any of those statistics with us. We can take it on notice. I do not know that we have them at all, but we can certainly see what—

**Senator SHERRY**—You do not know that you have them at all?

**Mr Konza**—I do not know that; that is right.

**Senator SHERRY**—What has the argument been about, then, that we have seen in the last few weeks concerning the abolition of the schemes if you do not know the cost to revenue?

**Mr Konza**—By 'we' I meant myself and my people. I am not sure whether Treasury has those figures or whether we supplied those figures to Treasury. We can certainly check.

**Senator SHERRY**—What about the revenue—

**CHAIR**—You are not suggesting, Mr Konza, that those figures are not available; you are just saying that within your brief they are not—

**Mr Konza**—Yes, sorry, that is what I am saying. I do not have them here.

**Senator SHERRY**—Perhaps Mr Callaghan can help us?

**Mr Callaghan**—I was just trying to understand your question. If I understand what has happened, the ATO had an interpretation of what the current law was, so in one sense there is no cost to revenue because taxpayers were operating under the ATO's interpretation of what the law was. The ATO have indicated that they have reconsidered their view of what the current law is. In a sense changing that, looking forward, would have implications for revenue going forward, but it is not a cost of the current arrangements.

**Senator SHERRY**—What is the implication to revenue going forward, then, that has been estimated?

**Mr Callaghan**—I do not have that estimate with me. We have seen published numbers about what the size of the investment is in the industry. Most of those would be deductions. It would have to be netted out, but that gives you an order of magnitude of the nature of deductions that would not be allowed. But there would be offsetting elements in there. I would not have the total cost available. I would have to take it on notice. Sorry, it is not a cost; it is what would be the gain in the non-forestry side?

**Senator SHERRY**—You seem to be indicating that an estimate has not been calculated. Has it been calculated?

**Mr Callaghan**—One has not been published.

**Senator SHERRY**—No, that is not what I asked.

**Mr Callaghan**—No—

**Senator SHERRY**—You know—

**Mr Callaghan**—Yes, estimates have been calculated.

**Senator SHERRY**—Have those estimates been conveyed to the Treasurer or Assistant Treasurer, the Minister for Revenue?

**Mr Callaghan**—You could assume that where we can we provide costing for revenue estimates with any of our policy advice.

**Senator SHERRY**—In terms of the current public debate, have those gains to revenue estimates been provided to the Prime Minister's office?

**Mr Callaghan**—I do not know.

**Senator SHERRY**—Does anyone here know?

**Mr Callaghan**—No-one is coming forward.

**Senator SHERRY**—Has the cost to revenue disaggregated the different treatment for forestry management schemes as distinct from non-forestry management schemes?

**Mr Callaghan**—Can I clarify, you are saying a cost to revenue?

**Senator SHERRY**—Going forward.

**Mr Callaghan**—What we are saying is that it is not a cost. It is going forward. With the change it would be a gain to revenue. It is what you benchmark. It always has to be against a benchmark, and the benchmark was the current law.

**Senator SHERRY**—In the calculations of estimates you have not done any historical back cost to revenue?

**Mr Callaghan**—That becomes very much a hypothetical, going back and saying that if the law was different you would—

**Senator SHERRY**—No, that is not what I asked. I have asked whether you have made an estimate. If you have not, say you have not.

**Mr Callaghan**—I am saying it would not be relevant at all. The law is the way it was and you would be going back to say that, if there was a different interpretation, a different law, what would be the outcome? There was not a different law.

**Senator SHERRY**—On the consultation that has occurred, I assume both ATO and revenue have been involved in consultation with the industry on this matter over the last few months, or has it just been the ATO?

**Mr Callaghan**—No, since the announcement—I forget the dates—on the forestry scheme, and certainly going back to the budget 2005 announcement of the review of forestry managed investment schemes, there was consultation and submissions were issued. Around the time of the last budget there was an announcement about a possible outline of what could be new arrangements and furthering consultations then. There have been consultations with industry throughout all that period. After that there was an announcement in December dealing with the forestry managed investment scheme, a new regime. More recently, the Minister for Revenue and Assistant Treasurer put out a statement that dealt with the non-forestry. Through that long period there have been ongoing consultations with a review on forestry announced back in 2005.

**Senator SHERRY**—Just dealing with forestry, where has that consultation process been coordinated from?

**Mr Callaghan**—It was conducted with the department of agriculture and ourselves, Treasury.

**Senator SHERRY**—Who specifically in Treasury?

**Mr Callaghan**—Within the revenue group.

**Senator SHERRY**—What are your observations about that review?

**Mr Callaghan**—Sorry, in what way?

**Senator SHERRY**—What are the observations about that review in respect of forestry?

**Mr Callaghan**—The review was undertaken, the information gathered and the government made a decision, made an announcement—

**Senator SHERRY**—There has presumably been a document put together as a consequence of that consultation?

**Mr Callaghan**—There was ongoing advice provided to the government coming from that consultation, as there always would be.

**CHAIR**—We are getting very close to commentary on policy, which the officer is not obligated to do.

**Senator SHERRY**—Yes, I understand that. Is the documentation on the review publicly available?

**Mr Callaghan**—The submissions, where those lodging the submissions indicated they would be public, were made public. There was not a report from the department at all that was made public.

**Senator SHERRY**—So the outcome, conclusions and analysis are not publicly available?

**Mr Callaghan**—That is right.

**Senator SHERRY**—Can you take on notice to make it publicly available?

**Mr Callaghan**—Certainly.

**Senator SHERRY**—Thank you. Turning to the non-forestry management investment schemes, what has been the process here?

**Mr Callaghan**—I do not have the dates in front of me, but when there was an announcement in 2006, shortly after the budget, with the indication of the possible outline of a new regime for the forestry sector, it indicated that there would be ongoing review of the application to the non-forestry sector. When the announcement was made in December about the forestry sector, the government indicated that they would shortly be announcing their position on the non-forestry. An announcement was made on I think 9 February regarding the non-forestry.

**Senator SHERRY**—Was that review-analysis part of the same process as for forestry?

**Mr Callaghan**—There was a continuation of the discussions that went forward. In many respects, many of the major players in the forestry are also the major players in the non-forestry.

**Senator SHERRY**—Yes, the same.

**Mr Callaghan**—So there is a continuation of it.

**Senator SHERRY**—Are the analysis and conclusions in respect of the non-forest management investment schemes part and parcel of that analysis in respect of forestry investment schemes?

**Mr Callaghan**—In the sense that, if you start from the basic principle of what the ATO was reconsidering in terms of the carrying on of the business which is the basis of the deduction, that is the starting point, and it is common. Then in terms of the two ultimate areas of where the investment is going, one into forestry, one into non-forestry, there are clear differences, as was indicated in the government's announcement of this.

**Senator SHERRY**—I understand there are differences, but in terms of the documentation are they one and the same documents?

**Mr Callaghan**—No, I do not think you could look at it like that. It is not saying that there is just a single document. There is a series of consultations, advices and considerations. There are different considerations dealing with the forestry sector, and then with the non-forestry sector, in the policy sense.

**Senator SHERRY**—Again, I just wanted to be clear about the documentation and whether it is effectively the same documentation covering both but related issues. But, in any event, can you take on notice to make public the documentation in respect of the non-forest managed investment schemes?

**Mr Callaghan**—Yes.

**Senator SHERRY**—Turning to the implementation of the announcements in respect of forestry and non-forestry, does either of those announcements require any legislation?

**Mr Callaghan**—In respect of forestry it does.

**Senator SHERRY**—Why is that?

**Mr Callaghan**—Because a new statutory deduction is being introduced for the forestry sector.

**Senator SHERRY**—With respect to the non-forestry sector, why is it the case that there is no legislation required there?

**Mr Callaghan**—The government announced that it would not be applying the same regime for the forestry sector as the non-forestry sector.

**Senator SHERRY**—I am entitled to ask about the process. At the end of the day whether I get the documentation is obviously up to the government. With respect to the non-forestry management schemes, and there not being a requirement for change to the law, are we effectively dealing with a change in interpretation of the law by the ATO?

**Mr D'Ascenzo**—The ATO is reconsidering its position in light of some judicial dicta that warrants us reviewing our position.

**Senator SHERRY**—When do you anticipate completion of that reviewing of your position?

**Mr D'Ascenzo**—My people are currently involved in drafting a draft public ruling. We would hope to get that out in the next month or so.

**Senator SHERRY**—It is my understanding that the draft public ruling will not be cutting across previous rulings that you have given in this area.

**Mr D'Ascenzo**—People are protected under the law in terms of previous rulings, so it is always a go-forward arrangement, if there is a change.

**Senator SHERRY**—Is that for new operations and not existing operations that are covered by those rulings that have been given?

**Mr D'Ascenzo**—The existing ones that are covered by the previous rulings stay afoot for the length and the terms of those previous rulings. Any new arrangements would come under whatever our new position or existing position might be.

**Senator SHERRY**—Effectively current arrangements for which there is an existing ruling will run out at the length of the terms of the ruling that you have already given?

**Mr D'Ascenzo**—That is right.

**Senator SHERRY**—What is the approximate number of schemes covered?

**Mr D'Ascenzo**—Our figures go back accurately for the 2004 year. In terms of product rulings in the 2004 year, we had a total of 82, broken up: afforestation, 42; agribusiness, 34; and film, six. In 2005: afforestation, 45; agribusiness, 63; and film, seven. In 2006: afforestation, 51; agribusiness, 64; film, nine; and finance, one.

**Senator SHERRY**—What would finance cover?

**Mr D'Ascenzo**—Obviously an arrangement involving the finance industry. I do not know the precise details of the arrangement.

**Senator SHERRY**—I would not go to the precise details. I am intrigued as to why we have a new category appearing.

**Mr D'Ascenzo**—In the period until now in 2007: afforestation, 29; agribusiness, 17; and film, two.

**Senator SHERRY**—At the present time, in terms of non-forestry, is it the aggregate of those four totals that you have given me, or have some of them since ceased?

**Mr D'Ascenzo**—I would presume that some would have ceased. I would presume that some may well be the same way in asking for a ruling in relation to the next year.

**Senator SHERRY**—What is the general length of the rulings?

**Mr D'Ascenzo**—Generally we give 12-month rulings, but arrangements could be such where they are for a longer period, depending on the circumstances.

**Senator SHERRY**—If your ruling is in the next month, would the bulk of them conclude in the next financial year?

**Mr D'Ascenzo**—It may differ. For instance, if you have an arrangement that involves an annual crop, that would be a 12-month ruling. Some of the longer ones would have a longer ruling period.

**Mr Konza**—We should take that on notice if you want an accurate answer to that, because I am concerned that some of the afforestation schemes, for example, can go out a number of years and the financing and the tax treatment of the payments would be covered by those years. We may have rulings that go longer, but the principle that the commissioner explained is really the important one—that is, that those schemes that have commenced and are covered by a ruling will stay on the same footing.

**Senator SHERRY**—That was my understanding. I just wanted to confirm that because some of the coverage of this matter would seem to indicate that they are all going to end come the next month or two when you give your ruling.

**Mr Konza**—It would certainly not be the existing industry. Whilst there is maintenance and care work that goes on within the industry, a lot of the industry is about establishing new plantations, and that is probably where that fear comes from.

**Senator SHERRY**—Are some of these effectively rolled over from year to year covering the same plantings?

**Mr Konza**—No, in the agribusiness area you can have that, but obviously not in afforestation.

**Senator SHERRY**—Forestry is a longer term.

**Mr Konza**—Yes.

**Senator SHERRY**—In agribusiness, if you have a ruling and it is a 12-month ruling, has it been possible on the same crop to get a further ruling the next year, effectively just rolling it over, or rolling it on?

**Mr Konza**—Yes, the ruling covers the transaction. If you were looking to grow something, which is an annual crop, then the ruling would cover the soil preparation to the clean-up, so they would cover that one year. When you get to afforestation, you are talking about the planting and after a few years there has to be the culling and lopping processes.

**Senator SHERRY**—It could be a 10- to 15-year time frame.

**Mr Konza**—Yes. You would get a small cash flow at some point and then you get the major cash flow at the end.

**Senator SHERRY**—Would that be true of some of the agribusiness crops—for example, walnuts?

**Mr Konza**—Yes. That is what the commissioner was saying. It is hard to give a generic answer when the product rulings will be based on the specific circumstances of the transaction that is being put forward.

**Senator SHERRY**—Nevertheless, we have a generic split between forestry and non-forestry, despite the fact that at least some of the products—certainly walnuts—would be on a longer crop rotation than forestry. I do not know what the length of their rotation is.

**Mr Konza**—I would be stretching my memory too much, but I recall that walnuts were a long-term investment.

**CHAIR**—I do not think that you should make the assumption that they are on a longer rotation. If you know they are then say so, but if you do not know then do not say so.

**Senator SHERRY**—It is certainly longer than one year.

**Mr Konza**—Yes.

**CHAIR**—It is a hypothetical element.

**Mr Konza**—It is longer than one year.

**CHAIR**—Mr D'Ascenzo, are you looking to table that gateway 2 procurement strategy review that you referred to earlier on?

**Mr D'Ascenzo**—Yes, I would happy to table that report.

**Senator SHERRY**—I turn to the issue of tax treatment of employees sacked for operational reasons and some of the tax implications of that. How does the ATO treat payments made to workers who are sacked for operational reasons?

**Mr Konza**—Are you referring to the treatment of redundancy payments?

**Senator SHERRY**—There would be a number of categories of payment. There would be the redundancy pay where it occurs. Obviously there would be unpaid annual leave, presumably long service leave in some circumstances, and, in a very small number of cases, accrued sick leave. That is a relatively rare payment. I would like you to go through those categories of payment where there is a difference.

**Mr Konza**—The treatment of redundancy payments depends on whether they are what is probably unhelpfully referred as either a bona fide redundancy or not. Bona fide redundancy is one where the position that the person occupies is no longer going to be filled. If someone is retrenched for operational reasons, the real question is whether that job is going to be done in the foreseeable future. If that job is not going to be filled in the foreseeable future, a concessional tax rate applies to that redundancy payment.

**Senator SHERRY**—Is there any limitation on the quantum, in terms of monetary payment, in those circumstances that is tax concessional, or the time period for which they have worked? How do you determine it? There would have to be some limitations.

**Mr Konza**—The calculation of the payment is left up to the employer. That is not something that we dictate, as far as I can recall. We do have a fairly substantial tax ruling in this area but it mainly talks about the circumstances in which someone is made redundant to ensure that people are not trying to get tax treatment for payments when they are simply resigning or effectively just being dismissed. Because if someone is retrenched and their job will continue to be done, then it does not get the concessional treatment under the tax law and it is taxed as just part of their normal income. It is hard to say what is envisaged under the phrase ‘operational reasons’ but, essentially, if that job is going to be filled by another person in the foreseeable future, then that would not be a bona fide redundancy. Unpaid annual leave and unpaid sick leave, in those rare circumstances that it is paid, would be considered ordinary income from the employment and taxed in the normal way.

**Senator SHERRY**—I take it you have a ruling in this area?

**Mr Konza**—For annual leave and sick leave?

**Senator SHERRY**—No, the bona fide redundancy?

**Mr Konza**—Yes, we do.

**Senator SHERRY**—Has that been updated at all in recent times?

**Mr Konza**—I have no knowledge of that, so I would need to check.

**Senator SHERRY**—What about updating in terms of the recent industrial relations changes? Are there definitional changes within that?

**Mr Konza**—I would need to check on that. I am not aware that it has been updated.

**Senator SHERRY**—There may be operational reasons other than redundancy.

**Mr Konza**—The test under the tax law is the redundancy of the employee. To be redundant in that sense, the work that person once did needs to be no longer done. That is the essence of our ruling.

**Senator SHERRY**—You could have a circumstance where the work will continue to be done but in a different way.

**Mr Konza**—Our ruling goes into those sorts of circumstances. As I said, I do not have a definite knowledge of whether that ruling has been reviewed in light of new legislation and environmental developments. I would need to check on that.

**Senator SHERRY**—I noticed in the press some speculation about the treatment of the payments made to employees with respect to the Beaconsfield mine in Tasmania. Are you aware of the circumstances of the tax treatment for those former employees? I do not know whether there are any current employees there at the moment, but for the former employees?

**Mr Konza**—We do not normally go into the specifics of identified taxpayers.

**Senator SHERRY**—I am not going to individual identified taxpayers. I am going to a group and a specific set of circumstances.

**Mr Konza**—I am not sure what your specific question is on that.

**Senator SHERRY**—Have you seen the media reports on this?

**Mr Konza**—I have seen the media reports.

**Senator SHERRY**—Would you describe the media reports as accurate? I am always a bit sceptical of some of the things in the media. Here is your chance to indicate that.

**CHAIR**—The trouble with this is that, if Mr Konza says yes, he is effectively responding yes to your previous question where he expressed concern about individuals and other matters. That is the ramification of him saying yes to your last answer, and I understand his hesitation.

**Senator SHERRY**—What are the issues that you are aware of, having acknowledged seeing the media reports?

**Mr Konza**—It has been a little while since I have looked at it. I thought there was some allegation in the press about the tax treatment of the payments that they might receive after the mine is sold.

**Senator SHERRY**—Have you or your officers initiated any inquiries into that tax treatment following the sale of a mine?

**Mr Konza**—Again, to answer that question would then talk about the payments that those former miners were going to get and the tax status. I am not confident that I should be talking about that.

**CHAIR**—Quite frankly, I do not think that it is appropriate for you to comment. That is, by implication, personal information for people potentially involved in that.

**Senator SHERRY**—I would like you to take on notice what is the range of tax treatments on the close of a business. I suspect we can reasonably apply that to any circumstances, including the circumstances of the Beaconsfield mine closure.

**CHAIR**—I do not think this witness can answer that. What you take out of the information that is provided will no doubt be used by you.

**Senator SHERRY**—Yes, but it is quite reasonable to provide the information of tax treatment for employees' payments on the close of a business.

**CHAIR**—That is a de facto way.

**Senator Coonan**—That is a generic matter.

**Senator SHERRY**—It is a generic matter; that is right.

**CHAIR**—I do not think that you could then extend it and say that we can therefore assume that would apply to these people.

**Senator SHERRY**—Well, the tax office can't.

**CHAIR**—I think you will take out of it what you want.

**Senator SHERRY**—Yes, that is right. I move on to the issue of split loans and the ATO's decision to withdraw ATO ID 2006/298. What is the current position with respect to this ID? Is there any further guidance to be provided to taxpayers?

**Mr Konza**—I am aware of the withdrawal of that ATO ID, but I am not aware of what decision may or may not have been made about its replacement or substitution.

**Senator SHERRY**—I understand that it was withdrawn because it was regarded as incomplete and therefore potentially misleading. Is there anyone here who can shed any light on this matter?

**Mr D'Ascenzo**—The reason that I asked the question of my colleague Mr Konza was that the split loans issue was recently decided by the High Court and the High Court's position is the law as far as Australia is concerned. I do not know whether the ID tried to explain or extend the High Court decision, but basically the advice to taxpayers is that the High Court decision is the law in Australia.

**Senator SHERRY**—I have a couple of questions on this issue but I will place them on notice for you. On the issue of refunds, apparently the ATO Tax Practitioner Forum draft minutes for November show the ATO has needed to implement procedures to speed up the processing and release of held refunds. A refund is supposed to be sent to a taxpayer within 28 days. Can you provide the committee with an update on the ATO's progress to improve the time period for the payment of refunds for taxpayers?

**Ms Crawford**—Generally speaking, the issue of refunds is tracking within our service standards, at present.

**Senator SHERRY**—Can you give me some more detail? What is 'tracking within service standards'?

**Ms Crawford**—Meeting the service standards that are set for refunds in relation to activity statements and also in relation to income tax. At present, in relation to the income tax year to date, the tax office has processed 96 per cent of original electronic lodgements within 14 days of lodgement and over 93 per cent of original paper returns within 42 days of lodgement. In relation to activity statements year to date, the tax office has processed 94 per cent within 14 days of lodgement.

**Senator SHERRY**—How does that compare with previous years?

**Ms Crawford**—That is fairly on par. Those service standards have not changed in my short time with the tax office. We met those service standards last financial year and we are tracking within service standard this year.

**Senator SHERRY**—Can you take on notice to supply some of the historical data going back a couple of years?

**Ms Crawford**—Certainly.

**Senator SHERRY**—I placed on notice a question, BET 31, regarding the revenue cost of tax deductibility provisions. Is someone aware of that question on notice?

**Mr D'Ascenzo**—Have we answered that?

**Senator SHERRY**—Yes, so you are aware of it.

**Mr D'Ascenzo**—Which number is it?

**Senator SHERRY**—It is BET 31. I do not know what 'BET' stands for. The topic was revenue cost of tax deductibility provisions. When you say that you have answered that, I have not been able to find it. Have you provided the answer?

**Mr D'Ascenzo**—I am not sure, but if you have asked us and you have had an answer—Mr Konza is saying that maybe it was not to the tax office. Was it to the tax office?

**Senator SHERRY**—Good question. I have a copy of it here.

**Mr D'Ascenzo**—I do not have that listed in my list.

**Senator SHERRY**—We have Revenue here. Do you have a record of that question?

**Mr Callaghan**—We are just checking. I think that comes from the budget estimates last year.

**Senator SHERRY**—Yes.

**Mr Callaghan**—We cannot check. We do not have those records with us.

**Senator SHERRY**—I do not have a record of a response. I am just seeking a response. It may have been sent but for some reason not received.

**Mr Callaghan**—If it is ours we will have to check.

**Senator SHERRY**—I can probably get the committee secretary to have a look. We will still be going after dinner so we can probably resolve it then.

**CHAIR**—I know that Senator Murray has a question.

**Senator SHERRY**—Yes, sure.

**Senator MURRAY**—We have not gone into the superannuation area yet. As far as I can gather, the tax office has taken the view that, with respect to simplified super matters coming before you, you are still in the process of assessing for the budget process exactly what additional resources and numbers you will need. Is that right? You have not determined exactly what you will need with respect to those super matters coming through?

**Mr D'Ascenzo**—We have the estimates, and they were well-organised estimates. What I am trying to explain is that, with the changes to the sequencing systems requirements, I need

to then match that against what sort of contractual arrangements I can enter into. Under the direct source contract that we have with Accenture, we have not yet gone into negotiation to sign that contract.

**Senator MURRAY**—Does the change to accounting standards that have come through affect the way in which you have to revise staff training or staff numbers at all? I will tell you why I am asking this. I was alerted to the fact that the Audit Office is picking up extra cost pressures as a result of those changes, and laterally I thought that may affect the tax office in some way.

**Mr D'Ascenzo**—Last year we ran our accounts on both existing plus the new measures as a trial and we made adjustments. From memory, it did not seem to play out in this area.

**Senator SHERRY**—I have some issues concerning revenue in terms of the childcare tax rebate. Why can't the ATO reissue tax returns for taxpayers claiming the rebate once the final CCB entitlement has been determined? What is the reason for that?

**Mr Konza**—Sorry, I did not understand the first part of that question.

**Senator SHERRY**—I understand that it is not possible for the ATO to reissue tax returns once the final entitlement has been determined. If that is not clear, I will get some clarification on the matter during the break.

**Mr Konza**—Thank you.

**Senator SHERRY**—For the family tax benefit part B, are there figures available on the income distribution of those who claim the benefit?

**Mr Konza**—I do not know. We would need to take that on notice and see whether an analysis has been done.

**Senator SHERRY**—If you could do that for me, please. On the issue of infrastructure, sections 51AD and division 16D, there were some announcements of changes to infrastructure treatment and other asset financing on 26 June 2005. Where is that up to? Are consultations still taking place?

**Mr Callaghan**—I believe there have been consultations taking place on the basis of legislation. I am not sure of the timing. If it is not the autumn session it might be the winter session when it is scheduled that this legislation will be introduced.

**Senator SHERRY**—Have instructions gone to the drafters of the legislation? Is that where it is at?

**Mr Callaghan**—There have been consultations on draft legislation.

**Senator SHERRY**—It has been a lengthy process. Are there any particular reasons for the length of that process?

**Mr Callaghan**—It is hard to point to particular factors. There have been extensive consultations. It has fitted in terms of other priorities that both the government and taxpayers have been working on. It is hard to point to a particular factor.

**Senator SHERRY**—I note it goes back to Senator Coonan's time as Assistant Treasurer when she made the original announcement on 26 June 2003.

**Mr Callaghan**—As they say, the consultations have been very extensive and it has been responding to issues that have come up. I think, as you noted, there was an announcement back in 2003. There was a substantial change to the definition in terms of the control tests, shall we say—whether it is lease, use or control of use in determining applicability. It is the outcome of a very extensive consultation period.

**Senator SHERRY**—I note that when the minister released the draft legislation back in 2003 she referred to providing a short extension of time for parties to consider the implications. That original short extension of time was in 2003. Can't you throw any light on the length of this process?

**Mr Callaghan**—No more than the nature of the consultations. Very significant issues were raised in determining applicability, which led to a change, as I say. In 2005 it was announced that it would be on the basis of lease, use or control of use of the asset test to determine which arrangements fell within the scope and which fell outside the scope. Just repeating myself, it was the outcome of very extensive consultations where significant issues were raised which led to a change in the thrust of the legislation in terms of its applicability.

**Senator SHERRY**—Whilst we are on reviews and submissions, in December 2005 the government called for submissions for a review into the same business test and submissions were due by January 2006. What is the status of that review?

**Mr Callaghan**—No announcement has been made by the government.

**Senator SHERRY**—Are consultations still taking place in this area?

**Mr Callaghan**—It is always an ongoing issue in the sense that taxpayers can come forward and be wanting to raise the factors around this particular measure. It is not a formal consultation period in the sense of having a deadline.

**Senator SHERRY**—A submission deadline of January 2006?

**Mr Callaghan**—That is right. It is not an extension of the deadline. There are always ongoing consultations on all issues.

**Senator SHERRY**—I understand that. Certainly from the queries we receive, it is always the length of time, in some cases, regarding when the matters are likely to come to a finality.

**Mr Callaghan**—Yes.

**Senator SHERRY**—You are not aware of when there would be any public release of documentation or conclusions reached as to this review?

**Mr Callaghan**—No.

**Senator SHERRY**—I have some questions concerning the tax deductibility of political donations. The Electoral Referendum Amendment (Electoral Integrity and Other Measures) Bill 2005 listed the cost of increasing the tax deductibility of political donations from \$100 to \$1,500 and extending it to corporations as: \$4.9 million, 2007-08; \$6.5 million, 2008-09; \$5.4 million, 2009-10; and \$5.7 million, 2010-11. Has there been any assessment of the level of political donations over the last three years?

**Mr Callaghan**—Can I check: did you have a question on notice on this?

**Senator SHERRY**—I do not have all my questions on notice with me, unfortunately, so you may or may not be correct.

**Mr Gallagher**—This goes back to a question from November, which was SBT56 in our numbering system. That question was: have the estimates changed? The answer to that question was, no, the estimates have not changed. In doing the costing we looked at the level of political donations from the Australian Electoral Commission website, so we did look at the pattern of political donations. We attempted to look at the pattern of political donations across an electoral cycle. The costings vary with the likely timing of elections. There has been some allowance in the costing for that to be done.

**Senator SHERRY**—Thank you for that, Mr Gallagher. As part of your analysis, what was the cost of the tax deductibility of political donations under the old regime? Do you have that information?

**Mr Gallagher**—No, we did not assess the base; we assessed the change. I do not have that information with me.

**Senator SHERRY**—Did you examine it?

**Mr Gallagher**—It may have been a by-product of the costing process. I would have to take the question on notice.

**Senator SHERRY**—Presumably you would have examined it in calculating the increase in the tax deductibility?

**CHAIR**—I think the witness said he wants to take this on notice.

**Senator SHERRY**—Yes, but I think it is reasonable to keep asking aspects of the question. I do not think I am being unreasonable with the witness. He would have had to examine both sets of costs to identify the difference.

**Mr Gallagher**—We had to look at what donations were over the threshold, the extent to which donations were over the threshold, and where there are multiple donations from essentially the same person/company we attempted to put them together so we could assess the application of the threshold.

**Senator SHERRY**—Was there any assumption made about behavioural effect and change as a consequence of the deductibility rules?

**Mr Gallagher**—I think there were behavioural assumptions in the costings. The costings were some time ago now. I cannot remember exactly what they were. But there were assumptions about behaviour.

**Senator SHERRY**—I want to go to some issues around the ATO tax costing model. Could you explain the nature of the model?

**Mr D'Ascenzo**—I cannot personally.

**Senator SHERRY**—Is there anyone who can?

**Mr D'Ascenzo**—Treasury might be aware of it. This is for costings of new policy measures and the like?

**Senator SHERRY**—Yes.

**Mr D'Ascenzo**—I am not aware of how that works.

**Mr Ray**—We have a lot of different models that we use, so you would need to be more precise about the particular measure you are interested in. It might well be a matter for Mr Gallagher.

**Senator SHERRY**—I will get clarification on that during the break.

**CHAIR**—We are going to move to two other agencies which have representatives here from Melbourne and who we are trying to get back tonight. I call to the table the Corporations and Markets Advisory Committee and also the Australian Accounting Standards Board.

[5.50 pm]

### **Corporations and Markets Advisory Committee**

#### **Australian Accounting Standards Board**

**Senator WONG**—Professor Boymal, we appreciate that you could make it; I understand there was a clash.

**Prof. Boymal**—Thank you very much. My board is meeting today and tomorrow.

**Senator WONG**—It is unfortunate timing, and we will try to get you back there, from my perspective, as soon as possible. There were some things that I did want to raise with you arising out of both an Audit Office report into the financial statements of Australian government entities and your action alert in terms of your current work. I could not find this, but you may well have done this. The Auditor-General refers to a policy paper you were seeking to issue in December. Has that gone out? This is in relation to public sector accounting standards.

**Prof. Boymal**—There is a policy paper—December does not ring a bell with me—on public sector accounting standards. I believe the last version of it was in October 2006. But it is a sort of running document, so we amend it and put an amended version back on the website. I think I have the document in front of me.

**Senator WONG**—I am just trying to find the paragraph in the Audit Office report to which I was referring. What is the status of that? The policy paper covered a range of issues around convergence of accounting standards in the public sector. Can you tell me what your time frame is to finalise the position on that?

**Prof. Boymal**—The document does cover a wide range of issues. Basically, it primarily talks about our proposal to have a look at three specific accounting standards that apply to the public sector. Those three are AAS27, 29 and 31. The topics they cover are local government, government departments and whole-of-government reporting. Our reason for—

**Senator WONG**—I have just worked out precisely what I was asking. I understand the policy paper deals with that. The Auditor-General said, at page 21, that the AASB intends to issue for public comment in December an exposure draft for a standard to draw the three standards to which you refer together. Has that actually occurred?

**Prof. Boymal**—No, that has not happened. We are still working on the exposure draft document. We are having a lot of consultation with interested constituents, but the actual

exposure draft has not yet been issued. It is not on our agenda for today's and tomorrow's meeting, but we expect it to be back on the agenda for our March meeting.

**Senator WONG**—It appears that there has been a delay at least from what the Auditor-General understood to be the time frame for that exposure draft. Has there been an issue from one of the stakeholders?

**Prof. Boymal**—Only that the process that we had in mind, which was to move many of the requirements in those three standards into specific topic-by-topic standards has proven to be more complex than we first thought. The further we dug into the detail the more we discovered that we had to put into other standards. So purely and simply it has become a larger job than we anticipated.

**Senator WONG**—So the time frame—

**Prof. Boymal**—The time frame is still that we want to get an exposure draft out on that ASAP. If we do not get that covered at our March meeting it would be at our April meeting; basically forthwith.

**Senator WONG**—There is another issue that I wanted to confirm with you: AASB 1049, which is financial reporting of general government sectors by government, which you issued in September last year, has a mandatory adoption date of 1 July 2008, but early adoption is permitted?

**Prof. Boymal**—Yes, that is so.

**Senator WONG**—As I understand it, there has been no decision to apply that earlier than the mandatory date?

**Prof. Boymal**—There has been a decision, and the decision was made by all heads of treasuries throughout Australia, and that is not to apply the standard early. Interestingly, there was a lot of pressure on us to complete that standard so that it could be adopted early. That is the way it goes. But we put in a requirement that caused some difficulties, and that requirement was that general government sector financial statements had to be produced simultaneously with the whole-of-government information. Our reason for doing that is that we believe that whole-of-government accounts contain critical information that the general government sector accounts perhaps do not. The way of protecting the whole-of-government accounts was to insist that they be produced simultaneously. But because we have a standard under GFS for the general government sector and we have not yet produced a standard for the whole-of-government under GFS, there was a feeling on the part of the heads of treasuries that producing those two different formats of accounts would of itself cause confusion. In trying to remedy one confusion we have caused another. They have decided to apply it for the application date that we set but not earlier.

**Senator WONG**—I am not an accountant and I always have this issue when you and I have these discussions, but the FBO is prepared in accordance with the GFS—correct? The final budget outcome in the Commonwealth is prepared in accordance with the GFS?

**Prof. Boymal**—Yes.

**Senator WONG**—And the consolidated financial statements are prepared in accordance with the accounting standards. Will 1049 harmonise those two—

**Prof. Boymal**—1049 will not harmonise those two but we are currently, and as a matter of urgency, working on an equivalent standard for whole-of-government, which we hope to get out by October-November this year, and that will harmonise them.

**Senator WONG**—I turn to the issue of the accounting treatment of unfunded public sector superannuation liabilities and the sensitivity of the measurement of those in terms of the yield on government bonds. The Auditor-General refers to that having been raised by DOFA with AASB; is that correct?

**Prof. Boymal**—I was not aware of the magnitude of the effect until I also read the Auditor-General's report, where he indicated that the liability for superannuation increased most substantially upon the first-year application of the new International Financial Reporting Standards. It is caused by a volatility in the market rates. I think he indicated that, for the first year of application, the discount rate moved, but it moved back for the second year. Fair value accounting, which is sort of behind all of this, introduces considerably more volatility, and this is an example of just that.

**Senator WONG**—Is the AASB doing any work to address that issue in terms of the specific treatment of public sector superannuation liability or is it just one of those things that have to be dealt with?

**Prof. Boymal**—It is the latter. As I said, fair value accounting introduces volatility and these numbers will go up and down as market interest rates and therefore discount rates applied move.

**Senator WONG**—The not-for-profit sector is another issue that you have been working on and it is outlined in your work program.

**Prof. Boymal**—Yes, that is right. Well over 50 per cent of our resources for this year will be devoted to public sector accounting and not-for-profit accounting in the private sector. The introduction of the International Financial Reporting Standards, which were designed for the for-profit sector had had some, you might say, unexpected consequences in the other sectors which we are trying to address as—

**Senator WONG**—The impact on the not-for-profit sector was raised in the context of the inquiries of the Parliamentary Joint Committee on Corporations and Financial Services. I am trying to work out some time frames around this. As I understand it, what you are looking at is a second set of rules that might be applied in the not-for-profit sector that would quarantine them from some of the more onerous aspects of IFRS?

**Prof. Boymal**—That is so. As to the time frame for that, I would expect an exposure draft towards the end of this year. It is more than a very quick fix, I am afraid. When the Financial Reporting Council directed us to introduce the International Financial Reporting Standards, they did not quite foresee the effects—and you might say the onerous nature—that fell upon the non-profit sectors, the private not-for-profits and the public sector. We are now addressing those issues as soon as we can.

**Senator WONG**—You made some public comment about this last year. You also raised the issue of the impact on SMEs. Is there an intention to seek to develop a set of standards applicable to SMEs?

**Prof. Boymal**—Indeed there is. The International Accounting Standards Board is about to issue an exposure draft virtually any day, within this month. It is our intention to make use of that exposure draft and basically establish a new regime for reporting by small and medium enterprises.

**Senator WONG**—Are there any other departures from the broad application of IFRS being considered other than the two we have discussed?

**Prof. Boymal**—I believe there is one. I have very little information about it. I understand that the banks have been looking to restructure and are having problems with the potential restructuring arising out of the International Financial Reporting Standards. Treasury is working on that and I have not been briefed on it yet.

**Senator MURRAY**—Before you shift away, I would assume that, if the international standards are being produced for SMEs and there was a problem for not-for-profits compared with for profits, that there would need to be an SME development for not-for-profits as well, taking into account some of the problems that have emerged?

**Prof. Boymal**—You are correct in saying that. The difficulty or the problem is that the International Accounting Standards Board writes standards for for-profit enterprises. It is up to the AASB to amend those standards to accommodate the other sectors. So, yes, you are correct, but it is not going to come from an international source, it will come from us—

**Senator MURRAY**—And will you pay attention to that area if and when it comes through?

**Prof. Boymal**—Absolutely, indeed. Yes, that is our intention.

**Senator MURRAY**—Is there interest from the international body in the work you are doing for not-for-profits?

**Prof. Boymal**—The blunt answer is no.

**Senator MURRAY**—But this is a universal problem; it is not a problem exclusive to Australia?

**Senator WONG**—Is it not the case that many other jurisdictions did not require not-for-profits to comply with IFRS? Is that not how they dealt with it?

**Prof. Boymal**—That is part of the problem. When we introduced, on the FRC direction, IFRS into Australia, it was across the board. Many other countries, and the whole of the European Union, for example, are only applying these international standards to their publicly listed entities. When you then turn to Europe and say, ‘Do you have this same problem?’ they say, ‘No, we don’t, because we didn’t apply these rules to those entities in the first place.’

**Senator MURRAY**—Is that so even for the United Kingdom? The United Kingdom has one of the best developed systems of definition of charities.

**Prof. Boymal**—Yes, but the short answer is that is the situation in the UK, too, because they have a separate set of standards for these entities we are talking about and have not applied IFRS, the international standards, to those entities. Australia is one of the very few countries that has done that and therefore many of the problems that emerge from applying them to those entities are actually being discovered in Australia.

**Senator MURRAY**—With respect to the different standards applied in the European Union, do you reference those not-for-profit standards to see if any elements can apply in the divergent model you are producing here?

**Prof. Boymal**—We are aware of the standards but, no, we do not reference them. Our reference point at this stage is the international accounting standards and how we should flex those.

**Senator MURRAY**—Can I ask why not, from a policy point of view? As you know, one of the benefits of the international standards in for-profit corporations was because there were so many transnational transactions. Corporations might be established in multiple countries and it was in their interest to have one standard which they could apply. The same applies really with respect to churches and charities. We can think of a name like Barnardos or the Salvation Army, for instance. Both are international bodies. Doesn't the same principle apply there?

**Prof. Boymal**—Yes, it does apply. The difficulty that we have is that some of those UK standards are really quite old and, in one respect, it would be a retrograde step. In the respect that you indicated, it also would be helpful.

**Senator MURRAY**—I am merely suggesting that you look at those elements which are not retrogressive, as it were, because if such harmonisation could occur it would be of use, and most of our major charities and churches are multinational.

**Prof. Boymal**—I will take that advice on notice.

**Senator MURRAY**—Thank you.

**Senator WONG**—The last issue that I wanted to raise was the work or your decision on emission rights. The action alert in relation to your meeting of 13 or 14 December states that you are considering a survey of accounting for emission rights such as renewable energy certificates prepared by the Energy Supply Association of Australia. You noted there was significant diversity in accounting adopted in Australia. Given the increasing importance of emissions schemes around the world, the board decided to request the IASB to address the issue, but it took the view that it would not seek to develop Australian requirements at this time and encourage the industry to develop its own guidelines. I suppose the first question is: why would you seek, in the face of diversity in accounting standards, simply to have the industry develop its own? Would there not be a public policy benefit in the statutory body actually starting to look at how one might develop a consistent standard for emissions?

**Prof. Boymal**—Yes, you are right. The industry has no authority to tell even its members what to do, whereas we have.

**Senator WONG**—That is my point.

**Prof. Boymal**—The industry could start by doing the research and making the suggestions and then putting them up to us. I think that what we had in mind—and it may not have been expressed all that well in that action alert—is to have the industry do the preliminary work and then put to us the suggestions so that can consider them, work on them and formalise them if we consider them appropriate.

**Senator WONG**—I have to say that is what I thought the Energy Supply Association had attempted to do. I suppose my question is this: is there a policy decision by the board not to

consider this issue until the IASB does, or are you going to actually do some work here in Australia, having a look at how one might come up with consistent accounting standards for emission rights?

**Prof. Boymal**—It is a bit of both, actually.

**Senator WONG**—They are inconsistent, though.

**Prof. Boymal**—Yes, I appreciate that point. It is far more desirable to get an international solution than a local solution if the issues are the same throughout the world, and that basically is because companies in one country will report the same as companies in other country if an international standard is created. At times, the International Accounting Standards Board is not sufficiently interested in a topic to do that. If that is the case, then we, the AASB, would not say that therefore anything should go in Australia. The sequence of events would be to try to get the IASB interested and, if they are interested, they will proceed with it, perhaps with our suggestions, but, if they are not interested, we then should try and standardise it for Australia only.

**Senator WONG**—Has there been contact with them since December?

**Prof. Boymal**—Not since December.

**Senator WONG**—You do not even know if they are interested.

**Prof. Boymal**—No.

**Senator WONG**—This is obviously a very topical issue.

**Prof. Boymal**—And becoming more topical.

**Senator WONG**—Becoming more so, and my impression—I have to be honest and I appreciate that you have filled out your response—from reading that is, ‘Oh, well, we will deal with that another time.’ It seems to me that the policy environment is likely to lead at some point to a need for such standards. It is just concerning that it seems to be, ‘Well, we will see if the IASB is interested, but we have not made contact with them. In the interim, we will talk to industry which has already put a suggestion, but we are not going to progress that any further.’

**Prof. Boymal**—That was the tone of the board’s decision, but I would have to agree with you that it is a rapidly moving target and we should speed the whole process up. I agree entirely.

**Senator WONG**—I might have spurred it on a little bit.

**Prof. Boymal**—You have, yes.

**Senator WONG**—Thank you very much, Professor. Mr Kluver, there is really only one issue I want to raise with you and that is Sons of Gwalia. I understand Mr Pearce has referred to that—

**Mr Kluver**—That is correct.

**Senator WONG**—with a range of three particular questions. I appreciate that you obviously have not done a report yet, but I presume you have had some consideration of the decision. I suppose my first question is this: I have had a range of views put to me about the

effect of the decision. One view has been that it does represent a very substantial alteration to our insolvency regime, and arguably undermining the rights of particular classes of creditors who have set the status within the Corporations Law. Do you have a view about the impact of the decision, particularly in relation to creditors' rights?

**CHAIR**—Is this a comment on the policy?

**Senator WONG**—No. It is a High Court decision that the government has referred to CMAC for response.

**CHAIR**—It is purely in relation to that?

**Senator WONG**—Yes. There is no government decision on that yet.

**Mr Kluver**—No. First of all, I make the point that the committee is aware of the reference but has not yet met on the matter. The first meeting of the committee will be next Monday, where it will be considering both this reference and also the long-tail liabilities reference, which it has had for some time. How far it will proceed with the Sons of Gwalia reference I think will be a matter for next Monday. Obviously, at this stage, it can only be of a preliminary matter. In relation to the specific point that you have raised, I think we could say that the Sons of Gwalia has a significant impact in a very limited area. There may be a perception in the commercial community or more generally that it has a wider impact than it does. What it stands for is the proposition that, if a shareholder, either individually or in a class action, takes an action against the company in relation to their shares—in the case of Sons of Gwalia it was an allegation that the company had failed to comply with continuous disclosure requirements—then in relation to that particular claim the shareholders are treated in the same manner as all other unsecured creditors and, therefore, are entitled to participate in an external administration, be it a voluntary administration, which was the case in Sons of Gwalia, or a liquidation.

Let me clarify a few other points because I think sometimes there may be a slight misconception about this impact. Possibly the greatest misconception is the notion that the issue that we are looking at is whether or not we should postpone all rights of persons simply because they are shareholders against the company in a liquidation. For example, what if a person holds one share in a company and is run over by the proverbial company truck and takes an action against the company in tort for breach of duty. In those circumstances, that person would be suing the company, not in their capacity as a shareholder but in their capacity as a tort victim.

There is no suggestion that the Sons of Gwalia has changed the rules in any regard whatsoever. That person always has been and will continue to have a right to claim insolvency as a creditor, because they are not seeking to claim a right qua their position of holding shares. It is only in that limited context that it has an impact. Having said that, of course, it is still a significant judgement because until now, even in the absence of a High Court judgement, there was some authority for the proposition that, where a shareholder was suing for a breach by the company in their position of a shareholder, nevertheless they were postponed to the rights of other unsecured creditors.

In regard to the reference that we have been given, we have been asked three questions. The first is whether the law should stand in light of Sons of Gwalia or be amended. The

second and third questions are what would be some consequential effects that we should look at, if either the law stands or is amended. The media discussion today has been principally on question 1 about terms of reference, but questions 2 and 3 also raise some very important questions that the advisory committee will need to consider, and it is in that broader context that the advisory committee will conduct its review.

**Senator WONG**—The first part of that I think was very helpful; thank you. There is one other issue. The long-tail liabilities inquiry to which you referred: that has been around for a while. When will the report be available? Are we likely to see a report shortly? Has it been postponed?

**Mr Kluver**—The long-tail liabilities reference has raised a number of quite complex questions. The advisory committee has met on a number of occasions and has considered these issues in some detail. The advisory committee has considered some of the issues but, of course, also had to deal with the three reports that we published last year. As I said at the beginning, the advisory committee will be looking in detail next Monday at long-tail liabilities. How long it will be before a particular document comes up, I do not know, but I can assure you that the committee tries to work as quickly as possible, consistent with the thoroughness with which we operate.

**Senator WONG**—You cannot even give me a ballpark, Mr Kluver?

**Mr Kluver**—Certainly, you will see a document this year.

**Senator WONG**—That is a big ballpark. It is a long, long-tail liabilities inquiry. I will look forward to hearing more about that. Thank you very much.

#### **Proceedings suspended from 6.19 pm to 7.51 pm**

**CHAIR**—Thank you for your indulgence to get some travellers from Melbourne back there tonight. Thank you for accommodating that request. We will return to consideration of the revenue group and Tax.

**Senator SHERRY**—I want to return to a question about the modelling that I think initially Mr Ray and Mr Gallagher were going to respond to. I have some clarification on that modelling now, so I will clear this matter up first. I referred to costing tax policy, but I am talking about the modelling of changes to tax and the projections of the impact in the income tax area on individuals.

**Mr Ray**—On income tax.

**Senator SHERRY**—On individuals. I am aware that there is a model. Does it have a title, or is it part of another model?

**Mr Gallagher**—Treasury has a personal tax microsimulation model which is used to model tax measures affecting personal tax. The model can also be used to model things relating to some elements of superannuation.

**Senator SHERRY**—My understanding is a large part of the data that is put into that model comes straight from the tax office?

**Mr Gallagher**—It is totally anonymous. All identifier data is removed by the tax office.

**Senator SHERRY**—Yes, but it is real life data effectively representative of taxpayers, presumably.

**Mr Gallagher**—It is after the point that *Tax Stats* is published. You appreciate that *Tax Stats* will come some time after the completion of the particular taxation year and then we will pick up the new sample at that point.

**Senator SHERRY**—How often is that model used?

**CHAIR**—Sorry to interrupt, but that is after that information has been reported, is it, that you start?

**Mr Gallagher**—Timing can vary a bit but the important thing here is to understand that after, say, the completion of the 2003-04 taxation year the tax returns start coming in the next year, but you will not have a reasonably good sample of the tax returns until 18 months after that year is finished. That is the lag. Senator Sherry has referred to real, live tax data; in this sense it is not really live, it is really looking back 18 months or so.

**Senator SHERRY**—Perhaps I should have said ‘real life experience’ that is then received.

**Mr Gallagher**—It allows us to see it essentially as the administrative system would see it.

**Senator SHERRY**—Is it correct to say that there would be no other model in Australia that would be able to so accurately directly replicate the experience of taxpayers within Australia?

**Mr Gallagher**—The Australian Taxation Office has their own approach to a personal tax microsimulation model. Whereas ours is based on an eight per cent sample of records currently, their model in actual fact uses the entire database. Therefore for anything involving a small population the model of the Australian Taxation Office is to be preferred.

**Senator SHERRY**—So when I said this is the most accurate model, I meant within the public sector. There would be nothing outside the public sector that could in any way replicate it.

**Mr Gallagher**—There would be nothing outside the public sector that would rival each of these models.

**Senator SHERRY**—How often is the model updated?

**Mr Gallagher**—In terms of data, the update tends to be annual. In terms of parameters, we update for budget and for MYEFO in terms of the out years, because there is not much point at this point knowing what a measure would have cost in 2003-04. The whole point of having a microsimulation model is you want to know what the measure is going to cost in 2007-08, and we use a range of microsimulation techniques to upgrade and reweight the file to try to make it represent a future population.

**Senator SHERRY**—You mentioned some aspects of superannuation. Was it used in respect of the recent budget announcements on superannuation?

**Mr Gallagher**—Data from the model dataset will have been extracted for use in the superannuation costings. It tends to be the case that it is more efficient often just to take out the superannuation information by itself, so the full model might not have been used.

**Senator SHERRY**—Just refresh my memory: did I see a reference in the budget papers and the projections on the superannuation matter to using the NATSEM model?

**Mr Gallagher**—The NATSEM model is used for a couple of purposes. When we want to do an extension of family payments to families that do not currently receive family payments, we use the NATSEM model STINMOD. Because those records are not in the administrative system, it is a way of looking beyond the people who are in the administrative system. We have our own version of the NATSEM model but we work closely with NATSEM in terms of their version of the model.

**Senator SHERRY**—The question I posed, the reference to NATSEM in the superannuation package, was that a question—

**Mr Gallagher**—No. I cannot think of anything that we would have used from the NATSEM model, STINMOD, in relation to the superannuation package.

**Senator SHERRY**—Just coming back to the personal tax model we have been discussing, who uses that model? Is it just your area?

**Mr Gallagher**—Yes. Our model is only used in my area. As I said, the Revenue Analysis Branch of the Australian Taxation Office have their own model.

**Senator SHERRY**—I was just going to come back to the tax office in respect of their use, but in terms of non-ATO it is your area that has the usage of access?

**Mr Gallagher**—Yes.

**Senator SHERRY**—Does anyone else have access, outside the ATO, within Treasury?

**Mr Gallagher**—No, and there is a variety of reasons for that.

**Senator SHERRY**—And they are?

**Mr Gallagher**—One is that, although the data has had all identifiers removed, it is still unit record data and we hold the sanctity of the privacy of the unit record data very dear. Therefore we do not want to have any more general access. I need to be able to certify the nature of all access to the data.

**Senator SHERRY**—You do that personally, do you?

**Mr Gallagher**—I know what it is being used for, yes.

**Senator SHERRY**—I will come back to the ATO and their use of the model, just so I am clear on this. It seems to me to be the same model to which the ATO has its total dataset, or usage, available. Is it the same model?

**Mr Gallagher**—No, it is not the same model.

**Senator SHERRY**—It is not the same model?

**Mr Gallagher**—No. They have their own approach. As I said, the whole trick here is not to get the records from 2003-04 but to translate them into records for 2007-08, 2008-09 et cetera, and they have different approaches for doing that.

**Senator SHERRY**—Could you explain that different approach, Mr D'Ascenzo, or is there someone who can do that for you?

**Mr D'Ascenzo**—I do not know whether Treasury can explain it for you. I cannot explain it myself.

**Senator SHERRY**—Is there anyone at ATO who can throw some light on this?

**Mr D'Ascenzo**—We have not got people here with that detail, but maybe Treasury can explain it.

**Mr Gallagher**—Yes, I can add some information on the differences.

**Senator SHERRY**—Thank you, Mr Gallagher.

**Mr Gallagher**—Ours is a sample model. Because it is a sample we use, essentially if I have got an eight per cent sample, I have got one record in 12½, so each record I have effectively counts as though it is 12½ taxpayers, and we have a system for changing the weights. Because the ATO have a full sample they have different procedures whereby they actually create records to be added as the taxpayer base grows, so they have different approaches to the growth in the number of taxpayers.

**Senator SHERRY**—I have a couple of questions on lodging via e-tax. Do you have information on the approximate number of taxpayers who are lodging via e-tax themselves—that is, not including tax agents who log electronically on behalf of the client?

**Mr Konza**—No, we do not because, whilst it is possible for a tax agent to lodge a return on behalf of a client via e-tax, that is not what they would normally do. They would usually log on to e-tax and be that taxpayer for the purposes of e-tax. I would not deny that it is possible for an agent to do that, but ordinarily agents use their own tax return lodgement system called the Electronic Lodgement System which is much more efficient. With e-tax, you are provided with an interview format—that is, when you log on to e-tax, it takes you through all the questions, prompts you and so forth. A registered agent would have already conducted an interview, so it would be a very inefficient way for them to do their business.

**Mr D'Ascenzo**—Our expectation is that virtually all the 1.6 million people who used e-tax would be self-preparers.

**Senator SHERRY**—Do we actually know what usage is being made of e-tax?

**Mr D'Ascenzo**—That is right.

**Senator SHERRY**—What is the approximate expenditure on e-tax each year by the ATO?

**Mr Konza**—We would have to take that on notice. Are you talking about the complete running costs, development costs and marketing?

**Senator SHERRY**—Yes. You would probably need to separate them.

**CHAIR**—You mean the processing costs?

**Senator SHERRY**—Yes. The marketing, the establishment costs and the ongoing running costs.

**Mr D'Ascenzo**—We can provide that.

**Senator SHERRY**—Have you carried out an evaluation of the savings to the ATO in terms of lodgement through e-tax, rather than through other processes?

**Mr Konza**—To my knowledge, we have not undertaken that recently. It has been done over the life of e-tax to demonstrate how the costs of running e-tax have been recouped.

**Mr D'Ascenzo**—We cannot give you an answer based on the information here because our perspective is that it is there to help people by allowing them to put facts into the system, and the system works out the underlying law for them and provides a much easier, simpler and more personalised approach.

**Senator SHERRY**—Have the trials commenced as a consequence of the \$10 million budget allocation to allow the electronic data provision for e-tax returns?

**Mr D'Ascenzo**—Is this for tax agents to make use of that?

**Senator SHERRY**—No. The description of the program was a \$5 million allocation in 2006-07 and 2007-08: 'Resources of \$10 million over two years to enable it to accelerate its program of providing taxpayer data electronically in e-tax returns. The measure will fund trials.' Do you know what I am referring to now?

**Mr D'Ascenzo**—With the prepopulation or filling in of returns, what we have been doing is allowing people to draw down external data sources for a range of information including Medicare, child care, bank interest and some registry information. Our next iteration is to see whether or not we can provide that information in a sample of returns but we have not yet got to that stage.

**Senator SHERRY**—When do you think you will get to that stage?

**Mr D'Ascenzo**—We cannot get to that stage until we broaden the basis upon which we get the information. For example, what we have been trying to do is to engage with a wider range of banks and financial institutions for dividend and interest information. We have to draw into our information employer details and wage information. That is the process that we are going through at the moment. Once we have that, we will try to compile it back in relation to those taxpayers who seem to have a simpler set of tax issues. Whether or not that will resolve matters for taxpayers is unsure. An ideal might be that the taxpayers will get the return to sign if they are happy with it. It will really depend on what the taxpayer's position is in terms of things like work related expenses, gifts and something that we cannot necessarily prefill, because the information is with the taxpayer.

**Mr Konza**—It is important to note that those datasets are going to be made available to tax agents, so the cost of that work cannot be completely referred to the e-tax product. Our observation, which we have discussed here before, is that taxpayers have been moving to e-tax in record numbers. It has been very successful, but we have also observed that they have moved back to tax agents when they have some complicated affairs in a particular year and then moved back again to e-tax. There is an ebb and flow of individual taxpayers.

**Senator SHERRY**—I want to come to some questions with the revenue group about revenue forecast contained in the Mid-Year Economic and Fiscal Outlook. I am looking at page 15 of the MYEFO. I want to understand the reasons behind the changes to the revenue forecasts. The revenues appear to have been revised slightly up in each year of the forward estimates. Can you explain the factors that have been driving that revision?

**Mr Ray**—If you turn to page 16 of MYEFO, you will see that the revised tax revenue estimates are driven by the flow-on effects of the lower than expected revenue outcome in 2005-06 and downward revisions to expected revenue from capital gains from investors and PRRT, broadly offset by higher than expected revenue from higher forecasts of nominal growth.

**Senator SHERRY**—Has there been any adjustment to forecasting methodology?

**Mr Ray**—No.

**Senator SHERRY**—Page 19 of the MYEFO suggests that there was no change in relation to commodity price outlook. Is that correct? I am looking at the quote.

**Mr Ray**—Whereabouts on page 19?

**Senator SHERRY**—I have an extract. The quote is, ‘The revenue estimates for 2006-07 and 2007-08.’

**Mr Ray**—You were discussing this with our colleagues in the macroeconomic group this morning, I think.

**Senator SHERRY**—Yes.

**Mr Ray**—For the 2006-07 budget, the key commodity prices were assumed to return to their long-run average over the first two projection years, so 2007-08 and 2008-09. At MYEFO, 2007-08 is a forecast and the commodity prices are assumed to return to their long-run averages over the two projection years.

**Senator SHERRY**—Is that the two-step approach?

**Mr Ray**—That is the two-step approach.

**Senator SHERRY**—As yet that has not been moved out.

**Mr Ray**—It was moved out at MYEFO.

**Senator SHERRY**—Sorry, it was moved out at MYEFO. My understanding from the discussion this morning was that it had not as yet been moved out but I suspect that was my misunderstanding of the response that I was given. If it moved out of MYEFO, does that have an impact on revenues?

**Mr Ray**—It has an impact on nominal growth and, through that, on revenues, yes.

**Senator SHERRY**—Was the peak in commodity prices adjusted from budget to MYEFO?

**Mr Ray**—The forecasts for both the current year and 2007-08 would take into account any new information that our colleagues had on commodity prices.

**Senator SHERRY**—The commodity price index has continued to increase since last year’s budget forecast. Is that correct?

**Mr Ray**—I am not an expert on that.

**Senator SHERRY**—I am looking at the RBA index of commodity prices. There does not seem to have been any downturn at all.

**Mr Ray**—This is explained in MYEFO at page 13. The terms of trade outcome is higher than expected with the budget reflecting higher non-rural commodity prices, so there was some adjustment.

**Senator SHERRY**—How would changes in the commodity price peak affect revenues?

**Mr Ray**—That is one of those rather complicated questions.

**Senator SHERRY**—I am sure I am going to get a complicated answer.

**Mr Ray**—We forecast revenue from a tops-down approach, so that we take account of growth in incomes and then flow those through various models to see what the impact is on tax receipts. If you are thinking about how a change in commodity prices affects it then you have got to think about how it would work its way through the whole economy and then see how that impacts on tax receipts.

**Senator SHERRY**—If the peak is higher than the current forecast, would revenues be higher?

**Mr Ray**—I do not quite understand what you mean by the peak being higher than the current forecast.

**Senator SHERRY**—We have the two-step forecast and we have a peak.

**Mr Ray**—No. The two steps is not a forecast; it is a technical assumption in the projection years.

**Senator SHERRY**—I will accept that. So if that peak is higher than the forecast?

**Mr Ray**—Are you asking me if commodity prices have moved since December?

**Senator SHERRY**—Yes.

**CHAIR**—That is a hypothetical question, so let's continue.

**Senator SHERRY**—It is nothing unusual.

**Mr Ray**—The problem in answering those sorts of questions is that, to answer it, you would need to assume that everything else was unchanged since December, as well.

**Senator SHERRY**—That is not the case?

**Mr Ray**—We have not revised our forecast since December, so we would have to look at it all.

**Senator SHERRY**—What sensitivity analysis has been done in relation to commodity prices and revenues?

**Mr Ray**—The sensitivity analysis that we publish both in the budget and in MYEFO is with respect to changes in various things, including employment, wages, output and prices. There is sensitivity analysis in those terms. The other thing that we have done is take into account the two-step wind-down in the projection years.

**Senator SHERRY**—Would you be aware of the OECD research published in the latest *Economic survey of Australia* in August 2006, which models the affect of temporary high commodity prices?

**Mr Ray**—Yes.

**Senator SHERRY**—Would you be aware that the OECD estimates that the higher terms of trade added 1¾ percentage points of GDP to Australia's general government budget surplus in 2005?

**Mr Ray**—Yes.

**Senator SHERRY**—We touched on that earlier.

**Mr Ray**—As Mr Parker explained this morning, that is the whole of the general government sector, so it includes the states.

**Senator SHERRY**—Yes. You pre-empted my next question by one. Do you agree with those estimates?

**Mr Ray**—Mr Parker said they were sort of in the ballpark. I do not have anything to add to what he said.

**Senator SHERRY**—Have you done an estimate of the share that may relate to the Commonwealth budget?

**Mr Ray**—Not using that methodology, no.

**Senator SHERRY**—'Not using that methodology': that seems to me to imply that you have done it using other methodology.

**Mr Ray**—No. We have discussed this before. What we are trying to do is forecast tax receipts in the aggregate. Therefore, we do not take bits and pieces. We do it from a top-down approach. We are taking the effect on factor incomes of all sorts of changes in the economy and then having a look at how they flow through to revenue.

**CHAIR**—Mr Callaghan, do you want to make a comment on that?

**Mr Callaghan**—No. I was just nodding in agreement.

**Senator SHERRY**—How would you split the improvement in revenues from the commodity boom across revenue heads?

**Mr Ray**—In the broad, we would expect that the commodity boom would have affected every revenue head. I cannot think of one that it would not.

**Senator SHERRY**—How would you determine the level of impact on those? Would you have to examine each one individually?

**Mr Ray**—That would be a rather difficult task. The way that the OECD has looked at this question is using a very different approach. It does not look at it by revenue head at all.

**Senator SHERRY**—What is the improvement in company revenues and personal income tax revenues?

**Mr Ray**—We do not have an estimate for how much of the improvement in those areas is as a result of the increase in the terms of trade.

**Senator SHERRY**—Given the ongoing health of employment growth, do you expect employment growth to be higher than forecast?

**Mr Ray**—That is a question for my macroeconomic colleagues.

**Senator SHERRY**—This is a new area. My colleague Senator Ludwig has asked Treasury on two occasions now for copies of the details for the costings of the original accredited client program that included duty deferral. Treasury's response indicated, 'The government does not generally provide the details of the costings of the proposals that are not government policy and which may or may not have been considered in the policy development process.' Is that still the attitude?

**Mr Callaghan**—That is right.

**Senator SHERRY**—Just to clarify then, if an accredited client program with duty deferral has been adopted as policy, Treasury would have no objection to providing the details of the costings?

**Mr Callaghan**—As you know, it depends on whether the government has published the information.

**Senator SHERRY**—So any publication would be effectively dependent on the government or the minister of the day?

**Mr Callaghan**—That is right. In this case what Senator Ludwig has been referring to is something that was in the government's decision-making process, and our role is providing policy advice to the government. He is asking for a costing of what may or may not have been considered by government and was not announced and not taken up as government policy. It is going very much to the policy advising role.

**Senator SHERRY**—But not adopted?

**Mr Callaghan**—That is right.

**Senator SHERRY**—Or not proceeded with?

**Mr Callaghan**—As it says in the answer that was provided on notice, the government does not provide costings of possible policies that may or may not have been considered, and to ask us to provide costings of something that may or may not have been considered by the government goes directly to our role as the policy adviser.

**Senator SHERRY**—Has there been an announced decision not to proceed?

**Mr Callaghan**—There has been an announcement of the decision that has gone, and I believe the legislation has been introduced, if not even passed, dealing with the accredited client program that was adopted by the government. As I said, I think the legislation has been passed.

**Senator SHERRY**—I am not aware. Senator Ludwig handles that.

**Mr Callaghan**—It has certainly been debated.

**Senator SHERRY**—This was discussed earlier this morning but, from the revenue group's point of view, has there been any consideration of the effects on revenue of issues surrounding overseas private equity, particularly, and the activity in the last year?

**Mr Callaghan**—No. As Mr Ray said and as was discussed this morning, our approach is at a tops-down, determining really what is happening at the macro level.

**Senator SHERRY**—Nothing at all?

**Mr Callaghan**—You are asking on a particular aspect of what might have been happening. Really, we look at what has been passed on from our macro colleagues in terms of the overall performance of the nominal economy. In the sense of whether that has been a factor that has been taken into account in looking at the overall performance of the nominal economy, that is a factor that I think was discussed this morning.

**Senator SHERRY**—It was discussed. On the issue of dependant rebates and the dependant tax offsets that are used, how many taxpayers claim the child housekeeper, housekeeper, parent, parent-in-law and invalid relative offsets? Do you have any data on that? I assume that is the ATO.

**Mr D'Ascenzo**—We do not have that specific data but we can take that on notice.

**Senator SHERRY**—I would like you to take on notice the income distribution of the taxpayers claiming those offsets within those categories. Is there any detail on the total cost to revenue?

**Mr D'Ascenzo**—I do not have those details here.

**Senator SHERRY**—I would like you to take that on notice. In terms of the completion of tax returns, have these rebates led to any issues of difficulty of completion that has been noticeable by the ATO?

**Mr D'Ascenzo**—Is this the childcare rebate?

**Senator SHERRY**—Yes.

**CHAIR**—I will just interrupt for a moment. When Senator Sherry asks you to take these matters on notice, would you please acknowledge that so that it is on the record?

**Mr D'Ascenzo**—By all means.

**Senator SHERRY**—The ones that I refer to are the child housekeeper, housekeeper, parent, parent-in-law and invalid relative offsets.

**Mr Konza**—We have no data on that. We provide extensive help to any taxpayer through TaxPack, e-tax and the telephone help lines, but we do not have any data that says that—

**Mr D'Ascenzo**—That people are having any particular difficulties.

**Senator SHERRY**—Do you have any observations at all that you are able to provide to us?

**Mr D'Ascenzo**—No.

**Senator SHERRY**—Please take those earlier questions on notice for me.

**Mr D'Ascenzo**—Yes, we will.

**Senator SHERRY**—Do you have an approximate number for taxpayers' claimed expenses for running a business from their home in 2005-06? The expenses that I refer to here are electricity, computer, depreciation et cetera. This does not include a proportion of a mortgage for running a home office.

**Mr Konza**—That data would not be collected by our computer systems. It would be included in the expenses of the business, so we have no data on that.

**Senator SHERRY**—Do you have a total figure for the total number of claimants who claim anything related to home expenses?

**Mr Konza**—I do not believe that that data exists.

**Senator SHERRY**—What about a proportion of a mortgage for running a home office in that year?

**Mr Konza**—I am afraid that is the same answer.

**Mr D'Ascenzo**—Just to put that in context of how we would get this sort of information in a systemic way, basically we use the information in returns and if there is a label on the return form then we are able to track those sort of labels. To keep returns at a manageable level for taxpayers, we do not ask the questions that give the dissection to that level of detail.

**Senator SHERRY**—I asked for the number of taxpayers claiming. Have you been able to estimate the extent of total expenses claimed for home office expenses at all in the aggregate?

**Mr Konza**—I do not think that data exists. The way that we manage those sort of claims is that we see total deduction claims that would be excessive or above average. We then send out schedules asking people to set out in detail the items that made up the claim. That allows us to manage the compliance risk that might be posed by those sort of claims but it does not allow us to compile an aggregate figure, as you are asking.

**Senator SHERRY**—I am a little surprised that you do not have some sort of estimate of either the numbers or the expense claim for the impact on revenue.

**Mr D'Ascenzo**—We do have a break-up of expense claims that are on our return forms, in other words the blocks, and we are able to match how those blocks are tracking.

**Senator JOYCE**—You could have a specific section on the return for home office expenses and you would be able to download that specifically?

**Mr D'Ascenzo**—We could but then you would have X number of pages. It is a question of how much in the way of compliance costs you want to burden the community with in terms of risk management.

**Senator JOYCE**—Do you just look for a bell curve and go for the extremes of the bell curve and, if it was outside the general tolerance, you would go and concentrate on that?

**Mr D'Ascenzo**—Our system in terms of individual returns does that but in terms of aggregate returns, we do carefully monitor how those aggregates are moving, on an annual basis and relative to how the economy is operating and what we expect, but if there is any jump there then as Mr Konza explained, we will then do follow-up survey work or direct active compliance activity.

**Senator JOYCE**—You send us little letters telling us to watch ourselves.

**Mr D'Ascenzo**—All of those helpful hints.

**Senator SHERRY**—I would like to come back to an issue that I started on earlier, where I sought some clarification about the childcare tax rebate and the way it is handled. At the moment are childcare costs notified by the childcare institution to the ATO direct?

**Mr Konza**—They are notified to the Department of Families, Community Services and Indigenous Affairs. FaCSIA advise us of that data.

**Senator SHERRY**—I presume the time lag in the payment occurs in the following financial year after the individual has lodged their tax return?

**Mr Konza**—That is right.

**Senator SHERRY**—Is that because the childcare benefit which is deducted will be dependent on the income lodged in that previous year?

**Mr Konza**—Yes.

**Senator SHERRY**—You have to deduct the childcare benefit, which is means tested, from the childcare costs, which are not means tested?

**Mr Konza**—That is correct.

**Senator SHERRY**—Has the ATO examined any way of being able to pay the benefit earlier?

**Mr Konza**—I am not aware of that. We could take that on notice.

**Mr D'Ascenzo**—I do not think that the current legislation would feasibly allow us to do that without the offsetting for the income.

**Mr Konza**—That is correct, yes.

**Mr D'Ascenzo**—Under the current regime that is not a feasible option.

**Senator SHERRY**—I was just asking if there had been any examination. My assumption would be that it would be very difficult, given that the childcare benefit is means tested and you have to have the income details for the year to apply the means test.

**Mr D'Ascenzo**—That is exactly right. In fact, one of the reasons we are now trying to amend the returns of people who have lodged but not claimed, after the event, is that we could not get the information in time for the current lodgement period.

**Senator SHERRY**—How has it improved things by automatically amending the eligible taxpayers' assessments?

**Mr D'Ascenzo**—Our communication and marketing already had an improvement from what was originally being returned. What we have now done for those people who have lodged but who did not claim the benefit—and our information indicates that they could claim it—is automatically provide them with a benefit. For some taxpayers whose taxable income was such that they could not have the full benefit of the claim, we have auto-amended and we have sent them a notice to say that they are entitled to have a childcare benefit and they are also entitled to an excess, which they can pass on to a relevant other person and give them the opportunity to do that. There are still some people who have not lodged their return. Many of these people work through agents and therefore they work under the normal agent lodgement program. Until they lodge there is not much we can do about it other than to ask agents to be alert to the availability of the childcare rebate when they do the return; but, if they do not, we will then go back and auto-amend again.

**Senator SHERRY**—I turn to some superannuation related issues. We talked earlier about the increase in staff employed in superannuation in the broad in the ATO. When that recruitment is completed, what would that represent as a proportion of the total ATO staff, approximately?

**Ms Vivian**—I will just take the peak year, because it does vary by year. That is about 900 staff. We have about 20,000 staff, so it is roughly four per cent.

**Senator SHERRY**—We have touched on this but I would like an update. Where are you at on the proposed media advertising campaign for the budget changes on superannuation?

**Ms Vivian**—Do you mean what are the activities that we have underway or are planning at the moment?

**Senator SHERRY**—Yes.

**Ms Vivian**—My previous answer to you at estimates was that this year our broad budget was about \$23 million. As to the activities that we have underway at the moment, we are working with government to look at what level of mass media campaign we may undertake, so there is research and various briefs underway there. I mentioned before that we are also starting work on about 200 products. There is probably somewhere near to 400 products that we have to change. We are starting to do quite a bit of work in prioritising that and working with industry about some of those issues.

**Senator SHERRY**—Before you go on, you referred earlier to research. Have research firms been commissioned to start conducting research?

**Ms Vivian**—We have completed some research, basic benchmarking, into what people understand about super.

**Senator SHERRY**—Who conducted that benchmarking?

**Ms Vivian**—The research was undertaken by DBM Consultants.

**Senator SHERRY**—Has that been received by the Tax Office?

**Ms Vivian**—It has been received by the Tax Office and government.

**Senator SHERRY**—Of course. I am sure they would always get that research. Is there any other research?

**Ms Vivian**—In terms of the super simplification campaign, as you can imagine it is early days, so we are working a lot more on our overall strategies and approaches as well.

**Senator SHERRY**—Has that \$23 million that you mentioned for this year been broken down into any likely expenditure areas as yet?

**Ms Vivian**—In terms of the initial estimates, the \$23 million was not totally plucked out of the air. It was based on some estimates of undertaking some research on what radio might cost. It was a whole range of activities. I can go into more detail if you like.

**Senator SHERRY**—I would like to because hopefully it is a bit more than just plucking it out of the air.

**Ms Vivian**—In saying that, it was based on previous activities that were undertaken. It was also an estimate. It was also about saying that these are some elements of the work that we

can do, but again it is a matter for government about what is undertaken. Broadly, there are dollars in there that we have estimated if we were to do an overall mail-out across Australia, bringing on consultants, doing a media buy and doing print production. They are the sorts of things that have gone into the estimate.

**Senator SHERRY**—Have media consultants been engaged yet?

**Ms Vivian**—No. As I mentioned, we have undertaken some research and we have just put out a tender for some firms to come forward with aspects of creative concepts.

**Senator SHERRY**—Creative concepts?

**Ms Vivian**—Yes.

**Senator SHERRY**—Piggy bank concepts, money tree concepts and things like that? Things that people might see as being associated with super?

**Ms Vivian**—Yes.

**Senator SHERRY**—You said \$23 million this year, so that is obviously this financial year. What about next financial year?

**Ms Vivian**—These are estimates, so we are at the early stages.

**Senator SHERRY**—I accept that. I am not going to hold you to the nearest dollar at this time.

**Ms Vivian**—In 2007-08 it is broadly about \$14 million, in 2008-09 it is about \$4.7 million and in 2009-10 it is about \$1.3 million.

**Senator SHERRY**—Do not hold me to my count, but that would be approximately \$43 million?.

**Ms Vivian**—That matches my approximation.

**Senator SHERRY**—Presumably that is included in the departmental administration costs line?

**Ms Vivian**—Yes, that was included in our estimates to government about how we might implement and administer this.

**Senator SHERRY**—Thank you for disaggregating that element of that figure. The disaggregation of that line, the admin costs, states ‘including capital’ but does not identify capital over those four years. Are you able to give me the approximate expenditure on capital in that administration item?

**Ms Vivian**—I can, although I can only give it to you for the tax office. Do not forget there are other agencies involved and they would have been included in that figure. Again, this is just an estimate. Most of the capital is actually tied up with our IT costs, so it does seem that some of the accounting treatments can vary. Out of the tax office costs it is about \$53 million.

**Senator SHERRY**—\$53 million in total over the four years?

**Ms Vivian**—Yes, over the four years. That was what was included in our estimates.

**Senator JOYCE**—How much did you spend on pencils last year?

**Ms Vivian**—I am unable to assist with that.

**Senator SHERRY**—Can you give me the figure for that \$53 million broken down over those four years?

**Ms Vivian**—I can. I preface that by saying that this is what is in our estimate, but it is potentially changing.

**Senator SHERRY**—I accept that. What is your estimate?

**Ms Vivian**—This year it was about \$11 million, for next year it is about \$30.5 million and for 2008-09 it is about \$10.8 million. Whilst it was over four years, in reality the estimate was over the first three years.

**Senator SHERRY**—So those figures you have given me and the advertising figures for each year are the ATO's costs?

**Ms Vivian**—Yes, the ATO's costs.

**Senator SHERRY**—There is still a substantial difference looking at this line item, and that is in other departments' expenditures?

**Ms Vivian**—No, we have other costs in addition to capital costs. There are a number of costs there in terms of—

**Senator SHERRY**—Staffing?

**Ms Vivian**—Staffing—to bring staff on to do some of the—

**Senator SHERRY**—So that I am clear on this: we have done the capital costs and the advertising costs, and the other cost is the staffing cost?

**Ms Vivian**—The staffing costs. Also, there would be some element of supply costs in there as well. We are doing a number of mail-outs that are tied up with the tax file number initiative along with a lost members register initiative.

**Senator SHERRY**—So that is separate from the marketing and advertising campaign?

**Ms Vivian**—Yes. For marketing and education, the way that we costed it is that it is more about communication and marketing.

**Senator SHERRY**—For the sake of analysis, can you give me, from the ATO's point of view, the total cost—you have given me the capital and the advertising and marketing costs—within that administration item?

**Ms Vivian**—It is \$366 million.

**Senator SHERRY**—The difference, which is \$111 million, would presumably be explained by non-ATO expenditure?

**Ms Vivian**—I could not comment on that. All I know is what component of our costs went into that costing.

**Senator SHERRY**—Thank you for giving me the component costs as you know them. Mr Lonsdale, is the difference in the admin items explicable as other departments' costs?

**Mr Lonsdale**—The admin costs are broken down in my MYEFO. I do not know whether you have it in front of you. It is at page 80.

**Senator SHERRY**—No, I do not have it in front of me, unfortunately. I will just get a copy of it, if I may. Do you have that page number?

**Mr Lonsdale**—Page 80. You will see a table there.

**Senator SHERRY**—Thank you for drawing this to my attention.

**Mr Lonsdale**—In the table the expense components are broken down by agency, and each line for each agency contains two components: the administration costs for the agency and the administered expense item as well. So, in the case of the tax office, the related capital components are at the second line across in table 47.6 and further down.

**Senator SHERRY**—Yes.

**Mr Lonsdale**—If you added both those lines across to the forward estimates period and took away the administration expense, you would get the co-contribution payment, which is set out further in the last paragraph of the measure.

**Senator SHERRY**—Yes.

**Mr Lonsdale**—It contains both of those components.

**Senator SHERRY**—The ATO has helpfully given us the media-specific costs in the items.

**Mr Lonsdale**—That is correct.

**Senator SHERRY**—That is not identified here on page 80, is it?

**Mr Lonsdale**—They are in that second line.

**Senator SHERRY**—Yes, they are in it. But they are not separately identified as media?

**Mr Lonsdale**—That is correct.

**Senator SHERRY**—Thanks for that. Given that we have just had a very helpful breakdown of some of the disaggregated costs that have not been published—the media, for example—I want to go to a couple of issues relating to the calculation of the components of the revenue figures that are contained on the back of the Treasurer's press release of 7 December. Perhaps I can start with some issues on which I started to pose some questions to Mr Gallagher at the hearing on the bills a couple of weeks ago. Ms Vivian, you were there, too. I posed a question about the estimated revenue to be gathered from the estimated number of persons for whom tax file numbers would not be received. That is in the figure. Can you give me that figure today, please?

**Mr Ray**—We took that question on notice and we have provided an answer to the committee.

**Senator SHERRY**—Can you just refresh my memory? What was the answer? I did not see anything.

**Mr Ray**—We did not provide the number. The information has not been published.

**Senator SHERRY**—Why is it not being published?

**Mr Ray**—Because the government has not published it.

**Senator SHERRY**—I have just been given an example—and we have just talked it through—of the government not publishing the advertising media as a separate category, yet I have just been given that by the ATO, broken down and disaggregated.

**Senator MURRAY**—Quite properly.

**Senator SHERRY**—Yes, quite properly, and I appreciate the tax office's cooperation. Why can I not get the figure that I have asked for on the non-provision of tax file numbers?

**CHAIR**—If this is a policy matter, this officer cannot respond to that question.

**Senator SHERRY**—I would beg to differ. If we go back to your opening statement, I think it is a perfectly reasonable question. When we have received the disaggregated figure—and we know that Ms Vivian has outlined it as an estimate—I do not see why we cannot reasonably receive a figure for this particular item. It has been costed, it has been published, it is on the public record—the revenue item—so why can we not receive an admitted estimate of the revenues that have been calculated?

**Mr Ray**—You did not ask us that question in the last hearings. You asked us for, I think, the estimated number of people—

**Senator SHERRY**—I think I asked for both. But I will ask for both now and I am happy to receive both the figures.

**Mr Ray**—We are happy to take that on notice again.

**Senator SHERRY**—Frankly, Mr Ray, I think you are just being smart. I put the question on notice and I did indicate that I would be seeking that information here. Frankly, I expected to get it at the hearing on the bills, but it has not been provided. Because I am not going to get the information in this area, I ask: are you able to provide any other information that has been calculated on the revenue components?

**Mr Ray**—It would depend on your question.

**Senator SHERRY**—The estimated loss to revenue in that measure from, for example, the exit tax removal?

**Mr Ray**—If your question goes to whether we can break down the net impact on revenue of various elements of the package, we would need to take it on notice.

**Senator SHERRY**—Why?

**Mr Ray**—Because, as we have been through many times, the government has not published that information.

**Senator SHERRY**—I know they have not published it, but the ATO have just given me a breakdown of the expense item administration costs when I asked for it.

**Mr Ray**—I am aware of that.

**Senator SHERRY**—And you are aware that on previous occasions—or at least on some occasions—when I have asked for a breakdown of the revenue calculation I have received it?

**Mr Ray**—I did not say you would not receive it. I said I would take it on notice.

**Senator SHERRY**—Yes, but you have taken at least one question on notice—actually, I think it is two—and apparently you have said no. I have not checked the answer. You have just referred to it.

**Senator Coonan**—He said he would take it on notice and that he would look at the breakdown. He did not say anything other than that. Did you?

**Mr Ray**—No.

**Senator SHERRY**—Let us be frank. I am not going to get it, am I, Mr Ray?

**CHAIR**—I do not think that is a reasonable question. You have asked a question. The officer has said he does not have that information and will take it on notice. What the outcome of that might be, I do not think should be a matter of conjecture tonight.

**Senator SHERRY**—I think it should be. You were not at the bills hearing, Mr Chair. That is being denied in a response. I did indicate that I would be pressing the issue here tonight. I think it is in breach of the opening statement that you read out. I am not going to press the issue any further because it is probably futile to do so tonight, but I will take it up at a meeting of the committee because, frankly, I think it is unreasonable. Just so that we are clear on what I would like on notice, in terms of the revenue components we are obviously dealing with the revenue loss as a result of the non-provision of a tax file number. Is the abolition of what is known as the exit tax a component? I just want to deal with the components.

**Mr Ray**—The revenue loss because of the non-provision of the tax file number?

**Senator SHERRY**—Yes. Sorry, that is a gain. There is a loss because you gain the revenue and then it is paid out—or at least largely paid out. I would like the estimate of both of those figures for each year. Then there is the loss to revenue. There may be other gains to revenue. Are you able to identify any other gains to revenue from this measure?

**Mr Ray**—As we discussed a couple of weeks ago, the package has some pluses and minuses in it. One of the things that you would expect to happen is that there would be a shift from, say, employment income that is taxed at marginal rates to a super fund—

**Senator SHERRY**—That is, as a consequence of behavioural change—

**Mr Ray**—That is correct.

**Senator SHERRY**—as distinct from loss resulting from the removal of taxes up to ETP, the exit tax, and the income tax free treatment? They are basically the categories of revenue we are dealing with, are they not? Are there any other categories?

**Mr Ray**—You would expect there would be a shift from other individuals to superannuation as well.

**Senator SHERRY**—The bottom line is: could I have the details, a list, of each item of revenue gain or loss within the category of revenue?

**Mr Ray**—What you are asking for is a head of revenue split of each element of the package?

**Senator SHERRY**—Yes, for each of the four years—obviously it is disaggregated—in the forward estimates. Having made no progress on the revenue side, the issue I did raise—

**Senator MURRAY**—I have one question on revenue. I have a thesis that this package of simplification reforms may in fact be a considerable revenue generator over the longer term, and I have posited my ideas in my additional remarks to the committee's report. I just have one question and I am not going to try and get you to respond to my thinking. Do you intend in your *Intergenerational Report* to take a long-term view as to what these changes might do both behaviourally, in terms of sustained changes in participation rates—namely, more people working—and in revenue gains?

**Mr Ray**—I think the short answer is that, in the *Intergenerational Report*, we have a technical assumption of a constant tax-to-GDP-ratio throughout the 40-year projection. We do not project in detail on the revenue side.

**Senator MURRAY**—One of the reasons why I dislike the fact that Treasury did not do any modelling of any note—not that we are aware of anyway—on this package is that I have a view that it may be \$7.2 billion revenue negative in four years. But I think elsewhere, over the longer term, this package will actually be a positive. I think the way in which it will alter investment and work patterns will be such as to generate considerable macro changes. Therefore, to assume that the past continues into the future would be a mistake, particularly from people of your quality and ability. I for one will be looking at your report to see if you will bring forward a different perception of how the future will be because of the way in which policy has been so materially adjusted in this period. I hope you take those remarks on board. I would be disappointed if you were to just assume a constant Australian environment in the sense that you summarised earlier.

**Mr Callaghan**—Going back to the discussion we had at budget estimates, when we said that we were doing some long-term thinking about this, the factors you are raising are the very issues that require us to think about what might be the implications of all of these. It is one thing to be thinking about all those impacts that may occur, but it is a very big jump to be able to generate a number and put it in, particularly for these behavioural aspects.

**Senator MURRAY**—I understand.

**Mr Callaghan**—To do any modelling you need to have a run of data over a period to be able to form a base. We are talking about some significant changes in incentive and behaviour, which is the conceptual thinking that is required. But there is a jump to then say, 'How can you put these into a quantified single number?'

**Senator MURRAY**—Although econometrics was never my strong suit—I insisted on writing my papers in English, not maths—I recognise and understand the point you are making. Nevertheless, I do not believe those issues should be ignored, even if they are just commented on in the text as opposed to numerically.

**Senator SHERRY**—On the same issue, has Treasury carried out any work on the longer-term impact to revenue of the measures beyond the year 2009-10?

**Mr Ray**—I think we have answered that question before in that we have definitely done some thinking about what the longer-term implications of the package would be.

**Senator SHERRY**—The thinking is even harder to get than the figures that I have been trying to get, which I know are on paper.

**Mr Ray**—Again, what we have said in the past is that we have not done definitive long-term quantitative work.

**Senator SHERRY**—Has there been any attempt to put this thinking down on paper to date?

**Mr Ray**—Not in a publishable form.

**Senator SHERRY**—No, that is not what I asked. I will get to whether you are going to give it to me and publish it. There has been some attempt to calculate impact on revenue beyond 2009-10 and it is on paper or in a computer somewhere?

**Mr Ray**—There has been some thinking that has been on paper, yes.

**Senator SHERRY**—Thank you. That is great. Could I put this on notice: can I have that, please?

**Mr Ray**—You can put that on notice.

**Senator SHERRY**—My question went to revenue. Have you carried out thinking—

**Mr Ray**—On expense side?

**Senator SHERRY**—Hopefully on paper—on the expense side. You anticipated my question. You have done that as well?

**Mr Ray**—We have done some thinking about the long-term implications of the package both on the revenue and the expense side, and in terms of what might be at least the direction of the impact on participation in the long run, and some thinking about the direction of the impacts on private savings in the long run.

**Senator SHERRY**—And expense in the case of expense items?

**Mr Ray**—Yes.

**Senator SHERRY**—For what years has that work been carried out beyond the 2009-10 year?

**Mr Ray**—It is more in terms of over a long horizon. You are taking account of cohort effects through several generations rather than—

**Senator SHERRY**—So it is not a year-by-year breakdown. It is a cumulative breakdown through for, say, 10, 20, 30, years?

**Mr Ray**—Some of the thinking may have used—I do not know off the top of my head—some output, but very preliminary output and not anything definitive that has been checked, that would break it down by year. That is not the way we prefer to think about it. Really, when we have been looking at the longer term implications, we have thought about it in terms of 10 to 20, that sort of thing, rather than year by year.

**Senator SHERRY**—I would understand why you would not do it in the one year.

**Mr Ray**—We do not have definitive estimates in 10 or 20 years let alone year by year. I should say on the revenue side—and this is the issue that we have discussed on several occasions—in terms of a long-term costing it has to be a costing against something, and it is not clear what that benchmark would be.

**Senator SHERRY**—I accept it is not clear what the benchmark would be.

**Mr Ray**—Therefore, we do not have—

**Senator SHERRY**—We have made slight progress tonight on the last conversation we have had. Either the thinking has become more advanced since we last discussed this, but we have got an acceptance or an admission that some work has been done.

**Mr Ray**—I think we have said that on many occasions that we have examined these issues. That is a rather different thing from having a costing.

**Senator SHERRY**—There are a couple of spikes in the costings in front of us on the revenue/expenses that I would seek an explanation to. The revenue impact for 2007-08 is \$1,276 million and then it drops down to \$1,160 million. Is that because of what is reported anecdotally in the media as a contribution surge in 2007-08 as a result of transitional measures? The figure drops down in 2008-09 quite significantly and then goes back up quite significantly in the following year.

**Mr Ray**—Yes. I think the best way to answer that is that the transitional measures would affect the profile.

**Senator SHERRY**—They are reflected in the 2007-08 figure?

**Mr Ray**—There is a bit of transition in 2006-07 as well.

**Senator SHERRY**—Yes, obviously in 2006-07. I am just looking at the 2007-08 figure, where there is a drop of just over a hundred million in 2008-09. Then it goes up significantly. Why does it go up significantly in 2009-10 from 2008-09?

**Mr Ray**—I expect that is to do with underlying growth.

**Senator SHERRY**—Underlying growth. The underlying growth goes from \$1,160 million in one year to \$1.413 billion. What is that? That is about a \$250 or \$260 million jump from that year in 2008-09. Is it anticipated that there is going to be a similar jump every year from then on?

**Mr Ray**—We do not have an estimate for the next year.

**Senator SHERRY**—\$250 million; it is going to add up pretty quickly if that is rate of increase.

**Mr Lonsdale**—I think what is complicating the discussion is that, as you mentioned before, within that line there is a range of factors. As you mentioned, some are pluses and some are minuses. They will offset and they will move as you go through years. It is difficult to point to one thing and say, 'That is contributing to this rise.' There is an amalgam of things in there that makes it a complicated question that you are asking.

**Senator SHERRY**—I have another question on the costings. The extension of the co-contribution to the self-employed, as you will note, is \$110 million and then \$115 million in 2008-09, and the same figure in 2009-10. I must say that I would have expected that that would go up each year. I am wondering why we have the same figure in 2008-09 as in 2009-10. Why has there not been some sort of slight increase? It seems to assume there is not going to be any increase in either self-employed numbers or contributions from the self-employed between the two years.

**Mr Lonsdale**—It sounds like Mr Gallagher knows the answer.

**Senator SHERRY**—He knows all of the answers. Whether I get them is another thing.

**Mr Gallagher**—I suspect part of the answer here is that the co-contribution is income tested and, as incomes rise, people will be out of the co-contribution range.

**Senator SHERRY**—That is offset?

**Mr Gallagher**—It is offsetting the ability-to-pay aspect that you are referring to.

**Senator SHERRY**—The parameters of the co-contribution—the \$28,000 and the \$58,000—are not indexed, are they?

**Mr Gallagher**—The bottom threshold will be indexed and the interval will be kept constant.

**Senator SHERRY**—That would explain that. I have one other issue on the costings on the revenue side. I think we were about to make some advance on this. In terms of the actual numbers for the non-provision of TFN numbers, I know Ms Vivian was involved in that. I know the ATO is so helpful in this area. Are you able to give me the ATO's estimate of the actual number of estimated non-provision of tax file numbers?

**Ms Vivian**—I suppose what I can share with you is the analysis we are doing to try and understand how we maximise the TFNs into the system. I think that when I spoke at the hearing we talked about a figure that we could match up to about 93 per cent.

**Senator SHERRY**—Yes, I recall that.

**Ms Vivian**—And that is right. It depends on which year you look at. What we are really saying is that of the members' contribution statements that come in it leaves about 3.5 to 4 million that are unmatched, and then we can match about 75 per cent of them. That leaves us with roughly about 900,000 that we cannot match. Again, what I am sharing with you is just the analysis, and it does vary; we are still getting into it. Of that roughly 900,000, we talked a bit about the existing accounts and it is the amounts that are over a thousand dollars where the penalty applies. When I have done a bit of a breakdown of that, about 25 per cent of those are contributions over a thousand dollars. The remainder sit in about 400,000 or under. We also have quite a large figure showing nil. That is that 285,000, which might be funds lodging just nil contributions or it might mean the data is not quite right. In terms of our starting to unpack it and to work on it—they are the really key people we need to focus on to get the TFNs in—it starts to give us some areas of what I would call leverage where we can really focus on those sorts of things.

**Senator SHERRY**—Above the thousand dollar contribution per annum category, which is the cut-off point, it is about 400,000 of that 900,000. Is that right?

**Ms Vivian**—No, it is about 230,000.

**Senator SHERRY**—Obviously, you would have had an exchange with presumably Mr Gallagher on calculating the revenue figure that I cannot get. You would have had an exchange, because you would have needed the information that you have just given me to provide a calculation of the revenue collection figure. That would have been necessary, would it not?

**Ms Vivian**—There is no doubt that during development our revenue analysis area would have provided details to Treasury. The figures I am giving you particularly are probably from the most recent members' contribution statements being lodged. I imagine there would have been earlier ones as well.

**Senator SHERRY**—Thank you for that. It is useful. In examining this group of about 230,000, where it seems it is going to be difficult to get the TFN, would you have carried out an examination of the sort of average contribution of this group? I do not think it is going to be representative of the incomes of the population. They are more likely to be lower income.

**Ms Vivian**—We are working on that. I do not underestimate the problem/challenge of getting the tax file numbers into the system. In terms of the analysis we have just done, it is the early days and I mentioned before that we want to work with the funds. Of that figure of 230,000, about 20 funds make up about 60 per cent of those numbers. In terms of the analysis you are talking about, we are still to do that.

**Senator SHERRY**—I do recall your mentioning the 20 funds. Do you have a list of those funds?

**Ms Vivian**—I was looking more at the 900,000 funds. In that 900,000 funds, 12 funds held over half of the accounts. Are you asking me whether, at that point in time, they were retail funds, or what the mix was?

**Senator SHERRY**—Yes, that is right. I think I referred specifically to REST, the retail hospitality fund.

**Ms Vivian**—From the analysis I have here, I would say that it is a mixed bag. Again, we still need to get in underneath it, but it was sort of made up of what I would say is like one government fund, three employer funds, five industry funds, and three public offer funds. It is right across the market.

**Senator SHERRY**—Across-the-board.

**Ms Vivian**—Again, I think we need to start working with those funds, to start to understand it and unpack it a bit more.

**Senator SHERRY**—Thank you for that. Ms Vivian, we have an approximate figure of 230,000. I assume that that number would decline over time?

**Ms Vivian**—That would be the aim. We would hope that it would decline. One of the things I would observe—and I think I have mentioned before at previous estimates—is that each year the members' contribution statements come in we are finding that we are getting a slightly higher number with TFNs coming in. I think it is a good example of where it is getting out into the community and it is improving each year. One would hope that it would decline. We are also confident that some of the changes announced in the package on a go-forward basis will also make a difference about getting tax file numbers in at the point of employment.

**Senator SHERRY**—Thank you for that. Just coming back to you, Mr Ray, don't they actually have the basis to work out the estimated revenue collection from TFN numbers?

**Mr Ray**—I cannot confirm that.

**Senator SHERRY**—Let me run through it, because when I put out the press release it will be useful for you to counter-respond with what your figure is, and then we will see whether I actually have it right. If we assume the 230,000 that Ms Vivian and the tax office have so usefully and rightly given the committee, I then took the average superannuation contribution each year in the year 2007-2008, multiplied them together and then took the new tax rate of?

**Mr Ray**—It is 46.5 per cent.

**Senator SHERRY**—If I took 46.5 per cent of that figure, taking off the 15 per cent, I would have the revenue figure, wouldn't I? I would have got it myself?

**Mr Lonsdale**—I think what complicates the issue a little bit is that the tax file number withholding arrangements that you are talking about in the main part will not become collected until after 30 June 2008.

**Senator SHERRY**—So in the 2008-09 year.

**Mr Lonsdale**—That is correct. The estimates that I think Ms Vivian is outlining is what the tax office thinks is the case at the moment in terms of estimated matching. The other issue that Ms Vivian touched on is that a range of initiatives will happen in between now and 2008 to increase that matching rate further.

**Senator SHERRY**—Yes.

**Mr Lonsdale**—You know about those?

**Senator SHERRY**—Yes, I do, and of course when I put out my press release having calculated my figures—to which you of course can publish the figures—I will reduce the 230,000. I will make a reasonable estimate. I know Mr Gallagher well enough by now to give a reasonable calculation, and we will see how accurate it is. Then we will see if we get the actual figures. We will see how close we get. While we are talking about trying to get information in the area of superannuation, I understand Mr McKinnon, the freedom of information editor of the *Australian*, has sought copies of forecasts and projections of superannuation revenue from taxes. Is that the case?

**Mr Ray**—Mr McKinnon has sought many things, but there is a live matter involving superannuation, yes. We discussed that last time.

**Senator SHERRY**—I have discussed what he has asked for on many occasions, too, and still have not got it. Has a formal response been sent to Mr McKinnon yet on the application for the superannuation tax figures?

**Mr Ray**—My recollection is that the request had a number of components and an original decision was made last year. That decision was appealed. The reviewer is sitting beside me. Mr Callaghan reviewed the decision and issued a formal decision again. Mr McKinnon has now appealed to the Administrative Appeals Tribunal, and that is where the matter is.

**Senator SHERRY**—I have another superannuation issue that someone in revenue may be able to help me with. It concerns Indigenous workers on what is known as the CDE program for remote Aboriginal communities. It is a form of payment that they receive. My understanding is—and I would be interesting to know whether this is correct—that this form

of payment is not for the purposes of the nine per cent superannuation guarantee. Can anyone confirm that?

**Mr Lonsdale**—I would have to take that on notice.

**Senator SHERRY**—Thank you. Ms Vivian, I had asked you about some lost files in the ATO on the super guarantee. There was a response in SBT96. I specifically referred to a Mr Cauldwell—it is on the record that he did not mind my using his name publicly—whose file, admitted by the ATO, was lost for his unpaid super, and he was awarded compensation of approximately \$500. I did ask you on notice, and I have received a response, for the number of other files that had been lost, the approximate number. The response I have received is along the lines that the ATO is unable to provide data on the number of lost or missing files in the superannuation business line or the period for which they were lost, and there is a further explanation. It does not really explain what was at the heart or the core of this loss of files.

**Ms Vivian**—I suppose at one level I did regret at that estimates not responding that, if I knew how many were lost, they probably were not lost.

**Senator SHERRY**—Yes, that was what came into my mind.

**Ms Vivian**—I think at the heart of the issue here is—and I think we have been quite open about it for some time—is that we do have some backlogs in actioning our super guarantee cases. Perhaps I can explain this by saying that there are two sides to it. On one side, from the office's side, as I said, there are some backlogs. We have been working through them, and I certainly expect by August this year that we will have tackled that. We have some extra resources into those and are really going through and tackling them at the moment. That is on one side.

From the taxpayer's perspective, some of the complaints that we see coming through from the various ministers' offices have expressed frustration, probably on both sides, about our inability to share what action is actually being taken. Under the current law—and the government has announced that it is making some changes here—we really only tell the taxpayer when we have taken action either that they are not eligible for super guarantee, that the employer has now paid it or that the employer is insolvent. We undertake quite a bit of work for a number of years following up employers entering into employment arrangements. Unfortunately, we are unable to give that information to the employee. I think from their angle what they perceive—and certainly I can understand this—is that they have made a complaint to the office and they hear nothing for many years. Again, with the changes that the government has announced under the secrecy provisions we will have the ability to write and tell the employee, without jeopardising information about the employer, about what we are doing and what progress we are making on the case.

**Senator SHERRY**—I understand that, and you know we have discussed this on many occasions. At the end of the day, in terms of the number of lost files, we are only going to get an idea of this when people actually complain and say, 'What have you done?' and you go to find their file and they say, 'Look, I have complained' and it is not on file; you cannot find the file. Then we will have some idea of the number of people involved.

**Ms Vivian**—Again, in the superannuation area, particularly in the last year, we have come a long way. Compared with the rest of the tax office, the staff were working with fairly

antiquated systems and working with paper files. We have now moved everything over so it is electronic. The information is there and the reports are there. That was what we were trying to say in the response to you. With the move over, the complaint might be more about lack of action or maybe about timeliness of action, but the concept of loss should not be occurring.

**Senator SHERRY**—I am sure over time you will identify where a person has complained and, if you cannot find the file, at some point in time we will get some idea of the number of lost files. I have a couple of unpaid SG issues that I will place on the record, because I have been asked to do so. There are a couple of questions that flow from this one. I do not know whether this one has been lost; some payment has been received. The complaint has been lost. In 1996 a Ms Marnie Brims made an application to the ATO over unpaid SG of approximately \$1,500. Seven years later, in 2003, she received a payment of \$55.49. She was informed the employer was on a payment plan but has received no further payments since. That brings it to 11 years and four months. That is really an extraordinarily long time. Is there a statute of limitations in terms of the ability of the ATO to take formal legal action against an employer for unpaid SG?

**Ms Vivian**—In terms of our ability to accept a complaint and to follow up on SG, we do not have any limiting time frames.

**Senator SHERRY**—But that is not the issue. A complaint is made, action is initiated and some payment is received. But it is more than 11 years now. It begs the question: has the ATO taken legal action against the employer after 11 years?

**Ms Vivian**—That is one of the issues that I was explaining about in terms of our inability at the moment to pass on to the employee what action we are taking. We have a couple of legal avenues open to us, and we do take them. Particularly with super guarantee with some of the small amounts we do tend to try to get the employer onto some payment arrangements; going down the path of insolvency is pretty difficult and a decision that would not be taken lightly in terms of the employer.

**Senator MURRAY**—In terms of your ability under the new legislation to give complainants better feedback, will the legislation allow you to go back and provide information to people that you formerly were not able to, such as the case here, with somebody in 1996?

**Ms Vivian**—The government is currently considering the legislation, so I am really not in a position to comment on that.

**Senator MURRAY**—I put it to you that you should consider it in your policy discussions with the government, because there are many aggrieved people, as you know. It is pointless for it to be just prospective if files are still alive.

**Ms Vivian**—Certainly it is frustrating for our staff too. They can see that we are taking some action and yet they are unable to pass that on. But at the end of the day it is also, with superannuation as well, reliant on our collecting the charge from the employer.

**Senator SHERRY**—There are two issues here. There is the obvious frustration. You know I discussed this, and in fact Mr Carmody admitted it was a good idea—I actually think it was my suggestion to remove that secrecy provision, if I recall, some years ago. That in itself is

useful, but it is the actual enforcement of unpaid super guarantee in the case of Ms Brims that I have just referred to—11 years and no apparent legal action. Enforcement action has been taken but no legal action. This apparently has gone to the Treasurer and has been emailed through to me in the last couple of days. This is from Mr Derych Thompson. I suspect you will get a referral from the Treasurer's office. He applauds the Treasurer for the changes in superannuation, but points out that he does not have superannuation because he cannot get it; he has not been paid his SG. He along with a number of other employees is apparently owed some \$200,000 by a company called Wangetti, located somewhere north of Cairns. Apparently they are persistent offenders. A very substantial sum of money is now involved concerning the nonpayment of SG. I would ask you to examine that case for me.

**Mr D'Ascenzo**—We will follow-up all of the matters that you referred to. The issue that Ms Vivian has been pointing out to you is that with the legislation we will be providing people with more information and that information hopefully will allay their concerns that the right thing is not being done in chasing up their money. I recall at the last Senate estimates that you gave an example—and it is a stark example—of a similar aggrieved taxpayer who had gone through a lot processes and still had not seen the sort of outcome that we would all have desired. It was interesting in that context; that matter involved a review by the Ombudsman, who reported that he was comfortable that due process had been taken. In a sense, that indicated that action was being taken and that that had been taken in an efficient and effective manner. Unfortunately, sometimes the issue of trying to clawback money from people who do not want to apply it in that way is a difficult one.

**Senator SHERRY**—How many prosecutions in the last financial year has the ATO actually commenced with respect to unpaid superannuation guarantee?

**Ms Vivian**—I would need to take that on notice.

**Senator SHERRY**—Another case that I would ask you to examine is Affordable Cairns Pty Ltd, which is in liquidation, according to my information. Approximately 25 employees are owed \$100,000 collectively in unpaid superannuation guarantee payments.

**CHAIR**—While you are looking at that, given the workload we have—and we are slipping—I propose that we will only have a five-minute break sometime between now and 10 o'clock.

**Senator SHERRY**—We are making pretty solid progress.

**CHAIR**—We are.

**Senator SHERRY**—At least on the questions. Some of the answers are a bit—

**CHAIR**—Does anyone have any objection to making it only a five-minute break?

**Senator SHERRY**—Do you want to do that now? I am happy to take it now.

**CHAIR**—We will break for literally five minutes.

**Proceedings suspended from 9.34 pm to 9.43 pm**

**Mr Callaghan**—Mr Chairman, could I just pass on that we chased up some information for Senator Sherry on a question on notice dealing with the revenue cost of tax-deductible

provisions. It was question BET-31. The answer was submitted to the committee on 7 August 2006.

**Senator SHERRY**—Thank you.

**CHAIR**—Thank you.

**Senator SHERRY**—There has been a provision of \$57.5 million over four years, including some \$7.2 million capital funding for IT infrastructure, for the implementation of the new tax practitioner legislative framework. Could you indicate how much of that has been spent in 2006-07 to date against the budgeted amount for 2006-07?

**Mr Konza**—I do not have a figure for that, but in general terms the answer is that not a great deal of that money would have been spent as yet. We do have project teams laying the groundwork, so to speak, for the new regime to come in, but not a great deal of work can happen until the legislation is presented.

**Senator SHERRY**—The planning for the IT infrastructure, Mr D'Ascenzo, has that been affected by the issues we talked about earlier? Has there had to be any consideration of deferring the expenditure in this area?

**Mr D'Ascenzo**—Not in that area.

**Senator SHERRY**—Could you just take on notice what has been spent to date?

**Mr D'Ascenzo**—We can provide that.

**Senator SHERRY**—Again, I anticipate this would be taken on notice. The Official Development Assistance, ODA, eligible expenditure and activities undertaken by the department since 2000-01, is this the correct area to ask about this?

**Mr Callaghan**—No. It is macroeconomic, I think.

**Senator SHERRY**—I will put that on notice then. At a previous estimates hearing there was some discussion of a tanker carrying oil that entered Australia. Do you recall that, Mr D'Ascenzo?

**Mr D'Ascenzo**—Vaguely.

**Senator SHERRY**—Is there provision for the return of taxes paid in light of an importation which is deemed to be illegal?

**Mr Jackson**—I recall the issue. We did look into that issue and that has been resolved. There is no need for any such action, but I would have to check on that. Did you have a particular tax, duties or charges in mind?

**Senator SHERRY**—Yes, duties and charges.

**Mr D'Ascenzo**—I will have to check on that.

**Senator SHERRY**—So that matter has been resolved?

**Mr Jackson**—I guess it is close to matters of particular business operators, and I would rather not comment on them, but I have looked into the matter.

**Senator SHERRY**—I have a number of questions about small business sector tax liability. I think I will place those on notice. I have finished in this area. I particularly thank the tax

office for its cooperation in providing me with breakdowns of figures where they have been able to. Thanks for that, Mr D'Ascenzo.

**CHAIR**—Thank you very much. It has been a long session so I thank you most sincerely. We will now move to the Fiscal Group.

[9.51 pm]

**Senator SHERRY**—I initially wanted to start in an area that was touched on this morning and kindly referred to your group. It is the issue of the environmental unit. I just want to turn, firstly, to the issue of carbon trading. The Stern report on page 12 of the summary noted there were four ways to lower carbon emissions. I will not read them out. Has there been any analysis of emissions trading as an efficient way to reduce demand for emissions-intensive goods and services within the fiscal environment unit group?

**Ms Mrakovcic**—The Stern review basically says that within an international framework it focuses on those four elements. Basically it talks about a carbon price, technological development, deforestation and adaptation. Your question then went specifically to the issue of an analysis of emissions trading; is that right?

**Senator SHERRY**—Yes.

**Ms Mrakovcic**—Basically I guess the analysis boils down to the fact that economic theory tells you that market based instruments, such as trading schemes and taxes, tend to be the most economically efficient way of delivering that kind of abatement.

**Senator SHERRY**—So your group has carried out analysis in this area?

**Ms Mrakovcic**—I would say that it has undertaken analysis of the economic literature, which basically makes that quite clear.

**Senator SHERRY**—When you say it makes it quite clear, is that a conclusion you have come to having considered the literature?

**Ms Mrakovcic**—I would say that the, if you like, findings using economic theory broadly suggest that basically market based instruments such as emissions trading and carbon taxes deliver the most economically efficient outcomes—those at least cost to the economy.

**Senator SHERRY**—Your environment unit presumably is the area where there would be a gathering of information analysis advice on climate change and emissions trading issues within Treasury?

**Ms Mrakovcic**—That is correct.

**Senator SHERRY**—What are the approximate staffing numbers of your unit at the present time?

**Ms Mrakovcic**—Approximately eight to nine people.

**Mr Tune**—It is the environment and agriculture unit, so it also doing some primary industry issues as well.

**Senator SHERRY**—How does the size of that unit compare to previous years?

**Ms Mrakovcic**—It has been broadly unchanged over the last few years. It may have been up one or two or down one or two at different times. I would say that it has been fairly stable at around the six to eight level over the past three years at least.

**Senator SHERRY**—I cannot recall your having attended estimates before. Are you new to the unit?

**Ms Mrakovcic**—I am the general manager of the division that covers industry, environment and defence issues. That is one of the three units within my division, and I have been in this position since June 2003.

**Mr Tune**—Ms Mrakovcic has been in attendance at estimates but we have not had many questions on these issues.

**Senator SHERRY**—You can anticipate a lot more in future.

**Mr Tune**—We thought we might get some tonight.

**Senator SHERRY**—I appreciate the anticipation. I would like to refer to the document *State and trends of the carbon market 2006*, which was published by the World Bank and the International Emissions Trading Association in May 2006. Are you familiar with that literature?

**Ms Mrakovcic**—I am aware of the publication but I would not say that I was intimately familiar with it.

**Senator SHERRY**—Are you aware of the estimate that the global carbon market was worth \$25 billion to \$30 billion in 2006?

**Ms Mrakovcic**—No, not as such.

**CHAIR**—Was that within the report?

**Senator SHERRY**—Yes, that is within the literature.

**Ms Mrakovcic**—Is that the value of the permits traded in the carbon market?

**Senator SHERRY**—Yes. Do you have any knowledge of the size of the European carbon market?

**Ms Mrakovcic**—No, not detailed knowledge. We have obviously been interested in how the market in the EU has operated in general terms but we are not intimately familiar with that detail.

**Senator SHERRY**—I understand from a report in the *China Daily* of 7 February—and I would not expect you to be familiar with it—that Beijing is expected to become the home of Asia's first carbon trading exchange. Putting aside the source of my information, are you aware that Beijing is to become the home of the carbon trading exchange in Asia?

**Ms Mrakovcic**—No.

**CHAIR**—If that article is accurate.

**Ms Mrakovcic**—I was not aware of that.

**Senator Coonan**—Can we have a translation?

**Senator SHERRY**—Whatever the veracity of the *China Daily* publication and the report that Beijing is to become the home, do you have any information about how the Asian exchange, wherever it is to be located, will be operating?

**Ms Mrakovcic**—No.

**Senator JOYCE**—What about the Indian one? Do you know anything about the Indian one, or the Mongolian one?

**Senator SHERRY**—Senator Joyce, when you move into opposition you will appreciate these opportunities. If you want to search for irrelevancy, look back over the *Hansard* to some previous contributions of former Senator Bishop, interspersed with tirades of officials.

**CHAIR**—That was not a question.

**Senator SHERRY**—That was a reflection on history to give Senator Joyce a bit of an update on the process. Have the different emission trading regimes and their impact on the Australian economy been examined at all?

**Ms Mrakovcic**—Can you be more specific on that?

**Senator SHERRY**—There are different models of trading emissions regimes that have been discussed within the debate that has been occurring. Have you examined any of the different trading models and their impact on Australia?

**Ms Mrakovcic**—We are aware of different models of emissions trading and we are aware of the issues that surround each of those emissions trading models, but there has not been any modelling or analysis of their impact on Australia.

**Senator JOYCE**—I would like to ask a relevant question. With these emissions trading models, is there a belief that, if we ever go down this path, we can actually have it so that it is relevant to people on the ground? What I mean by that is, for instance, with farmers and the carbon that they obviously have tied up in things such as timber on their property, can they be part of the process so that they feel some sort of sense of ownership and want to participate in it? The fear is, currently, that this debate will benefit big business and government but people on the ground are going to be ignored. In any discussions that you have come across or are aware of, does it show relevance of how it connects to the individual Australian citizen on the ground being a participant in the process and being a benefactor of it?

**Ms Mrakovcic**—It comes down to the whole set of design issues around how you might set up an emissions trading scheme, as to what sectors are covered, what kinds of incentives are provided for inclusion for different sectors to undertake abatement activity and the extent to which different sectors of the economy are impacted by the cost of abatement activities.

**Senator JOYCE**—Would the bush, forest or trees be seen as a relevant item of trade in an emissions trading scheme?

**Mr Tune**—You would imagine that someone who planted trees on their farm or property could enter that trading system.

**Senator JOYCE**—Would it be also viable if they were just there and endemic to the area and they say that they will never touch them but they will trade them?

**Ms Mrakovcic**—It goes back to the design issues. There is no clear answer. It is basically an arbitrary issue as to how you design the scheme.

**Senator JOYCE**—The point that I am getting to is that the ownership of carbon as tied up in trees becomes a possible negotiable instrument at some time in the future if this goes forward. If that is the case, change of ownership of that carbon as held in forest or trees when a government takes control of the asset—as the Queensland government has, by the stroke of a pen, taken that asset from the landholders and invested it in the state; and in New South Wales they have done the same thing—means the government has stolen an extremely valuable asset that would have been worth billions of dollars had it been held by the landholder.

**Ms Mrakovcic**—It comes down to the issue of where the property right has been deemed to have been held at any particular time.

**Senator SHERRY**—No-one is going to get on board with it. That is the whole point. They believe that it was stolen. They had the right to do whatever they wanted with that vegetation and now they do not. If they are not participating in it then they are just going to believe that it is another act of theft—theft by the government off the individual.

**CHAIR**—Your point is well made, Senator Joyce. Senator Sherry, you need to cut to the chase in this line of questioning. It is stretching relevance.

**Senator SHERRY**—Has the analysis in your area to date examined the effect on the mining sector of the national emissions trading system?

**Mr Tune**—We have not done detailed work in those sorts of areas. That is clearly being looked at by the Climate Change Task Force set up in the Prime Minister's department and the lead person in that is Dr Martin Parkinson, Executive Director of Treasury, and there is another Treasury officer there as well. They are getting more into that detail that we have to date.

**CHAIR**—I take it that you have no detailed knowledge of these matters?

**Mr Tune**—No. We do a lot of analysis around greenhouse and climate change issues. We have not got down to the point of designing a scheme or anything like that.

**Senator SHERRY**—Or modelling the impacts of the scheme?

**Mr Tune**—Yes. As Ms Mrakovcic was saying, it is the impact on the sectors, whether it be the agriculture sector, the mining sector, or whatever. It depends crucially on how you design the scheme. It is very hard to talk about these things in the abstract unless you are talking about an actual proposition that is on the table and then you can start to analyse it.

**Ms Mrakovcic**—For example, if you are talking about the mining sector, are you talking about the fugitive emissions associated with the extraction of those sorts of minerals and ores as such? If you were talking about coalmining, for example, it is not really a very large sector when it comes to contributing to emissions within the economy.

**CHAIR**—Are you saying that you have not done any modelling?

**Ms Mrakovcic**—A lot of these estimates around the contribution of different sectors to total emissions are produced by other agencies, such as the department of environment.

**Senator SHERRY**—Yes. You are here tonight, so we are just trying to determine what level of research or modelling, if any, you have conducted, and it is apparent that you have not done very much at all in that regard.

**Mr Tune**—We have not done modelling, because it is very hard to do the modelling in the absence of modelling something that is specific.

**Senator SHERRY**—Policy options analysis?

**Mr Tune**—Yes, we have done that. We have provided advice to the government on those sorts of issues.

**Senator SHERRY**—What areas have you done options analysis in?

**Mr Tune**—On the sorts of issues that we have been talking about.

**Senator SHERRY**—Does that include the impact on specific industry sectors?

**Ms Mrakovic**—We should be clear about this. We do not have the modelling capability within Treasury to undertake that kind of analysis. You need CGE modelling capability to look at those kinds of issues in detail. We can think through the conceptual issues. For what I understood you to mean, in terms of that precision modelling or a quantitative estimation, you need to rely on CGE models, and agencies such as ABARE have that capability.

**Senator SHERRY**—You do not have that capability. I accept that. Which other agencies of government have that capability?

**Ms Mrakovic**—ABARE has that modelling capability.

**Senator SHERRY**—Are you aware of anyone else within government that would have that modelling capability?

**Mr Francis**—I understand the Productivity Commission has users, typically consultants, to do their own work in that area, but they have close relationships with the consultants they use and they have a medium-term contractual relationship with consultants who understand it so they tend to use the same type of model and they would have some capability as well.

**Senator WONG**—Did anyone in Treasury, in particular in your area, have any involvement in the preparation of the Prime Minister's water announcement on 25 January?

**Mr Tune**—We had some involvement.

**Senator WONG**—Could you describe that involvement?

**Mr Tune**—I can, in brief.

**CHAIR**—That is okay if it is not in the context of what advice was given to government.

**Senator WONG**—Skate around that.

**Mr Tune**—We were informed very broadly that some thinking was being done in the Prime Minister's department around mid-December. They were tossing ideas around. The work was in the very early stages. There were certainly no details. We were informed on Friday 12 January that some more detailed, further work had been done and that there would be a statement by the Prime Minister. Subsequent to that, on the following Monday, which would have been the 15th, when I returned from leave and took over from Ms Mrakovic,

who had been acting in my position, I had a conversation with people over in PM&C and we were invited to join them in a meeting the following day to cast our eye over the work they had been doing and to provide some comment if we wished to do so. We did attend that meeting. There were a couple of other meetings from that period on until the period when the Prime Minister announced the package on 25 January.

**Senator WONG**—You may be aware of some answers that Finance and Prime Minister and Cabinet may have given in this area.

**Mr Tune**—Yes.

**Senator WONG**—As I recall the evidence from Finance, the first time they saw any costings was at the meeting of the 16th. Would that be the same for Treasury?

**Mr Tune**—Yes. We had a broad indication of what the costs were. This thing was moving. It was iterating towards a firm proposition but it was indicated then that the costings could be reasonably high.

**Senator WONG**—When did you become aware of the parameters of the \$10 billion over 10 years?

**Mr Tune**—On that date. That was on the table that day that it was likely to be in that order.

**Senator WONG**—The 16th?

**Mr Tune**—Yes, the 16th.

**Senator WONG**—Was that the first occasion on which Treasury became aware of the extent of the proposed expenditure?

**Mr Tune**—That is correct.

**Senator WONG**—Do the current additional estimates statements reflect that proposed expenditure?

**Mr Tune**—No, they do not.

**Senator WONG**—Are you able to indicate where the money is coming from?

**Mr Tune**—The money is coming from consolidated revenue when it is eventually decided.

**Senator WONG**—Has there been any allocation as yet as to which portfolios will have what proportion of expenditure?

**Mr Tune**—No, not that I am aware of.

**Senator WONG**—Presumably Treasury would know that if that happened.

**Mr Tune**—It is largely for Finance to determine that. They will be doing the detailed work on the costings with the agencies concerned.

**Senator WONG**—We talked about Welfare to Work and some of the modelling that you did on the impact of that policy change.

**Mr Tune**—Yes.

**Senator WONG**—That included employment effects and a range of other expenditure and revenue effects. Was Treasury ever asked to do any modelling of the impact of the water announcement on jobs or employment?

**Mr Tune**—No, we were not.

**Senator WONG**—Have you done any modelling on the employment impacts of the water plan?

**Mr Tune**—No, none at all.

**Senator WONG**—Have you done any modelling on any structural adjustment impacts, in terms of people exiting the industry?

**Mr Tune**—No.

**Senator WONG**—Have you been asked to do any since?

**Mr Tune**—No.

**Senator SHERRY**—With the issue of climate change, has there been any consideration by your group of incorporation of any of the impacts of climate change or drought in the upcoming *Intergenerational report*?

**Mr Tune**—I have indicated this before that, under the Charter of Budget Honesty Act, the Treasurer or the government is required to release the next *IGR* by the main budget. We are in the throes of doing lots of work on it at the moment. We are having a look and a think about how we can incorporate issues around the environment into the report. As you know, the *IGR* focuses mainly on the fiscal side of things. In particular, it is looking at the impact of demographic change on the expenditure side of the budget, so you can look at what the expenditure implications on the environment side might be by looking at what has been happening in history and then taking that forward. But, there are broader issues around the environment and, in particular, greenhouse gases that you might want to incorporate. I do not think that you can incorporate those into the number crunching per se but we are trying to think through how we might talk about those and try to demonstrate that, because environmental sustainability is one aspect of sustainability, which is what the act talks about. We are trying to do as much as we can in that area but I would not expect us to have firm numbers that we will be putting into the report.

**Senator SHERRY**—I will not go any further on that matter. We will deal with that when the *IGR* is released at the May estimates.

**Mr Tune**—Thank you.

**Senator SHERRY**—I have some issues involving the cost of federalism, if I can use that terminology. In September 2006 Access Economics provided a report to the Business Council of Australia, entitled *The costs of federalism* and Access estimated the total government costs of inefficient federalism at about \$9 billion in the 2004-05 year. Is Treasury aware of that Access Economics report?

**Mr Willcock**—Yes, we are.

**Senator SHERRY**—Has Treasury itself done any estimates of costs to the federal government or to all Australian governments of inefficient federalism?

**Mr Willcock**—No, we have not.

**Senator SHERRY**—Have you done any estimate of cost to government and/or all governments of our federal structures and some of the difficulties that emerge from the jurisdictional issues within federal, state or local government?

**Mr Willcock**—Do you mean in terms of seeking to quantify the costs of so-called overlap or duplication that arises from having different tiers of government?

**Senator SHERRY**—Yes.

**Mr Willcock**—No, we have not.

**Senator SHERRY**—You are aware of the report and obviously the issue, so does Treasury intend to undertake any work in this area?

**Mr Willcock**—We are aware of that report and we are aware of other reports from other individuals or other bodies but we are not intending to undertake an exercise of seeking to quantify those things.

**Senator SHERRY**—Let us take one specific area of administering grants to the states—SPPs—over and above the cost of the states or the federal government directly funding and running the programs themselves. Has Treasury carried out any analysis of that particular aspect?

**Mr Willcock**—No, we have not.

**Senator SHERRY**—Can you point me to any work that you have knowledge of outside fiscal within Treasury of work in this area?

**Mr Willcock**—Not within Treasury. I know that the Access report that you referred to that was done for the BCA seeks to quantify that particular alleged cost.

**Senator SHERRY**—Is there anything within government?

**Mr Willcock**—No.

**Senator SHERRY**—Any other government department or agency?

**Mr Willcock**—Short of going through portfolio budget statements for each individual agency and seeking to identify it that way.

**Senator SHERRY**—I just wanted to see if you were aware of anything happening in any area. Is the social policy division involved in the national reform agenda human capital work?

**Mr Tune**—I am involved in that, as this is the social policy division.

**Senator SHERRY**—In that case, can you describe the nature of the involvement in that agenda?

**Mr Tune**—Yes. Under the COAG rubric and the national reform agenda, in particular, there is a senior officials group, which is the head of the Department of the Prime Minister and Cabinet, as well as heads of premiers departments, and below that there are two groups. One looks at competition and regulation and the other one looks at human capital. That committee is chaired by a deputy secretary in the Prime Minister's department. I am also a Commonwealth member of that group. There are two of us: one from Treasury and one from

PM&C. There are representatives from each of the state and territory premiers departments and, in some cases, there is also a state treasury representative on it. We have been working away for about a year now, following the COAG agreement in February last year, developing the agenda.

**Senator SHERRY**—Does that involve analysis and verification of costings for different proposals?

**Mr Tune**—Yes, we are trying to cost firm proposals where they have been put forward.

**Senator SHERRY**—Does that include the cost of providing preschool education for four-year-olds?

**Mr Tune**—Preschool education for four-year-olds?

**Senator SHERRY**—Yes.

**Mr Tune**—No, that option has not been taken to that point.

**Senator SHERRY**—Has Treasury undertaken an assessment of the work done by the Productivity Commission on the potential economic benefits of greater investment in human capital?

**Mr Tune**—Yes, we have. We have been working very closely with the PC through the course of all that work that they have been doing, as have state treasuries. The heads of treasuries, as a group, have been tasked to oversight or work with the PC.

**Senator JOYCE**—About the investment in human capital and the returns on that, isn't that a nefarious type of subject? How do you make that a quantifiable issue to study? It is all in the eye of the beholder, isn't it?

**Mr Tune**—It is extremely difficult; I would accept that. The way that the PC has gone about it is that the underlying objectives of the NRA in both the human capital side and the competition regulation side are to improve labour force participation and also to improve productivity, so what the PC have tried to do is to look around for outer envelopes. If you can increase labour force participation in Australia by X, what might be the flowthrough effects to economic growth?

**Senator JOYCE**—It must be a very tenuous model. It is a model based on a model based on a mystery wrapped up in another mystery. How do we start defining these in such a way that it is reliable and the model can be put to work and come up with results that are definable, repeatable and have some sort of scientific basis to it? Every time I hear this argument about capital I wonder what it is all about.

**Mr Tune**—I will run through an example. If you want to increase year 12 retention rates, that is an investment in human capital. Basically, education is human capital and investing in skills. You try to work through what that might mean in terms of the chances of those extra kids who have got year 12 over and above where you were before in terms of their skills, their capacity to get a job and hence the increase in participation that you get in the labour force, and, from that, the improvement in economic growth and GDP per capita you get. You can do that. It relies on a lot of assumptions and you need to be really careful in interpreting the

results. You should not take them as gospel, by any means, but they can be indicative of the benefits that you can get.

**Senator JOYCE**—You could put up an argument to say that the nuclear family has more potential to get people to uni than another family. I do not know whether it does. I am being deliberately contentious and saying therefore there is a human capital value in the promotion of a certain family outcome.

**Mr Tune**—Absolutely. I do not disagree with that.

**Senator JOYCE**—It is a one size fits all approach. Who wrote the theory on human capital? What is his name?

**Mr Tune**—Gary Beckett, an American economist.

**Senator JOYCE**—He must have a lot of spare time.

**Senator SHERRY**—The work that we have been discussing was signed off by the Prime Minister.

**Mr Tune**—It was requested by COAG.

**Senator SHERRY**—It was with the approval of the Prime Minister, as the leader.

**Mr Tune**—Absolutely.

**Senator SHERRY**—Is it correct that, in 2004 or thereabouts, the heads of treasuries were charged with a review of child care?

**Mr Tune**—In 2004?

**Senator SHERRY**—Yes

**Mr Tune**—Not that I am aware of.

**Senator SHERRY**—Have they been charged with a review of child care? I may have the date wrong.

**Mr Tune**—No. There were childcare elements within the human capital agenda for the NRA.

**Senator SHERRY**—What were those elements?

**Mr Tune**—Just to look at the issue of child care. The COAG communique talks about issues around early childhood development, in which child care is a component.

**Senator SHERRY**—In that context, workforce participation?

**Mr Tune**—Yes.

**Senator SHERRY**—I want to go to an issue in the budget group.

**Mr Tune**—The fiscal group; there is no budget group.

**Senator SHERRY**—Budget policy advice.

**Mr Tune**—That is the fiscal group.

**Senator SHERRY**—That is what I meant. It goes to page 35 of MYEFO, table 17.

**Mr Tune**—We have that.

**Senator SHERRY**—I seek an explanation about five or six lines from the bottom of that table. There is a net swap interest received line and then a series of figures of estimates and projections across. Have you got that line?

**Mr Tune**—Yes, I can see that.

**Senator SHERRY**—I want to compare that to the same table—obviously MYEFO is an update—in Budget Paper No. 1, Statement 2, Fiscal Outlook. It is the same table and same categories but obviously updated figures. Again, I go to the net swap interest received line in the budget paper by way of contrast. If you look in Budget Paper No. 1, that line across is a series of positives—138, 110, 86, 74, 58—but in the same line in MYEFO it is positive in 2006-07 and then it becomes a series of negative figures, so the change has been to negative in those three out-years. Can you provide me with an explanation as to why it has moved from positive to negative?

**Mr Martine**—Those numbers are essentially driven by a technical assumption about interest rates. What we do not try to do in the budget is try to forecast future interest rates. We take the interest rates at a certain point and project the current rates across the forward estimates. Effectively what you are seeing in this table is an unusual situation where we have what we call an inverted yield curve. In fact, short-term interest rates are at the moment higher than long-term interest rates. With the swap program, where they are normally swapping out of long-term rates into short-term rates, you would normally see across the forward estimates a positive number there. But because we have this technical assumption that we project current rates and we have this temporary phenomenon of short-term rates being higher than long-term, then you see some negative numbers. It is no-one's expectation that the short-term rates will stay higher than the long-term rates. Generally, when that happens it corrects itself. What we would normally expect to see, once we hit those years, is the yield curve back where it normally is, and we would normally expect to see some positives.

**Senator SHERRY**—It is an unusual circumstance, isn't it?

**Mr Martine**—Very unusual. It is very much driven by this technical assumption. We do not try to attempt to forecast those interest rates across the forward years. I would not be sitting here if I could. I would go and get a job somewhere else.

**Senator SHERRY**—Thank you.

**CHAIR**—Thank you very much.

[10.28 pm]

**CHAIR**—We are up to Outcome 4, Well functioning markets. Are there any questions on output group 4.1, Markets group?

**Senator SHERRY**—I would like to look at the Financial Literacy Foundation. Is there an estimate of expenditure for the foundation for the year 2009-10?

**Mr McCray**—No. The funding for the foundation is committed to 2008-09. There is to be a review of the continued existence of the foundation before the 2008-09 budget, and of course decisions will flow from that.

**Senator SHERRY**—Presumably that review has not commenced?

**Mr McCray**—No. That will probably be late this year and running into January or February next year.

**Senator SHERRY**—Who is conducting that review?

**Mr McCray**—It is an officials' review reporting to ministers, so we will be providing the report to colleagues in PM&C, Finance, and so on.

**Senator SHERRY**—Can you refresh me on the budget allocations for 2008-09 and 2007-08?

**Mr McCray**—In each year it is \$5 million indexed, so \$5 million was our starting point and it is just a touch over \$5 million in each of those years.

**Senator SHERRY**—I have some matters relating to foreign investment. I understand that Treasury officers on the Foreign Investment Review Board are currently involved in reviewing the Airline Partners Australia takeover bid for Qantas. Is that the case?

**Mr Murphy**—Yes.

**Senator SHERRY**—Can you explain how the Foreign Acquisitions and Takeovers Act allows the Treasurer to prohibit or impose conditions on a foreign takeover where the bidder's proposed stake in the target company would not exceed the relevant foreign interest threshold?

**Mr Murphy**—The matter is still before the government. The APA have lodged a formal notice with the government under section 25 of FATA and we are examining their proposed arrangement.

**Senator JOYCE**—They volunteered that—

**Mr Murphy**—That does not really matter. The fact is that a notice has been lodged and that sets in train a process. Under that process there is a 30 day—

**Senator JOYCE**—What I am referring to is that the government did not order it; it volunteered to be part of a process. It has chosen to be part of a process. It was not asked by the government to be part of the process and now that it has nominated that it is willing to be part of the process, it has now been captured by the process.

**Mr Colmer**—There are a number of avenues to get examination under the FATA. There is a provision for compulsory notification but the vast majority of cases come under the voluntary notification, although that is not a defined concept as such. The reality of the situation is that there is a potential for compulsory notification in some circumstances, but that is limited to specific circumstances around some share acquisitions under section 26A. It is not at all unusual for people to submit proposals.

**Senator JOYCE**—That is the case in this instance.

**Mr Colmer**—The case in this instance is that APA has submitted a notification and it is being dealt with in the terms of the Foreign Acquisitions and Takeovers Act. There is a 30-day statutory period.

**Senator JOYCE**—I understand the process. For the record, they were not ordered: they volunteered.

**Mr Murphy**—There is power under the act to seek information.

**Senator JOYCE**—I know. I am saying with this Qantas bid they volunteered. You did not order them to, did you? I would be surprised if you did.

**Mr Murphy**—Qantas elected to, or APA did—

**Senator JOYCE**—That is right. That is the point that I wanted on the record.

**CHAIR**—I think he answered the question about three minutes ago with a yes. It is on the record.

**Senator SHERRY**—Is there an issue around the ability of the Foreign Acquisitions and Takeovers Act to provide coverage of Qantas airlines subsidiaries?

**Mr Colmer**—There is nothing under the Foreign Acquisition and Takeovers Act. You may be thinking of the Qantas Sale Act, which is a department of transport administered act.

**Senator SHERRY**—Yes. Are you aware that there is an issue in that respect?

**Mr Colmer**—Are you referring to something in particular?

**Senator SHERRY**—The alleged inability to capture subsidiaries of Qantas—for example, Jetstar.

**Mr Colmer**—The Qantas Sale Act was a 1992 act, and, as you would understand, that predates a lot of the arrangements. The information that I have had from the department of transport is that Jetstar and any other Australian international airline is caught under the Air Navigation Act and the arrangements under that, which are broadly similar to those under the Qantas Sale Act. My understanding is that, whilst the Qantas Sale Act applies to Qantas as such and not other Australian international airlines, there are broadly similar provisions in the Air Navigation Act which apply.

**Senator SHERRY**—Is there any indication as to the time frame for consideration of this matter?

**Mr Colmer**—The statutory deadline under the act is 30 days. That expires on 7 March. There is provision to extend that time if it is considered necessary, and that can be extended by another 90 days.

**Senator SHERRY**—Who is required to give that extension?

**Mr Colmer**—The Treasurer is the responsible minister for the Foreign Acquisitions and Takeovers Act. The extension could be done under delegation from the Treasurer.

**Senator JOYCE**—Is 30 days an appropriate period of time to examine something like this?

**Mr Colmer**—That is the parliament's legislative provision.

**Senator SHERRY**—Where there has been an examination previously by the Foreign Investment Review Board with respect to foreign acquisitions, do you have any details as to the length of time taken?

**Mr Colmer**—I do have some figures on that. If you will just bear with me for a minute.

**CHAIR**—If you do not have those figures you can take that on notice.

**Mr Colmer**—I will get that information for you on notice.

**Senator SHERRY**—You referred to the Treasurer's delegation. To whom is it possible for him to delegate?

**Mr Colmer**—The general arrangement is that the parliamentary secretary deals with a lot of the cases, and some of the smaller cases are dealt with in the department. Officers in the department have the delegation for cases under \$100 million as a general rule.

**Senator SHERRY**—Has there been any recent analysis of the impact of the US free trade agreement, the Thailand free trade agreement and the Singapore free trade agreement?

**Mr Murphy**—I cannot point to any reports or formal analysis that has been done. There may have been. I would have to check. I am not aware of any.

**Senator SHERRY**—So no analysis on any of those three agreements to date?

**Mr Murphy**—No. Question about free trade agreements would be better directed to the Department of Foreign Affairs and Trade, but we can check on that for you.

**Senator JOYCE**—What are the criteria that you think the Qantas bid will be examined under in regard to the national interest, considering that you are in foreign investment? What are the key foreign investment issues that you would be hoping to cover?

**Mr Colmer**—There are a number of issues that the Foreign Investment Review Board will be looking at. The national interest is an undefined concept, but the Foreign Investment Review Board will be looking particularly at matters such as control of the airline, the ongoing viability of the airline, debt levels and similar sorts of things.

**Senator JOYCE**—In your matrix of debt levels, do you look at current trends of interest rates and the capacity for future events that might affect it?

**Mr Colmer**—We will be looking to reassure ourselves as best we can that Qantas remains a viable airline. That is clearly a national interest issue.

**Senator JOYCE**—Do you take the cost of a failed airline into consideration in your examinations in terms of what the implications of that would be?

**Mr Colmer**—In what sense?

**Senator JOYCE**—That if it falls flat on its face by reason of an overextension of debt what the cost will be for the government to pick up the pieces.

**Mr Colmer**—There are a number of hypothetical considerations in there; firstly, whether or not it falls flat on its face and, secondly, whether or not the government picks up the pieces. They are difficult things to predict and deal with in any sense.

**CHAIR**—In all fairness, I have said a number of times that we are not going to deal in hypotheticals. I will say that again in response to that question.

**Senator SHERRY**—Mr Murphy, are you or other officers aware of the review that has been undertaken into the FICS financial industry dispute resolution body and its powers? They were recently reviewed and updated.

**Mr Murphy**—I know that there have been some concerns about whether it can handle complaints about financial advisers.

**Senator SHERRY**—I was going to get to that. I just want to establish if you were aware of the recent review?

**Mr Murphy**—I am not sure whether there has been a review.

**Senator SHERRY**—I will cut to the central issue of the \$100,000 cut-off, the threshold. Has your division been involved in any work on the \$100,000 threshold limitation?

**Mr Murphy**—I know that is an issue. Mr Miller might be able to help us here.

**Mr Miller**—It is an independent body. It sets its limits.

**Ms Smith**—We know that they are reviewing their upper limit of \$100,000. At the moment that is internal to FICS.

**Senator SHERRY**—So you have had no input into that issue at all?

**Ms Smith**—We are aware that they are reviewing it.

**Senator SHERRY**—Is that it?

**Ms Smith**—Yes.

**Senator JOYCE**—In your examination of the Qantas bid, did you examine the Ansett bid and the conditions that were put on it?

**Mr Colmer**—We have looked at the Ansett conditions.

**Senator JOYCE**—Did you draw any parallels?

**Senator Coonan**—I think we are straying into how this process is actually being carried out.

**Senator JOYCE**—I will ask one question and then I will leave it alone. You said that national interest was a vague topic. Do you reflect on what the Americans put down as their national interests in their airline policy?

**Mr Colmer**—I am not exactly sure what you are referring to. Would you like to share that with me? My understanding of—

**Senator JOYCE**—It is foreign investment limits on domestic airlines in the United States.

**Mr Colmer**—That is right. There are limits on foreign investment in Australian airlines too.

**Senator JOYCE**—They are different, though, aren't they?

**Mr Colmer**—I am not sure off the top of my head what the American limits are.

**Senator JOYCE**—25 per cent.

**Mr Colmer**—Ours is 49 under the Qantas Sale Act, yes.

**Senator JOYCE**—I was curious as to whether you did the comparative analysis between the two policies.

**Mr Colmer**—The observation around policies on foreign investment internationally is that there are a lot of similarities internationally—not only between Australia and America—but there are also significant differences internationally. The Americans are probably one of the more restrictive nations when it comes to airlines. Airlines do have a particular place in the American investment policy. That is reflected more generally in international investments.

**Senator JOYCE**—Do you take into account the viability of Qantas should the current restrictions on certain routes that Qantas have be lifted, or is that hypothetical?

**Mr Murphy**—It is under examination by the government.

**CHAIR**—All these matters would be hypothetical.

**Senator Coonan**—It is a very broad policy. A better way to describe it is as a broad policy, not a vague one. It is meant to be broad and interpreted broadly.

**Senator SHERRY**—There has been the release of the Insurance Contracts Act reform package. Are you aware of that?

**Mr Murphy**—Yes, that was a couple of days ago.

**Senator SHERRY**—I want to refresh my memory here. When did that review commence?

**Mr Murphy**—The review was conducted by Alan Cameron and Nancy Milne. Senator Coonan, as the minister for revenue, instituted the review of the Insurance Contracts Act. The primary issue at the time was section 54 of the act. That review was conducted and a report was made by Nancy Milne and Alan Cameron. It has been under consideration by the government. Earlier this week, the parliamentary secretary released the findings of that report. Mr Miller can give you more detail on it.

**Mr Miller**—Do you want any specific dates?

**Senator SHERRY**—I asked when it commenced. My recollection was 2003 or 2004.

**Mr Miller**—The review panel reported on section 54 in October 2003.

**Mr Murphy**—That was the first stage.

**Mr Miller**—That was the first stage, and draft provisions were released for consultation in March 2004. In May 2004, the panel then wrote to the government with some recommendations to revise those draft provisions. The review panel finalised its report on the remainder of the act in June 2004. The report was released in January 2005.

**Senator SHERRY**—So the package that has been released is effectively the end of the process?

**Mr Miller**—Yes.

**Senator SHERRY**—I did ask about the issue of mortgage brokers on a previous occasion. Are you able to give me an update about where the mortgage broking issue—the state legislation and the coordination around that—is at the present time?

**Mr Murphy**—I understand the states have agreed to move ahead with legislation.

**Ms Smith**—We understand that draft legislation is to be prepared in the state context by New South Wales.

**Senator SHERRY**—For all states?

**Ms Smith**—On behalf of Parliamentary Counsels Committee, so that sounds as if it is all states.

**Mr Murphy**—Yes.

**Senator SHERRY**—The Commonwealth has a coordinating role here, doesn't it? It did agree not to act, given the states agreed to act in a coordinative way?

**Mr Murphy**—Yes, but it is the responsibility of the states.

**Senator SHERRY**—Yes, I understand that. It is an area of regulation where the Commonwealth has decided not to proceed, if you like.

**Mr Murphy**—Yes; we feel it is a state responsibility.

**Senator SHERRY**—It is a state responsibility. That was the agreed position.

**Mr Murphy**—Yes.

**Senator SHERRY**—I did refer at the previous estimates that there were some differences emerging in the legislation that had been developed between the states. Do you have any information you can provide on them?

**Ms Smith**—No, I have not. Could I take it on notice?

**Senator SHERRY**—Yes. Are there any other areas of regulation of financial services that are currently being considered by state governments that you are aware of?

**Ms Smith**—Not strictly financial services. Property investment advice has been considered by the states.

**Mr Murphy**—Yes.

**Senator SHERRY**—Property investment advice? That is real estate advice?

**Mr Murphy**—It is a question of whether that is a financial service. The difficulty there is that your problem would be you pick up real estate agents and that type of thing.

**Senator SHERRY**—Has that been the subject of Commonwealth-state ministerial discussions?

**Mr Murphy**—It has been raised in the context of discussions, especially after Henry Kay and these type of characters. Again, trying to target the area you wish to target without picking up every estate agent and having to license them is the difficulty.

**Senator SHERRY**—I know what happens in Tasmania, but presumably there would be state real estate acts in each state, and to varying degrees there would be regulation, albeit different, between the states and territories at the present time.

**Mr Murphy**—We say there should be proper disclosures under those acts. Where it comes to financial advice, the Commonwealth or FSR should pick them up if they move into financial advice.

**Senator SHERRY**—That is what you say?

**Mr Murphy**—Yes. That is how we see it.

**Senator SHERRY**—That is, the department and the Commonwealth at this stage

**Mr Murphy**—Yes, that is how we see it.

**Senator SHERRY**—Is that a part of the understanding with the states at the present time—where they move into financial advice—because this could be quite a difficult definitional issue?

**Mr Murphy**—They would be quite happy for that type of service, whatever you want to call it, to be picked up and regulated by the Commonwealth.

**Senator SHERRY**—Yes.

**Mr Murphy**—That is pretty clear. Where it is property advice, that is where you have got this grey area.

**Senator SHERRY**—For example, if a real estate agent is recommending the sale of a property and points out the virtues of the garden and other aspects of the house, that is property advice. But if they say, 'Invest in this property for your retirement'—which is a fairly common line—that would be financial advice?

**Mr Murphy**—No. I am talking about the Corporations Act financial services. It would have to be actually a financial service.

**Senator SHERRY**—Okay. Has this been the subject of some sort of memorandum communique?

**Mr Murphy**—It has been discussed a number of times and it is discussed in other forums. It could be discussed in the Commonwealth-state consumer forum. Mr French might be able to help there.

**Senator SHERRY**—Yes.

**Mr French**—This matter has been discussed in the context of the Ministerial Council on Consumer Affairs.

**Senator SHERRY**—Has there been a conclusion reached?

**Mr French**—No. There has been work examining the options. Ruth Smith would know more about the ins and outs of the current state of that. Some of the issues you have been raising are the root of the difficulty in working out what to do in this area, because you have got states regulating in the area of real estate and the Commonwealth in the area of financial services. The difficulty is coming to an option which appropriately covers these issues; it would be quite difficult to come to grips with.

**Mr Murphy**—As a practical matter what you would find is the real estate agent may refer a person to a financial planner—they may even have them in the premises—and those people become clients, if you like, of the financial planner.

**Senator SHERRY**—Also, presumably they could refer them to a mortgage broker or another financial institution?

**Mr Murphy**—Yes.

**Senator SHERRY**—Just to make sure I understand, there has been no formal agreement on division of responsibilities, if you like, at this stage?

**Mr Murphy**—The states are fully aware of the Commonwealth's position that, if they wish to seek to further regulate people who are not caught under Commonwealth legislation—the Corporations Act—as providing a financial service, it is a matter for them.

**Mr French**—There has been a working party of the Standing Committee of Officials on Consumer Affairs which has been looking at the issue, and work has been undertaken on regulatory impact assessment.

**Senator SHERRY**—I understand that. Take this question on notice, because I have to finish: has there been the issuing of any sort of formal communiques, agreements or understandings in this area to date?

**Mr French**—There have been. We can take that on notice, but there have been a number of statements by the ministerial council as it relates to the progress of that work.

**Senator SHERRY**—Thank you.

**Senator JOYCE**—Mr Colmer, what are your views in regard to the national interest and regional air services?

**Mr Colmer**—I do not think my view is the key issue.

**Senator JOYCE**—Who defines the view of national interest when you report back to the Treasurer?

**Mr Colmer**—The Treasurer decides what the national interest is.

**Senator JOYCE**—Has he given any view about what you should be investigating?

**Mr Colmer**—The proposal is under consideration, and FIRB will be providing its advice to the Treasurer. That is a matter of policy advice to the government.

**Senator JOYCE**—Technically, what sort of advice do you provide him if he does not tell you what to provide him with?

**Mr Colmer**—We have established procedures. We have not had specific instructions from the Treasurer on what sort of advice he wants, but we are aware of the general issues that the Treasurer—

**Senator JOYCE**—You are aware of it, but you have not had specific instructions. That is incredible. That is quite clairvoyant.

**Mr Colmer**—No.

**Senator Coonan**—There are established procedures.

**Mr Murphy**—We will provide advice, and any issues that we have not covered we can be directed or requested by the Treasurer to provide information on. In this instance, there is a bidder statement, a target statement and a lot of discussion in the financial press. The market forces certain disclosures on the parties. It is for us now to seek any further information we need. There have been requests made.

**Senator JOYCE**—I was asking a specific question—and that is how I got into this—about regional air services. I am trying to work out who is setting the criteria for that.

**Mr Murphy**—It is a relevant issue and it is part of the mix of all the things that have to be considered and that are put to the Treasurer, and it is under this very broad criteria.

**Senator JOYCE**—He told you to provide him with that?

**Senator Coonan**—We do it as a matter of course.

**Mr Murphy**—We do it as a matter of course, but there have been discussions on the issue with various parties within Treasury, and these things are dealt with in considerable depth.

**Senator JOYCE**—And that ‘considerable depth’ includes how regional airlines interplay with the national interest?

**Mr Murphy**—Yes. National interest, as has been said, has very overarching criteria.

**CHAIR**—I think a nod is as good as a wink to a blind horse, Senator Joyce. If there are no further questions, you are excused. Thank you for your attendance. I hope you enjoy what very little is left of Valentine’s Day.

[10.58 pm]

#### **Australian Bureau of Statistics**

**CHAIR**—Welcome to you all. We made the decision to try and get you through tonight, so you will be either very cross with us or very pleased with us. In any event, you are here. I know that Senator Watson has a matter he wants to raise with you.

**Senator WATSON**—I have a retail constituent who has had an ongoing problem with the ABS. The problem is that you appear to have lost some documentation. By way of background, the constituent, a retailer, has been providing labour force price information to you for a period of some years and requested some relief because it is a somewhat onerous responsibility. The constituent had a business in the city and was called upon to provide this information, which duly took place. A second business was added in the country and the two businesses were added together for the purposes of providing this information to the bureau. Subsequently, the first business in the city was sold, which left one business in the country. For some reason, the bureau maintains that the business in the country, which is perhaps only about two years old, does not fulfil the five-year time frame. I believe this is a very unusual sort of interpretation. The bureau just maintains: ‘We have no records of any other business.’ Could you throw some light on it for me?

**Mr Harper**—You are correct. Our records only show that that business has been selected in the Labour Price Index survey since November 2004. We have no other records of that business having been selected in an ABS survey.

**Senator WATSON**—That seems an unusual situation when the history that I have outlined to you is as I have said.

**Mr Harper**—My understanding is that the provider in question has not provided us with any information to substantiate the claim that the business had previously been selected in ABS surveys. We maintain very comprehensive records of businesses that are selected in our collections.

**Senator WATSON**—What does a business have to provide to convince you if you no longer have the records?

**Mr Harper**—If the business was able to provide us with copies of previous survey forms, for example, we could look at them.

**Senator WATSON**—Otherwise you will proceed to prosecution; is that right?

**Mr Harper**—At this stage we have issued a notice of direction. My understanding is that the business has not complied with the notice of direction. Prosecution is a possibility in those circumstances, but it is not up to the ABS to prosecute. If we chose to make a recommendation to the DPP, it would be up to the DPP to then determine whether prosecution was appropriate or not.

**Senator WATSON**—The redress you suggest is for them to try and find their old records?

**Mr Harper**—That would be helpful if they believe that they have been selected as that business in previous ABS surveys.

**Senator WATSON**—Is this an unusual occurrence?

**Mr Harper**—It is highly unusual. I have never had situations before where people have claimed that they have been in ABS surveys previously without our being able to find a record of it. Can I make one further observation? If the business operated under a different ABN previously, that may be a factor.

**Senator WATSON**—That is quite possible.

**Mr Harper**—If we were provided with the ABN of the pre-existing business, that could help us.

**Senator WATSON**—That is quite possible, because they were distinct businesses. But for the purpose of your statistics, because they were like businesses, a person accumulated the two lots of information and provided one consolidated return.

**Committee adjourned at 11.04 pm**